



▲ Chuuk, Federated States of Micronesia.

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PACIFIC FINANCE SECTOR BRIEFS

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FEDERATED STATES OF MICRONESIA AT A GLANCE

FEDERATED STATES OF MICRONESIA

The Federated States of Micronesia (FSM) is a small island country that is highly dependent on external aid, in particular from the United States (US). The second Compact of Free Association Agreement (the Compact), which became effective in 2004, has continued to provide funding in the form of grants to finance major public services such as education, health, and infrastructure. The Compact grants are due to expire in 2023, after which the FSM is expected to finance public expenses with its own revenues and income from the Compact Trust Fund, which was established in 2004 and receives annual contributions from the US government. As of 30 September 2017, the value of the trust fund was estimated at around \$565 million, which is below the amount needed to meet the estimated \$1.65 billion target for simple sustainability by 2023.¹

The FSM's economy stagnated between 1995 and 2015 but experienced volatile growth between 2015 and 2018. The economy continues to experience volatile growth, driven largely by the domestic seine fishing operations. The FSM recorded a strong gross domestic product (GDP) growth of 5% in 2015, which weakened in 2016 to 0.7% and improved in 2017 to 3.2%. In 2018, the economy continued to grow with the slower rate of 2.0%.² The public sector continues to dominate the economy, with private economic activities limited to subsistence farming and fishing.

Population	102,500 (2017) ^a
GDP (current \$)	\$374 million (2018) ^b
GDP per capita	\$3,657 (2018) ^b
GNI per capita	\$3,590 (2017) ^a
Domestic credit provided by the banking sector (% of GDP)	-42.2% (2016) ^c

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

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

^b Source: ADB.

^c Source: ADB. 2017. *Key Indicators for Asia and the Pacific 2017*. Manila.

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 \$1.65 billion. In comparison, the "safer sustainability" estimate, which accounts for market volatility and periodic fiscal shocks, is \$2.76 billion. With \$565 million as of end-September 2017, the fund's projected value by 2023 is just \$1.1 billion.

² As of 30 September 2018.



The private sector's share of the FSM economy has declined from 1997 to 2017. Part of the labor force continues to migrate to neighboring countries, particularly the US, to find job opportunities. As a result, the country's population diminished at an average rate of 0.4% a year from 2000 to 2010 and remained almost unchanged between 2010 and 2017. High dependence on imports, in particular fuel and food, makes the FSM's economy highly vulnerable to global commodity price hikes.

The FSM exhibits characteristics of a fragile nation.

Complex decision-making processes, rooted in the loosely federated political structure and the geographical distances between the country's small island states, make it difficult for policy makers to coordinate, and achieve consensus on, national reforms and programs. Lengthy delays in economic reforms, caused by a lack of coordinated decision-making and capacity constraints in government agencies, hamper the effective use of development partner funds. The FSM's main development challenges are stimulating economic growth through private sector development and attaining long-term fiscal sustainability, particularly in light of the gradual phasing out of the Compact grants by the end of 2023.

FINANCE SECTOR OVERVIEW

The FSM is moderately monetized. The ratio of broad money (M2) to GDP averaged around 59% from 2011 to 2017 (Table 1). With the public sector dominating the economy, private enterprises have minimal impact on the output and creation of money. While private sector credit is gradually rising, its share relative to GDP remains at low levels, averaging only 18.4% of total output from 2011 to 2015. Weak private sector participation, among other reasons, has greatly contributed to the stagnation of the FSM's economy.

The FSM's finance sector is not fully regulated. It comprises two commercial banks: one local bank, the Bank of the Federated States of Micronesia; and a foreign-owned bank, the Bank of Guam. The FSM Banking Board serves as the regulator of the country's banking system. In 2017, the International Monetary Fund (IMF) noted that the two government-supervised commercial banks were well-capitalized and had sufficient liquidity, yet there were small credit unions that were not subject to government oversight. The Government of the FSM is taking steps to include credit unions under the supervision of the FSM Banking Board.

FINANCE SECTOR PERFORMANCE AND ACCESS

While there are constraints on the demand side of financing in the FSM, the supply side is showing steady growth.

The IMF (2017) observed that the scarcity of bankable projects was due to difficult business conditions, such as slow progress on land reforms, which hinders the securing of long-term leases on land and the use of land as collateral (Graduate School USA [2017] also noted the limited ability of businesses to prepare business plans and financial statements as contributing factors). Hence, while private sector credit is growing, growth led by the private sector remains limited because land-related issues hinder domestic private investment. On the other hand, bank deposits in the FSM grew at an average of 7.7% a year from 2011 to 2015 (Table 2). The IMF (2017) reported that although the number of deposit accounts with commercial banks had grown to 37,540 (565 per 1,000 adults) in 2013, by 2016 it had dropped to 26,885 (around 400 per 1,000 adults) (Table 3). This was primarily due to the implementation of a minimum \$100 requirement for savings accounts. The lack of bankable domestic projects is reflected in the FSM's loan-to-deposit ratio which, at 20%, is one of the lowest in the region.

Table 1: Nominal Gross Domestic Product, 2011–2017

	2011	2012	2013	2014	2015	2016	2017
GDP (\$ million)	310.5	326.1	316.0	318.0	315.2	329.9	338.1
M2 (\$ million)	164.1	203.7	193.7	203.6	193.2	185.8	182.4
M2/GDP (%)	52.9	62.4	61.3	64.0	61.3	56.3	54.0
Private sector credit (\$ million)	55.2	56.8	54.0	56.5	68.9		
Private sector credit/GDP (%)	17.8	17.4	17.1	17.8	21.9		

GDP = gross domestic product, M2 = broad money.

Sources: Asian Development Bank and Federated States of Micronesia Banking Board.

Table 2: Finance Sector Performance Indicators

	2011	2012	2013	2014	2015	2016	2017
NPL ratio (%)			2.9	2.6	2.0		
Deposits (\$ million)	166.2	204.4	213.2	243.9	253.0	234.2	253.3
Commercial bank loans to the private sector (\$ million)	55.2	56.8	54.0	56.5	68.9		
Deposit rate (%)	0.6	0.4	0.4	0.4	0.4	0.4	0.5
Lending rate (%)	14.4	14.3	15.7	15.7	15.7	15.7	16.1

NPL = nonperforming loans.

Sources: Federated States of Micronesia Banking Board, Graduate School USA, International Monetary Fund, and World Bank.

Table 3: Financial Access Indicators

Access Indicators	2012	2013	2014	2015	2016	2017
Number of bank branches	8	8	8	8	8	8
Number of ATMs	10	10	10	10	10	10
Number of deposit accounts with commercial banks	36,346	37,540	38,526	30,296	28,301	26,885
Number of loan accounts with commercial banks	6,537	6,626	7,109	7,448	7,709	7,775

Source: International Monetary Fund.

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