



▲ Boys fetching clean water from a water station in Ebeye, Marshall Islands.

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PACIFIC FINANCE SECTOR BRIEFS

ADB PACIFIC LIAISON AND COORDINATION OFFICE

MARSHALL ISLANDS

The Marshall Islands is a relatively small and remote economy. The service sector is the largest contributor to the country's economy, with output driven by government expenditure, and assistance from the United States (US). The latter comes mostly in the form of annual grants under the Compact of Free Association (the Compact) between the two countries. Agriculture (including fisheries) is the second-largest sector, and its contribution to the economy has risen sharply in recent years, due to higher fisheries license revenues. Industrial output accounts for the smallest share in the economy, with construction and utilities making the greatest contributions to this sector.

Long-term fiscal sustainability is a primary concern for the Marshall Islands, given the forthcoming end to the Compact grants. Compact grants have covered a large part of the annual budgets and contributed to the country's Compact Trust Fund. As it awaits the completion of the current Compact Agreement in 2023, the Marshall Islands faces challenges in long-term fiscal planning. The Government of the Marshall Islands must continue needed economic reforms, including the strengthening of public financial management, to generate revenue for its increased contributions to the Compact Trust Fund. This will facilitate long-term fiscal sustainability in 2024 and beyond. As of 30 September 2017, the value of the trust fund had grown to \$355 million due to market gains of 14.1% and contributions from the US (\$16.1 million) and Taipei, China (\$2.4 million).¹

MARSHALL ISLANDS AT A GLANCE

Population

54,354 (2017)^a

GDP (current \$)

\$214.4 million (2018)^b

GDP per capita

\$3,856 (2018)^b

GNI per capita

\$4,800 (2017)^a

GDP = gross domestic product,
GNI = gross national income.

^a Source: Asian Development Bank. 2018. *Key Indicators for Asia and the Pacific 2018*. Manila.

^b Source: Asian Development Bank.

¹ Graduate School USA (2018) provides two estimates for the required balance of the trust fund by 2023. The "simple sustainability" estimate, which represents the amount needed to transition to trust fund distributions from fiscal year 2024 onward under smooth and favorable economic conditions, is \$544 million. In comparison, the "safer sustainability" estimate, which accounts for market volatility and periodic fiscal shocks, is \$908 million. With \$355 million as of end-September 2017, the fund's projected value by 2023 is \$715 million.

FINANCE SECTOR OVERVIEW, PERFORMANCE, AND ISSUES

The financial system comprises eight formal financial institutions (Table 1). The country has three main banks: The Bank of the Marshall Islands (BOMI) is a locally owned bank, the Bank of Guam is a branch of a foreign-owned bank, and the Marshall Islands Development Bank (MIDB) is the country's development bank. The two commercial banks are under the supervision of the Banking Commission, while there are calls to include the MIDB under the commission's oversight. Meanwhile, the sector also has two large money transfer operators (MoneyGram and Western Union), two insurance companies, and a pension fund.

Private sector credit and deposits exhibited similar trends from 2011 to 2017. The values of both loans and deposits initially dropped in 2012, but recovered by 2013 and have followed an upward trend since (Table 2). Growth in deposits averaged 22% from 2013 to 2017, while private sector credit expanded at an average of 15.5% over the same period. Although the value of loans recovered quickly, bank assets did not post growth until 2014, following two successive years of decline.

The Marshall Islands must strengthen its regulatory framework. With household debt reaching 60% of total employees' compensation, the International Monetary Fund (IMF) proposed in 2018 that the Banking Commission place stricter criteria on the classification of nonperforming loans, as well as imposing a ceiling on the debt service ratio. The Graduate School USA (2016) is likewise concerned that such a figure indicates a level of household indebtedness that will not only impose burdens on household finances, but may also threaten the stability of the banking system. Meanwhile, the IMF (2016) pointed out that, to ensure and safeguard the stability of the country's finance sector, the Banking Commission must also include the MIDB in its oversight. In 2017, the Marshall Islands cabinet authorized the Banking Commission to conduct prudential supervision of and establish new prudential guidelines for MIDB.

Table 1: Financial System of the Republic of the Marshall Islands

Type of Institution	Number
Commercial banks	2
Pension fund	1
Development bank	1
Insurance companies	2
Money transfer agents	2
Total	8

Source: International Monetary Fund.

The Marshall Islands is at risk of losing its only correspondent banking relationship (CBR). The BOMI, the only domestic commercial bank in the Marshall Islands, was notified by its correspondent bank, the First Hawaiian Bank, in 2015 that the latter is considering termination of the CBR, mainly owing to concerns about the rising costs of complying with heightened anti-terrorism financial rules in the US. A withdrawal would adversely affect the economy as the country would lose all connections with US banks, including the links that facilitate routine financial transactions to individuals, businesses, and government agencies. It could disrupt international payments and economic activity, and weaken financial inclusion, especially for the outer islands which are served by the BOMI. Currently, the CBR is renewed every year, conditional on the Marshall Islands' progress in improving the anti-money laundering and combating the financing of terrorism framework. The government has taken steps to respond to this, such as drafting a new anti-money laundering legislation that is consistent with global standards and consulting external experts and US authorities to maintain financial links, given the use of the US dollar as legal tender in the Marshall Islands (IMF 2016). While the First Hawaiian Bank is satisfied with the recent progress made by BOMI in tightening its procedures on anti-money laundering and countering the financing of terrorism, a permanent solution still needs to be found.

Table 2: Financial System Performance Indicators

	2011	2012	2013	2014	2015	2016	2017 ^a
Commercial bank assets (\$ million)	132.0	118.9	110.8	156.9	189.4	220.4	261.8
Deposits (\$ million)	98.2	85.0	90.8	118.9	152.9	183.3	227.2
Private sector credit (\$ million)	60.2	59.4	60.0	79.4	89.6	101.1	119.7
Deposit rate (%)			1.9	1.6	1.7	1.6	1.3
Lending rate (%)			14.1	11.3	10.7	10.4	11.0

^a Assessed as of 30 September 2017.

Sources: Graduate School USA. 2016. *RMI FY2015 Statistical Compendium*. Honolulu; Graduate School USA. 2018. *RMI FY2017 Statistical Appendices*. Honolulu.

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