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Vanuatu: 2009 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Alternate Executive Director for Vanuatu

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2009 Article IV consultation with Vanuatu, the following documents have been released and are included in this package:

- The staff report for the 2009 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on February 26, 2009, with the officials of Vanuatu on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 16, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its May 11, 2009, discussion of the staff report that concluded the Article IV consultation.

- A statement by the Alternate Executive Director for Vanuatu.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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VANUATU

Staff Report for the 2009 Article IV Consultation

Prepared by the Staff Representatives for the 2009 Consultation with Vanuatu

Approved by Subir Lall and Anthony Boote

April 16, 2009

- **Discussions:** Held in Port Vila, February 18–26, 2009. The mission met the Prime Minister, the Minister of Finance, Governor of the Central Bank, other ministries and government agencies, public enterprises, the business community, and donors.
- **Team:** N. Thacker (head), M. Iizuka (all APD), and S. Ogawa (OAP). Mr. Ha (OED) joined the mission.
- **Mission Focus:** Impact of the global slowdown and measures to reduce the adverse impact.
- **Past Fund Advice:** Executive Directors' comments at the conclusion of the last Article IV consultation on February 26, 2007 can be found at http://www.imf.org/external/np/sec/pn/2007/pn0727.htm. Effectiveness of past surveillance is mixed. Although the overall fiscal position has improved, the wage bill has continued to increase and public enterprises remain poorly managed.
- **Exchange rate regime:** Vanuatu officially maintains an adjustable peg exchange rate arrangement, linked to a transactions-weighted basket of currencies. The *de facto* classification is "other managed," as the weights are not disclosed and cannot be confirmed. Vanuatu has accepted the obligations of Article VIII, Sections 2, 3, and 4, and the exchange rate system is free of restrictions on payments and transfers for current international transactions.
- **Outreach:** The mission met the business community and donors. It also issued a press statement.
- **Economic statistics:** Vanuatu's data are sufficient for surveillance purposes, and significant progress has been made with technical assistance from PFTAC advisors, but weaknesses remain. Data on national accounts and balance of payments need further improvement, and data on fiscal operations needs to be more timely. Data on operations of public enterprises should be collected systematically.

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EXECUTIVE SUMMARY

Background

- **Economic performance has remained strong over the past several years,** driven primarily by tourism, construction activities, and aid inflows. Inflation picked up last year, reflecting the lagged impact of higher international food and fuel prices and an acceleration in bank credit to the private sector during the first three quarters. Fiscal balance improved on better tax compliance and continued strong growth. The current account deficit widened last year, but was largely financed by donor flows.

- **Vanuatu has so far been largely shielded from the impact of the global slowdowns, but the slowdown in Australia and New Zealand are likely to have spillover effects.** Vanuatu's close links with these two countries, mainly through tourism and foreign direct investment, have contributed significantly to its remarkable growth performance in recent years. But they have also heightened Vanuatu's vulnerability to the projected downturn in these two countries, and there are some indications that growth is slowing.

- **There has been some progress in structural reforms, but more remains to be done.** Fiscal structural reforms should be further advanced to reorient expenditure and widen the tax base, while policies to support private sector development are also needed.

Key Policy Issues

- **Vanuatu is well placed to take counter-cyclical measures should growth slow more than expected.** Given the strong fiscal position, the authorities have room to use temporary fiscal stimulus measures in addition to expediting pipeline infrastructure projects. While close monitoring of banks is necessary given the rapid growth in private sector credit last year, the wide differential in policy rates between Vanuatu and its major trading partner countries suggests there is some scope for monetary easing if things deteriorate more than expected.

- **Financial sector supervision could be further improved.** In addition to improvements in the oversight of commercial banks, supervision of the newly established Vanuatu Agricultural Development Bank (VADB) and the Vanuatu National Provident Fund (VNPF) should be enhanced.

- **Structural reforms that reduce the cost of doing business are critical to ensure sustained growth**. In particular, improvements in infrastructure, including road transport, port and wharf facilities, and enhanced flexibility of the labor market are needed.

I. Introduction

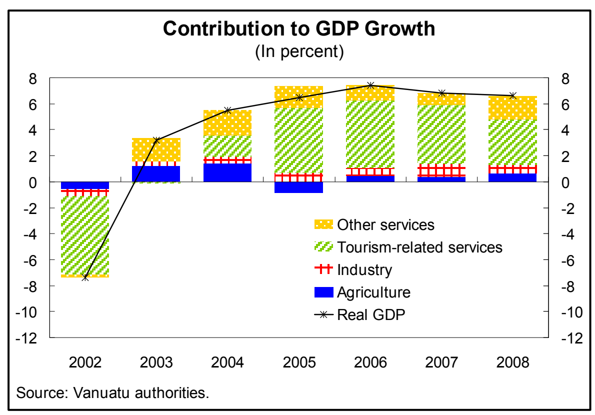
1. **After a period of relative political instability, the political situation has stabilized.** With no party commanding a majority, a coalition government, headed by Edward Natapai, took office on September 22. After defeating several opposition-led no-confidence votes, the political situation has stabilized and the government is moving ahead on policymaking. The 2009 budget was also finally passed in March. With support from donors, a number of initiatives, including improving transparency of government operations, are underway.

2. **The 2009 Article IV consultation focused on the spillovers from the global slowdown in Vanuatu and measures to reduce its adverse impact on the economy.** In particular, while Vanuatu's close links with Australia and New Zealand (through tourism and foreign direct investment (FDI)) have been the major sources of growth so far, they have heightened Vanuatu's vulnerability to the projected downturn in these two countries. In addition, growth could be affected further if concerns about the global slowdown were to drive domestic banks to cut back lending. On the positive side, the decline in food and fuel prices should help reduce inflationary pressures, providing room to ease monetary policy.

II. Recent Economic Development and Outlook

A. Economic Backdrop

3. **Vanuatu has so far been largely sheltered from the impact of the global financial turmoil.** Coming out of a decade of stagnant growth, Vanuatu has grown at an average rate of 6 percent in 2003–08, outperforming most of the other Pacific Island countries (PICs), while maintaining a relatively low inflation rate and an improving fiscal balance (Box 1).



- **A booming tourist sector helped to keep economic activity buoyant.** Growth remained strong in 2008 at 6½ percent, driven primarily by the service sector (which accounts for about two-thirds of GDP) and aid inflows, including increased disbursements from the Millennium Challenge Account (MCA). The agricultural sector also pitched in last year on the back of higher commodity prices.

Box 1. Vanuatu's Recent Success

After several years of low growth, economic growth in Vanuatu has picked up since 2003. A booming tourism sector combined with FDI, particularly in real estate by Australians, has helped Vanuatu achieve these high growth rates. Inflation has remained low compared to other PICs, and the introduction of VAT, combined with improved tax compliance and strengthened expenditure controls, has resulted in improvements in the fiscal position. Some factors for Vanuatu's success are:

- **Progresses in transportation and communication sector:** Vanuatu has a natural advantage over other PICs in terms of proximity to Australia and New Zealand, encouraging low-cost carriers to offer flights to Vanuatu, including Pacific Blue, which initiated an international flight operation in 2004. Following this, the government relaxed restrictions and allowed foreign carriers to compete with the local airlines. Port Vila is now connected with Australia, New Zealand, and Fiji by several airlines. In addition, the government ended the monopoly in the telecommunication sector in 2006 by allowing a second telecommunication license. More recently, Digicel has been allowed to offer cellular phone services in Vanuatu.

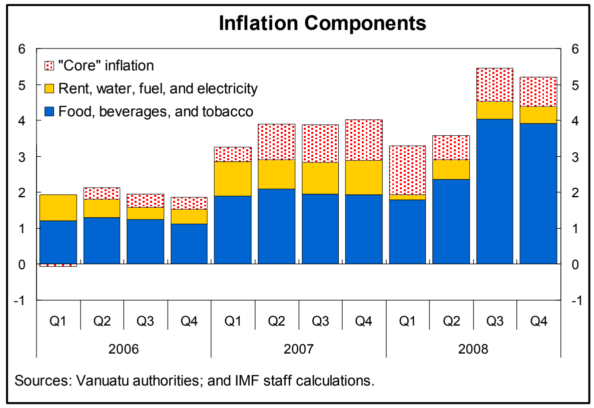
- **Fiscal resource management:** Introduction of VAT and commitment to capacity building in the tax office have contributed to an increase in government revenues. The government has also improved transparency in fiscal management through more frequent reporting. The regulatory framework for the state-owned utility company has been strengthened. Privatization of Air Vanuatu is also under consideration and should help reduce inefficiencies in the state-owned enterprise sector.

- **Sound monetary and financial policy:** With the help of technical assistance from the Pacific Financial Assistance Center (PFTAC) and other donors, the Reserve Bank of Vanuatu (RBV) has increased capacity and transparency of monetary operations. The exchange rate arrangement has helped to contain inflationary pressures. The banking sector follows international prudential standards. Vanuatu's AML/CFT framework has been assessed against the Financial Action Task Force (FATF) 40+9 Recommendations in 2007 by the Asia-Pacific Group on Money Laundering. Progress has been made in many areas over the past few years and further improvements are underway.

- **Political stability:** While the government changed hands frequently in 1995–2003, political stability under the former coalition government, which managed to stay in office for four years, boosted confidence in the economy and enabled the government to pursue structural and fiscal reforms.

Continued reform efforts are essential for further growth. Notwithstanding the recent impressive performance, if reform efforts stall and political instability reappears, Vanuatu could fall back to lower growth rates.

- **Inflation accelerated to 5.8 percent in 2008 from 4.1 percent in 2007.** The increase was driven largely by the pass-through of higher international food and fuel prices, with the depreciation in the Australian dollar since August and rapid private sector credit growth also being contributory factors.[1] More recently, food and fuel prices have started to decline, and with core inflation remaining relatively stable, the second round effects appear to be limited and manageable.



- **The current account deficit widened but was largely financed by aid flows.** The current account deteriorated in 2008 as rising exports, driven primarily by the recovery in copra and coconut oil exports and tourist revenues, were more than offset by increased imports of food and fuel, and machinery and transport equipment (the latter due to infrastructure projects under the MCA). An uptick in aid inflows, mainly disbursements from the MCA, helped finance the large import bill. On the other hand, FDI slowed considerably in 2008 as Australia and New Zealand, the largest sources of FDI, came under increasing strain from the financial crisis. Foreign exchange reserves remain comfortable at about 5½ months of projected imports of goods.

- **Overall, fiscal performance continued to improve.** The overall fiscal surplus increased to 2.2 percent of GDP in 2008, following a small surplus in 2007. Improved VAT and trade taxes, reflecting an improvement in tax compliance, more than offset the additional (election-related) spending on goods and services. Development expenditure also picked up as the long-awaited donor financing from the MCA began to feed into capital projects.[2]

- **Credit growth accelerated in 2008.** Bank lending increased significantly last year, in part reflecting the entry of a fourth foreign-owned commercial bank. Most bank loans went to the construction and consumer finance sectors. However, tighter liquidity conditions in the domestic money market combined with stricter lending standards have resulted in a slow down in credit growth since the fourth quarter of 2008.

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[1] Staff estimates suggest transmission lag is about a quarter between international prices and domestic prices.

[2] Of the total $66 million that Vanuatu is to receive from the MCA account, about $29 million has been disbursed, with the remaining $37 million to be disbursed by March 2011, the bulk of which is expected in 2009.

- **There has been some progress on structural reforms.** A new Utilities Act aimed at strengthening the regulatory framework was passed in 2007. The Personal Property Securities Act, which broadens the range of assets that can be used as collateral and strengthens the rights of secured creditors, was passed in 2008. In addition, the telecommunications sector has been opened up to foreign competition.

B. Outlook and Risks

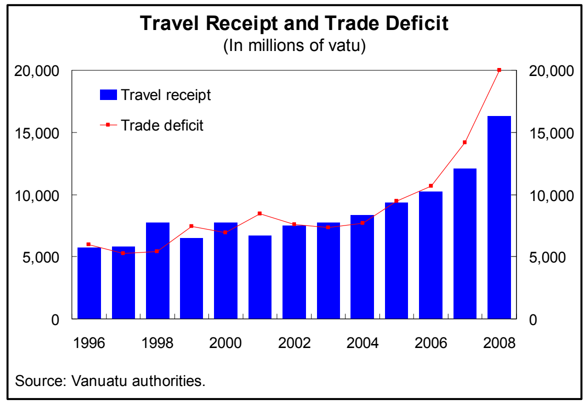
4. The global slowdown is likely to affect Vanuatu more than some of the other PICs, given its heavy dependence on tourism.

- **Growth is projected to moderate to 3 percent in 2009.** Indications (based on banking sector data) are that real estate activity, which has attracted capital inflows from Australia and New Zealand, has begun to slow. While tourist arrivals remain strong (airlines and hotel operators suggested confirmed bookings through May remain strong; frequency of cruise ships has also increased this year so far), spending by tourists has declined (Box 2). However, MCA disbursements, which picked up last year after several delays, are expected to remain strong and combined with other aid inflows should help alleviate some of the negative impact on growth. In addition, the recent easing in monetary policy and a more accommodative fiscal stance for the 2009 budget would help cushion the impact on growth. Inflation will likely fall, reflecting lower international food and fuel prices. The current account deficit is expected to narrow and foreign exchange reserves to improve, reflecting lower imports due to the decline in commodity prices.

- **Risks to the outlook are tilted to the downside.** Should the global slowdown be more protracted than expected, including in Australia and New Zealand, this would further exacerbate the negative impact on tourism and FDI. Furthermore, with three of the four commercial banks being subsidiaries of foreign banks, banks could come under increasing pressure from their parent companies to tighten lending standards and add to the slowdown in growth.

5. The authorities agreed that growth will moderate in 2009, but only modestly. The authorities project growth in 2009 at 4½ percent, somewhat higher than staff's projections. While there was no fundamental difference in views, the authorities believe that the impact from the global slowdown is likely to be smaller given the dominance of subsistence farming and continued strong tourist arrivals based on Vanuatu's geographic advantage. Also, Australians concerned about future income are likely to curb their travel budgets and instead of far away vacations may come to Vanuatu. That said, the authorities concurred with the staff's views that overall the risks to the economic outlook are tilted to the downside given developments in the global economy.

Box 2. Tourism Sector in Vanuatu



Tourism plays a greater role in Vanuatu's economy compared to other PICs. Helped by the open sky policy adopted by the government in 2004, visitor arrivals have grown at an annualized rate of about 13 percent since then. Travel receipts cover most of the gap arising from trade in goods and have been the largest source of foreign exchange revenue. Tourism-related sectors (wholesale and retail trade, hotels and restaurants, and transport and communication) play an increasingly important role in the domestic economy. These three sectors account for over two-thirds of GDP, and about 70 percent of the increase in real GDP in the three most recent years.

While tourist arrivals have held up well so far, there are some risks going forward. Visitor arrivals by air continued to show strong growth in the first two months of this year , boosted by the addition of a direct flight from Melbourne in January. The frequency of cruise ships also increased in the first two months. However, slowing growth in Australia and New Zealand could have an adverse impact as three-fourths of tourists come from these two countries. During the IT crisis, downturns in these countries, together with cyclone-related disasters pushed down travel receipt by 18 percent in 2001. There is also anecdotal evidence that tourist spending per day is declining. On the positive side, lower fuel prices may provide some relief through reduced flight costs.

III. Policy Discussions

Against this backdrop, policy discussions focused on how Vanuatu could mitigate the effects of the global slowdown, especially if tourism were to nosedive. In this context, staff recommended that while fiscal policy should be primarily used to counter the effects of a downturn, the relatively high policy rate in Vanuatu provides scope to use monetary policy (though constrained by the exchange rate system) by lowering the policy rate to those prevailing in trading partner countries, notably Australia and New Zealand. However, it will be critical to ensure that any policy easing is supportive of growth without creating inflationary pressures. In addition, the mission stressed that continued structural reforms remain critical to place the economy on a higher trajectory of long-term sustainable growth.

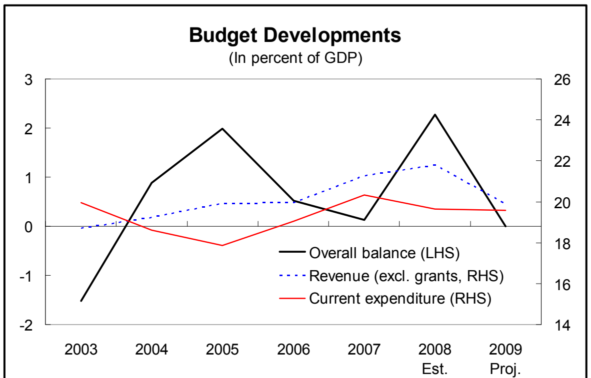
A. Macroeconomic Policies

Fiscal Policy

Background

6. Fiscal performance has improved substantially.

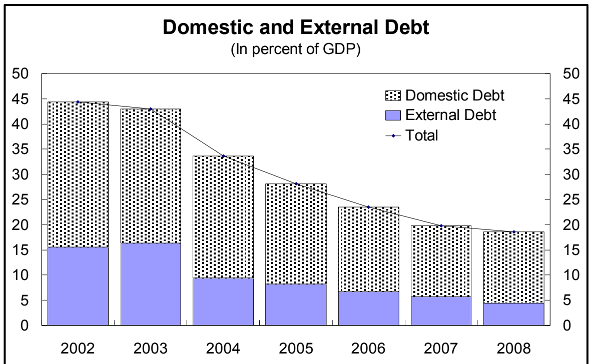
- **The budget surplus for 2008 is estimated at 2.3 percent of GDP.** Reflecting improved tax compliance (partly due to additional staffing in the tax office) and continued strong growth, total revenues, especially from VAT and trade taxes, were up by 16 percent from 2007. Expenditures were higher than in the budget, although the strong revenue performance resulted in a sizable fiscal surplus. Furthermore, expenditure remains skewed toward nonproductive spending, with all revenue collections going toward meeting recurrent expenditure. The wage bill continued to constitute about half of recurrent expenditure, and allocations for emergency spending were, in part, used to finance election-related spending.



Sources: Vanuatu authorities; and IMF staff estimates.

- **The 2009 budget is expected to be broadly balanced.** In light of the projected slowdown in economic activity, the mission's revenue projections are somewhat lower than in the authorities' budget (which envisages fiscal surplus of about 1 percent of GDP). Keeping recurrent expenditure similar to the authorities' projections, staff projects the fiscal balance to be broadly balanced.

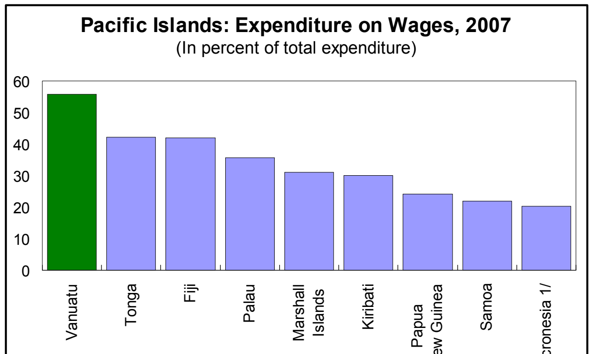
7. Fiscal consolidation has helped to reduce debt. The authorities' successful efforts at fiscal consolidation combined with no new borrowing for several years led to a decline in the debt-to-GDP ratio to about 14 percent in 2007 from over 40 percent in 2002. The debt ratio inched up in 2008 reflecting disbursements under a newly contracted bilateral loan to finance the "E-government project" which will computerize fiscal operations across the different ministries and enhance expenditure tracking and transparency. That said, the debt ratio remains low, gradually declining over the medium term and debt burden indicators remain below the indicative thresholds (see Appendix I on debt analysis).



Sources: Vanuatu authorities; and IMF staff estimates.

8. Several structural problems continue to hinder effective fiscal management.

- **Large public wage bill.** Vanuatu's wage bill (in percent of total expenditure) is the highest among PICs, while the share of public employment in total employment is broadly the same as in other PICs. Furthermore, this ratio has increased from 10½ percent of GDP in 2005 to an estimated 12 percent of GDP in 2008.



Source: Country authorities; and IMF staff estimates.
1/ 2006 data for Micronesia.

- **Inefficient public enterprises.** In total, there are 24 public enterprises in Vanuatu, the majority of which continue to receive financial assistance from time to time. While some of them (e.g., Air Vanuatu) have played a critical role in supporting Vanuatu's key industry, tourism, privatization (under consideration for Air Vanuatu) and/or better management could help to reduce the burden on the budget.

- **Narrow tax base.** Vanuatu has a relatively low tax revenue/GDP ratio among PICs. This reflects the existence of large tax exemptions (especially on interisland shipping and tourism), estimated at average of 3½ percent of GDP.

Staff views

9. The mission welcomed the recent fiscal performance and the more accommodative fiscal stance under the 2009 budget. The authorities are on firmer ground to use counter-cyclical fiscal policy given the fiscal consolidation achieved so far. The overall accommodative fiscal stance in the 2009 budget (although there are no explicit stimulative measures) appears appropriate, especially given some signs of a forthcoming slowdown. The fiscal balance is expected to remain in surplus over the medium term as economic activity and tax revenues recover. That said, the authorities should avoid an expansion in areas where retrenching spending is difficult (e.g., a general increase in the public wage bill) so as not to jeopardize medium-term fiscal sustainability.

10. In the event of a sharper-than-expected downturn, a fiscal stimulus could be provided through better prioritization of fiscal spending and additional donor support. Measures could be designed to counter the effect of the global slowdown on Vanuatu, including the following:

- Allowing the automatic stabilizers to work. While the scope for automatic stabilizers is limited by Vanuatu's dependence on VAT, the budget could accommodate a decline in other taxes, notably customs and property taxes.

- Expanding the social safety net (with assistance from donors), including conditional cash transfers targeted to those who lose their jobs as businesses cut back spending. The 2006 Household Income and Expenditure Survey suggests that urban areas are more susceptible to the global slowdown with more than 30 percent of the urban population being wage earners, while the majority of the rural population appears to be engaged in subsistence agriculture.

- Expediting implementation of pending projects in road construction, including in the outer islands.

- Bringing forward new projects (principally financed by additional donor funding).

11. From a longer-term perspective, the mission emphasized that the authorities should focus on fiscal "structural" reforms as below:

- **Reorienting expenditure.** More than half of the recurrent budget is spent on the wage bill, crowding out expenditure in areas that could help improve the productive capacity of the economy. Most development expenditure is currently financed by aid inflows. While aid inflows are expected to remain strong over the next few years, the government could increase development spending in priority areas through restructuring expenditures. These measures include:

    - streamlining the wage bill by eliminating vacant positions, and avoiding ad-hoc increases in wages;

    - enhancing monitoring and accountability of public enterprises to improve efficiency, and restructuring those that continue to make losses and require government subsidies; and

    - improving the budget framework to establish transparency and accountability, including through the passage and implementation of the Public Expenditure Financial Management (PEFM) Act.

- **Widening the tax base.** The staff stressed streamlining the large tax exemptions, especially in the tourism sector and rationalizing exemptions in interisland shipping. In addition, tax administration could be further rationalized by better integrating the VAT and customs duty collection.

12. External debt should be maintained at a low level, especially given donors willingness to provide aid. The mission underscored that the authorities should improve their capacity to implement aid-related programs and work more closely with donors to align donor assistance with their own development objectives. This would allow more effective use of donor assistance while eliminating the need to borrow.

The authorities' views

13. The authorities agreed with the thrust of staff's assessments.

- **2009 budget.** The authorities agreed that the revenue target may be challenging to achieve, but they believed that this could be achieved through enhanced efficiency of the tax system, including the introduction of a Large Tax Payer Unit this year.

- **Policy response to a larger-than-expected slowdown.** The authorities welcomed the mission's focus on this issue and indicated initiation of contingent plans, including possibly asking donors to expedite their projects and taking steps to streamline bureaucracy within the government to expedite projects in the pipeline.

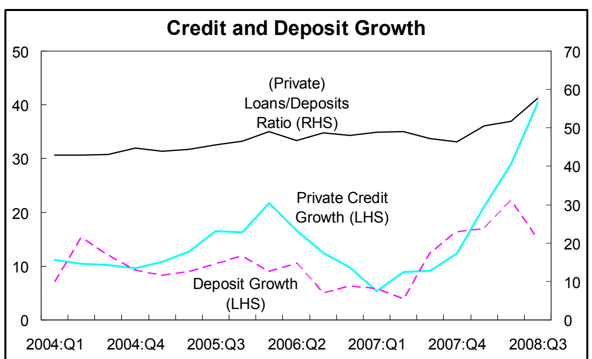
- **Structural issues.** While the authorities stressed that Vanuatu's dispersed landscape requires a larger civil service especially in education, they agreed that there is scope to streamline expenditures. In this respect, the authorities have started to reduce vacant positions in the public sector. They strongly agreed on the need to monitor public enterprises and recognized that more transparent fiscal management is necessary. With this in mind, the PEFM bill, which will enhance budget monitoring and transparency, has been submitted to parliament.

- **External debt.** The authorities stressed that the newly contracted loan was a one-off event and would help provide cheap financing for improving the efficiency and transparency of budget spending. They have no further plans to borrow and remain strongly committed to reducing their debt levels.

Monetary Policy

Background

14. Following a monetary tightening in September, the RBV reversed course in December as the liquidity condition in the interbank market tightened. In addition to the lagged impact of rising food and fuel prices, strong growth in domestic credit was fueling inflationary pressures. In an effort to prevent these pressures from becoming entrenched, the RBV raised its discount rate by 25 basis points in September. However, the monetary stance was eased in December—the discount rate was lowered by 25 bps to 6 percent, and the Liquid Asset Requirement (LAR) and the Statutory Reserve Deposit (SRD) requirement were reduced respectively to 7 percent and 5 percent (from 8 percent and 10 percent)—following a



Source: Vanuatu authorities.

liquidity shortage in the banking sector, caused in large part because lending had accelerated while deposit growth remained modest.

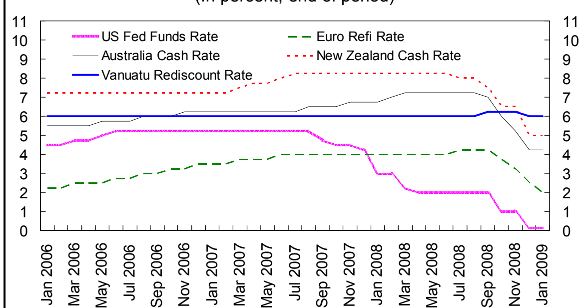
Staff views

15. With lending and inflation decelerating recently, and assuming credit growth continues to moderate, there is some scope to ease the monetary stance if the global slowdown has a significant adverse impact on the economy.

- While inflation is starting to come down, it is still too early to assess the impact of last year's credit expansion (very strong until the third quarter and slowing thereafter) on bank balance sheets. In particular, with most loans concentrated in the construction and consumer finance sectors, a slowdown in growth could have potentially significant negative consequences for bank balance sheets. Staff underscored the need to monitor bank balance sheets closely and ensure that they were complying with all prudential regulations.

- That said, the policy rate in Vanuatu still remains significantly above those in Australia and New Zealand (countries with relatively large weights in the currency basket), providing the central bank room to reduce rates, if growth begins to slow more than expected. Alternatively, the SRD could be lowered as this has a more direct impact by releasing additional liquidity in the banking sector than a change in the policy rate. However, any easing in monetary policy, before it is undertaken, should ensure that RBV's goal of achieving low inflation and ensuring a sound banking system are not jeopardized.

Policy Rates
(In percent, end of period)



Sources: CEIC Data Company Ltd; and Reserve Bank of Vanuatu.

The authorities' views

16. The authorities concurred with the mission's assessment and agreed that their policy stance going forward should be guided by developments on both the domestic front as well as spillovers from the global slowdown. The authorities agreed with the need to closely monitor bank balance sheets for signs of portfolio deterioration. If inflation fails to decline to the 3–4 percent range and the economy proves resilient to the global downturn, they may tighten the SRD/LAR requirements. On the other hand, if growth slows substantially a more accommodative stance may be warranted. In this context, apart from standing ready to provide liquidity in the case of emergency, they are also exploring other financial assets, besides the RBV notes, that can be used as collateral for liquidity provision.

Exchange Rate and Competitiveness

Background

17. **Staff analysis suggests that Vanuatu's REER is broadly in line with economic fundamentals.** With the fluctuations in major currencies broadly offsetting each other, the vatu has been largely stable in real effective terms since early 2000s (Box 3). Although the trade deficit has risen recently, exports of both goods and services were strong and helped to finance the large import bill due to higher international prices of food and fuel. Foreign exchange reserves remain strong.

Staff views

18. **The current exchange rate policy remains appropriate.** Given the small size of the economy and limited administrative capacity to conduct monetary policy, the relative stability of the nominal effective exchange rate has provided an important anchor for inflation expectations. Structural bottlenecks and international commodity prices, rather than external price competitiveness, better explain the modest widening in the current account deficit last year. That said, the current account deficit, mainly reflecting FDI and donor-financed imports, is expected to remain large over the medium term.

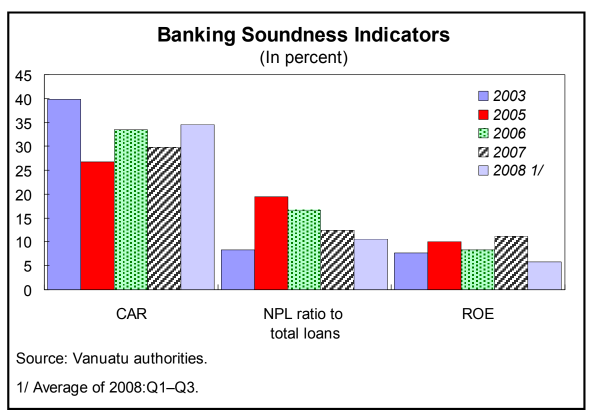
Authorities' views

19. **The authorities continue to believe that their current basket regime remains appropriate.** They shared the mission's views that eliminating structural bottlenecks holds the key to increasing competitiveness.

Financial Sector

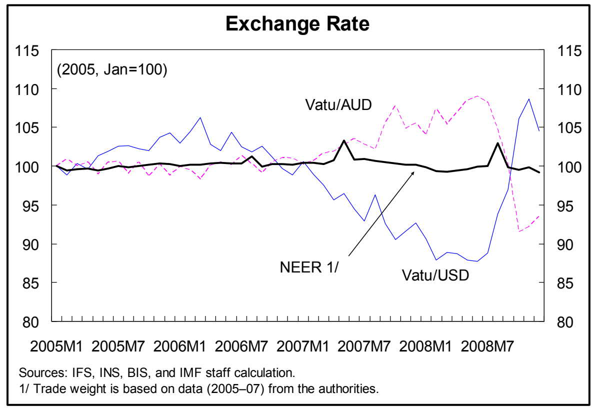
Background

20. **Despite rapid credit growth, the banking system remains sound.** Banks are well capitalized with the capital adequacy ratio above 30 percent while nonperforming loans (NPLs) have been declining rapidly. (partly reflecting the recent rapid growth in total loans). Profitability remains high although the tight financing conditions toward the end of the year led to a decline in lending margins.

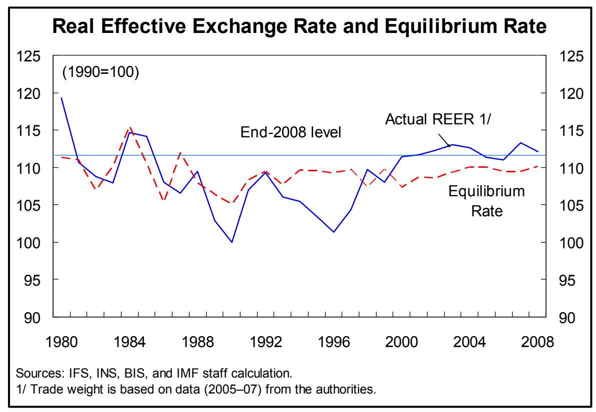


Box 3. An Exchange Rate Assessment for Vanuatu

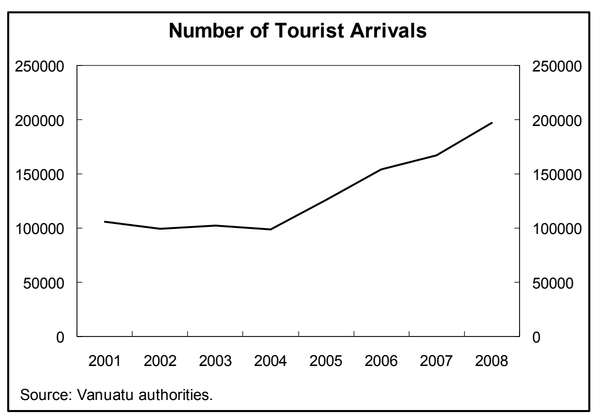
- **Vanuatu's currency has been stable in nominal effective terms.** While the bilateral nominal exchange rate against the U.S. dollar and the Australian dollar was volatile, the impact has been largely offsetting. This has helped to keep the NEER stable, despite rapid currency movements during the recent period of financial market volatility.



- **The real effective value of the vatu has remained broadly in line with economic fundamentals.** With inflation in Vanuatu under control, and moving broadly in line with those of major trading partners, the vatu has also been stable in real effective terms. A quantitative exchange rate assessment based on the fiscal position and the terms of trade confirms that the vatu remains in line with economic fundamentals.[1]



- **External price competitiveness is not an issue.** Receipts from tourism have been increasing and commodity exports have also increased while the REER continued to remain unchanged. This suggests that structural factors (e.g., liberalization of the aviation sector) and commodity prices (especially last year) drive these two rather than exchange rate considerations. That said, if commodity prices weaken and wages continue to increase, they could affect competitiveness in the future.



[1] Data constraints preclude implementing the macroeconomic and external sustainability approaches.

20. The VADB was established last year, with an initial capital of vatu 200 million from the budget (total capitalization to reach vatu 500 million by 2011) with the aim of providing loans to farmers. The VNPF has also started to engage in providing loans to its members with their savings in the provident fund as the collateral.

Staff views

21. Financial sector supervision should be enhanced given the recent rapid growth of credit and the global financial environment. In this context, the authorities should be vigilant of the additional risks commercial banks face from a possible slowdown, especially given their exposure to personal and construction-related loans. Both the VADB and VNPF should be brought under RBV supervision. While financial sector supervisory standards are in line with international practice and financial sector supervision has been strengthened significantly, lack of sufficiently trained staff still constrains the effectiveness of monitoring. In addition, the recent decision to move insurance supervision from the Financial Service Commission to RBV should be carefully planned and enough resources should be devoted to ensure adequate supervision. The mission also underscored the importance of making the Financial Intelligence Unit fully operational so that it can enforce AML/CFT provisions.

The authorities' views

22. The authorities agreed with the importance of enhanced supervision given the current environment. In particular, they underscored that they have been closely watching the recent increase in personal-consumption loans and have alerted banks. The authorities are planning to bring VADB under central bank supervision to ensure sound management. On AML/CFT, the authorities reiterated their commitment to fully implement the regulations and indicated that they were seeking additional technical assistance for training staff.

B. Policies to Support Sustainable Growth

Background

23. There have been some improvements in the business climate, but much remains to be done. Recent steps taken by the government are encouraging (as described in the background section), but several challenges remain:

- **Infrastructure bottlenecks.** Poor infrastructure, including lack of a good road network, lack of interisland shipping, lack of storage facilities at wharfs, congestion at ports, all raise the cost of doing business.
- **Labor market cost.** A new Employment Act (passed by parliament, but not yet implemented), would raise the severance pay scale fourfold. This could raise labor

costs significantly and has raised widespread concerns across the business community. [3]

Staff views

24. Staff underscored the importance of continued structural reforms to help reduce business costs. Improving infrastructure to lower trade-related costs at ports would help Vanuatu raise its growth potential. At the same time, striking a better balance between workers rights and employer constraints with regard to the Employment Act will help to improve worker pay and safeguard employment while ensuring that Vanuatu remains attractive for businesses.

Authorities' views

25. The authorities pointed to a number of steps being taken to address structural bottlenecks:

- Discussions are underway with a donor to upgrade the wharf facilities. The Efate Ring Road (financed by MCA) is underway and due to be completed by early 2011. They are also seeking donor assistance to extend roads further and develop interisland shipping.

- Plans for privatizing Air Vanuatu are underway and the government is trying to identify other enterprises that could be privatized.

- The Employment Act is being reviewed and the government plans to consult all stakeholders in order to reach a consensus before implementing the act.

IV. Staff Appraisal

26. Vanuatu has recently shown remarkable growth, but is not immune to the current global slowdown. Driven by strong growth in tourism and construction sectors, real GDP has been growing at an average of 6 percent in the last five years. Although the impact from the global slowdown is yet to be felt, construction-related FDI and spending by tourists appear to show some signs of a slow down. At this conjuncture, growth in 2009 is expected to be at 3 percent, with risks tilted to the downside.

27. Vanuatu is well positioned to respond with counter-cyclical fiscal measures, should growth slow more than expected. The 2009 budget aims for a more modest surplus than last year and in this sense is more accommodative. However, given the strong fiscal position and low public debt, the authorities have room to use temporary fiscal stimulus

[3] It raises severance pay from the current two weeks to eight weeks for every year of work.

measures (e.g., targeted conditional cash transfers) to cushion the impact on the economy. In addition, expediting pipeline infrastructure projects will also help.

28. A cautious easing of the monetary stance may be warranted if the slow down turns out to be more serious than anticipated. Domestic price pressures have been coming down, although with a lag compared to most other regions. Provided inflation continues to decline and bank balance sheets remain strong, the monetary stance could be further relaxed to support growth.

29. Further improvements in bank supervision are advisable. In particular, closer monitoring of bank balance sheets, including RBV supervision of VADB, will help early detection of any signs of deterioration in loan quality and help the authorities to take timely action to ensure a continued sound banking system.

30. The current exchange rate regime remains appropriate. The exchange rate appears to be broadly in line with economic fundamentals. With a sound reserve position supported by tourism and capital inflows, there appears to be little sign of exchange rate misalignment.

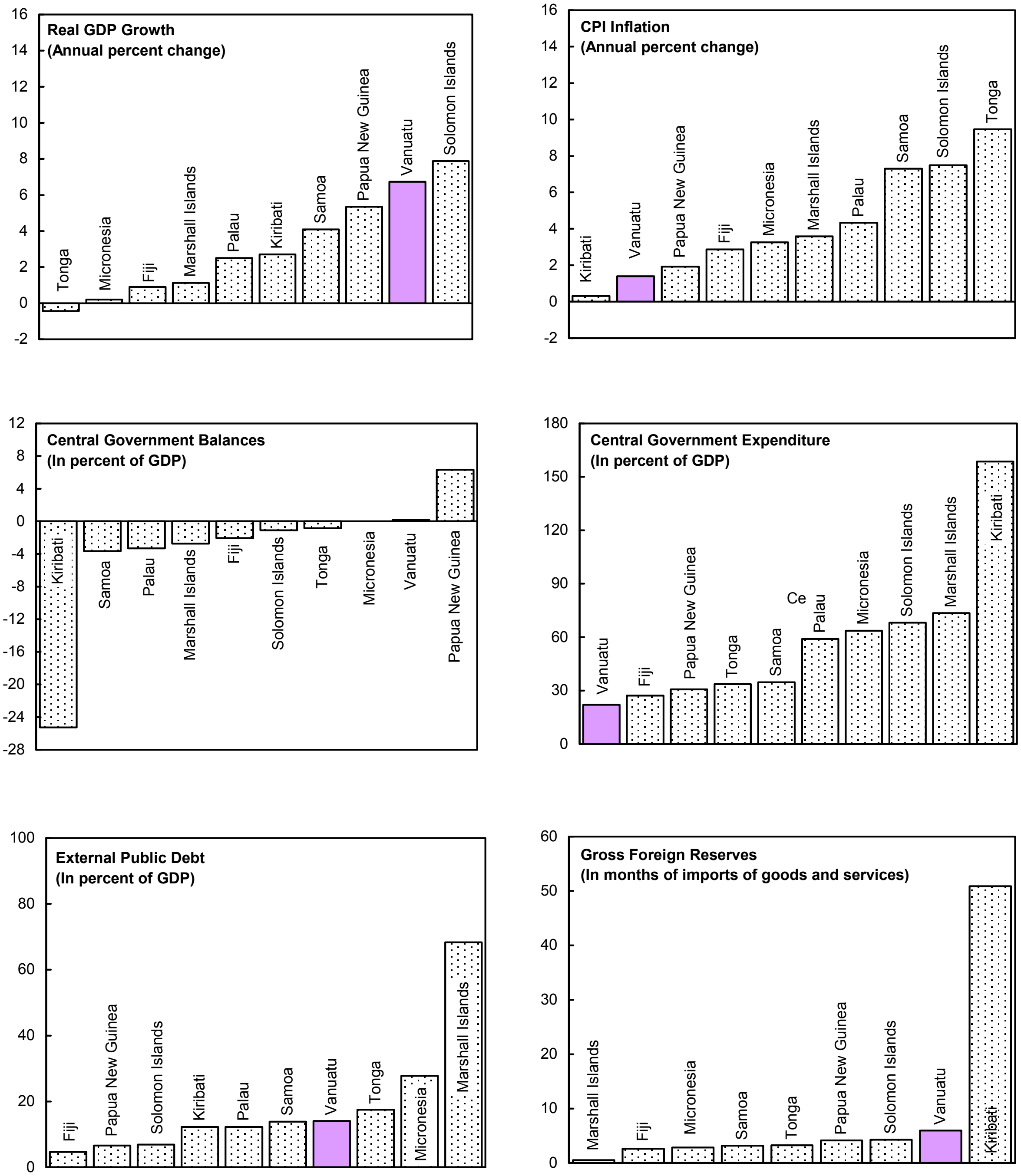
31. Further structural reforms are necessary to sustain a high growth path. The significant progress to date has already yielded tangible results. Looking forward, the priority areas are improving road and port infrastructure, improving management and efficiency at public enterprises, and ensuring a flexible labor market.

32. Improving capacity to compile statistics is necessary. The authorities identified several areas for technical assistance, especially to improve national accounts and balance of payments data. Fund staff, including through PFTAC, will continue to provide assistance in these areas.

33. It is recommended that the next Article IV consultation with Vanuatu takes place on a 24-month cycle.

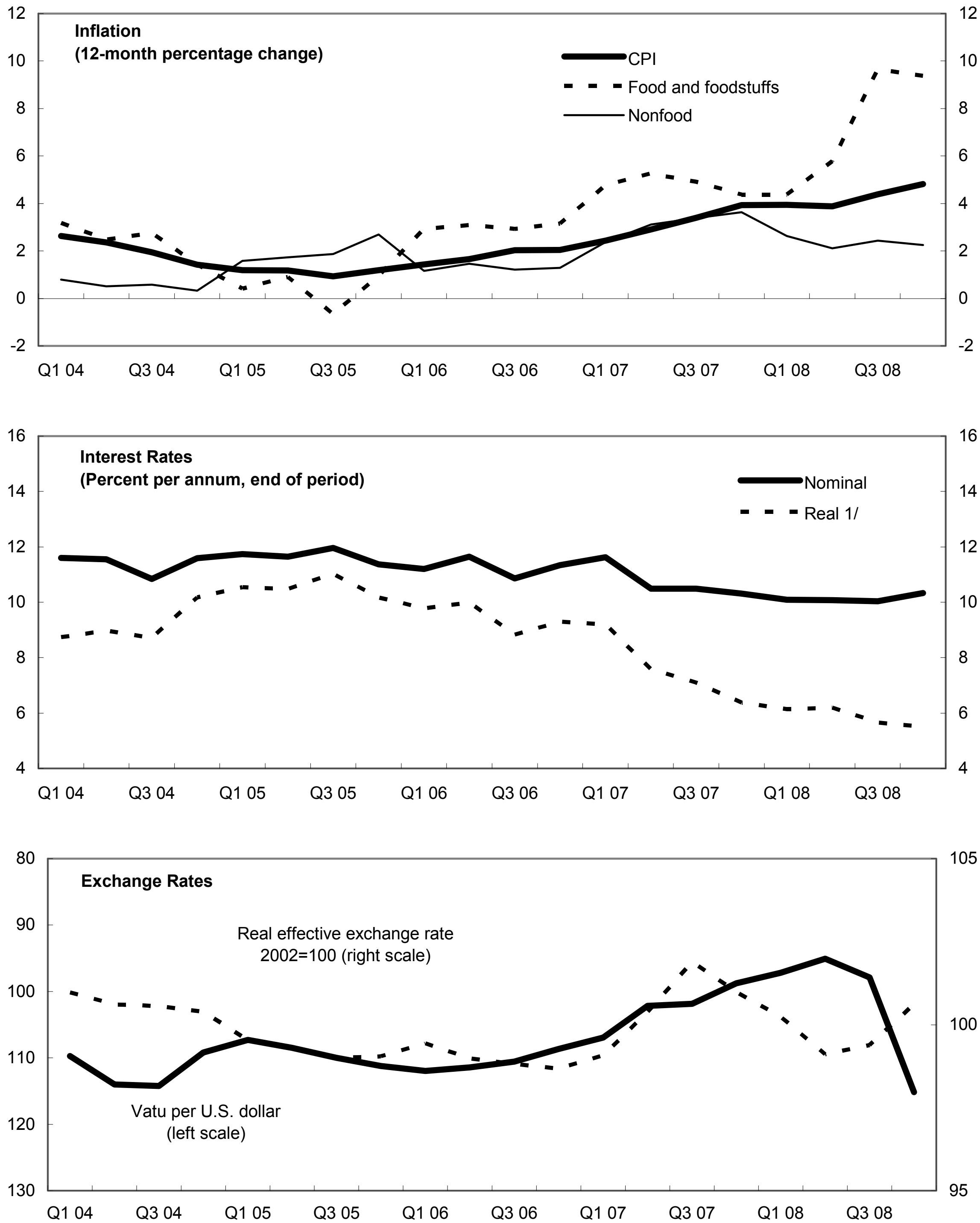
Figure 1. Vanuatu: Regional Comparators

(Averages, 2006–08)



Sources: Vanuatu authorities; and IMF staff estimates.

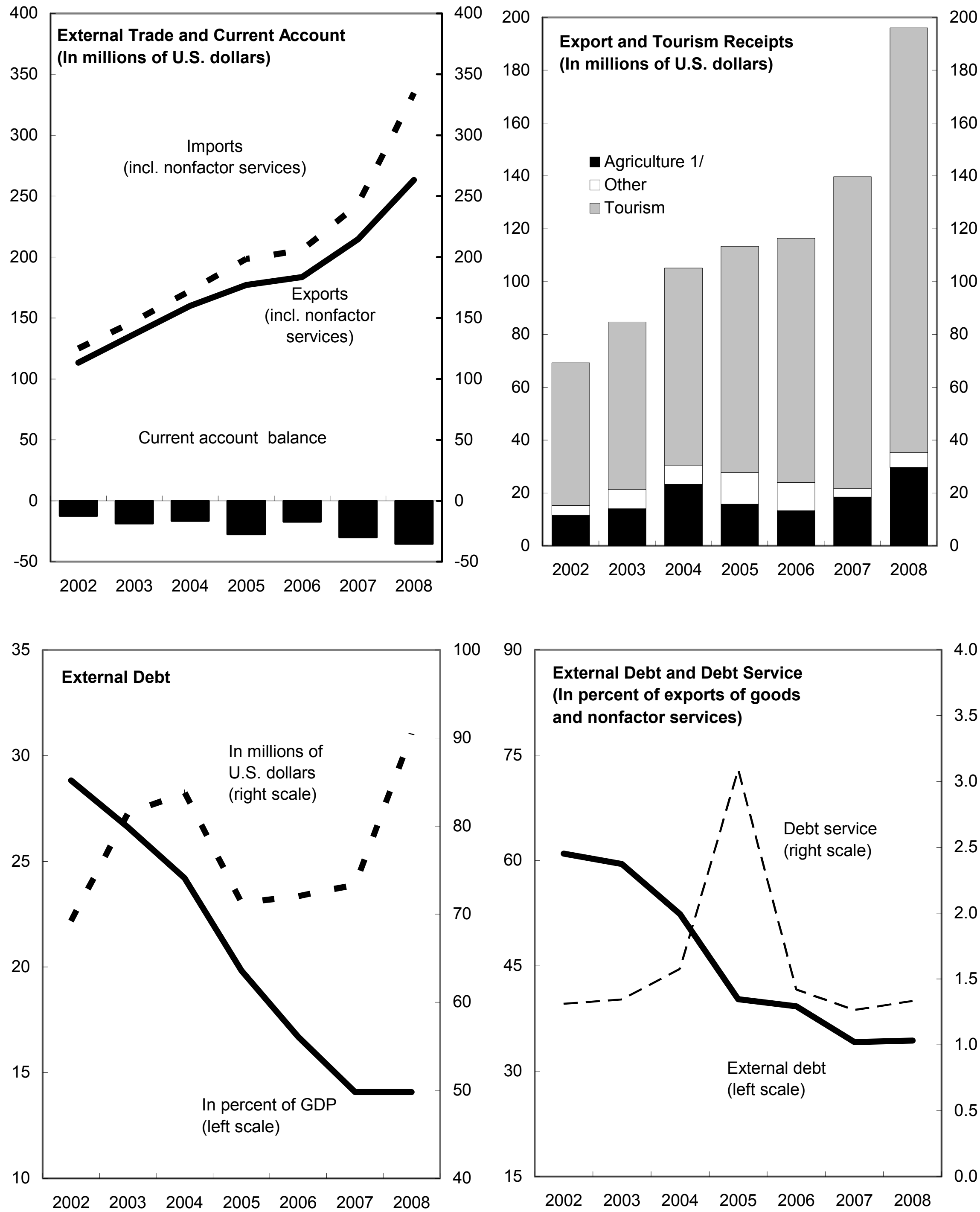
Figure 2. Vanuatu: Selected Economic Indicators, 2004–08



Sources: Vanuatu authorities; and IMF staff estimates.

1/ Measured with respect to a weighted-average lending rate on bank loans and the four-quarter average inflation rate.

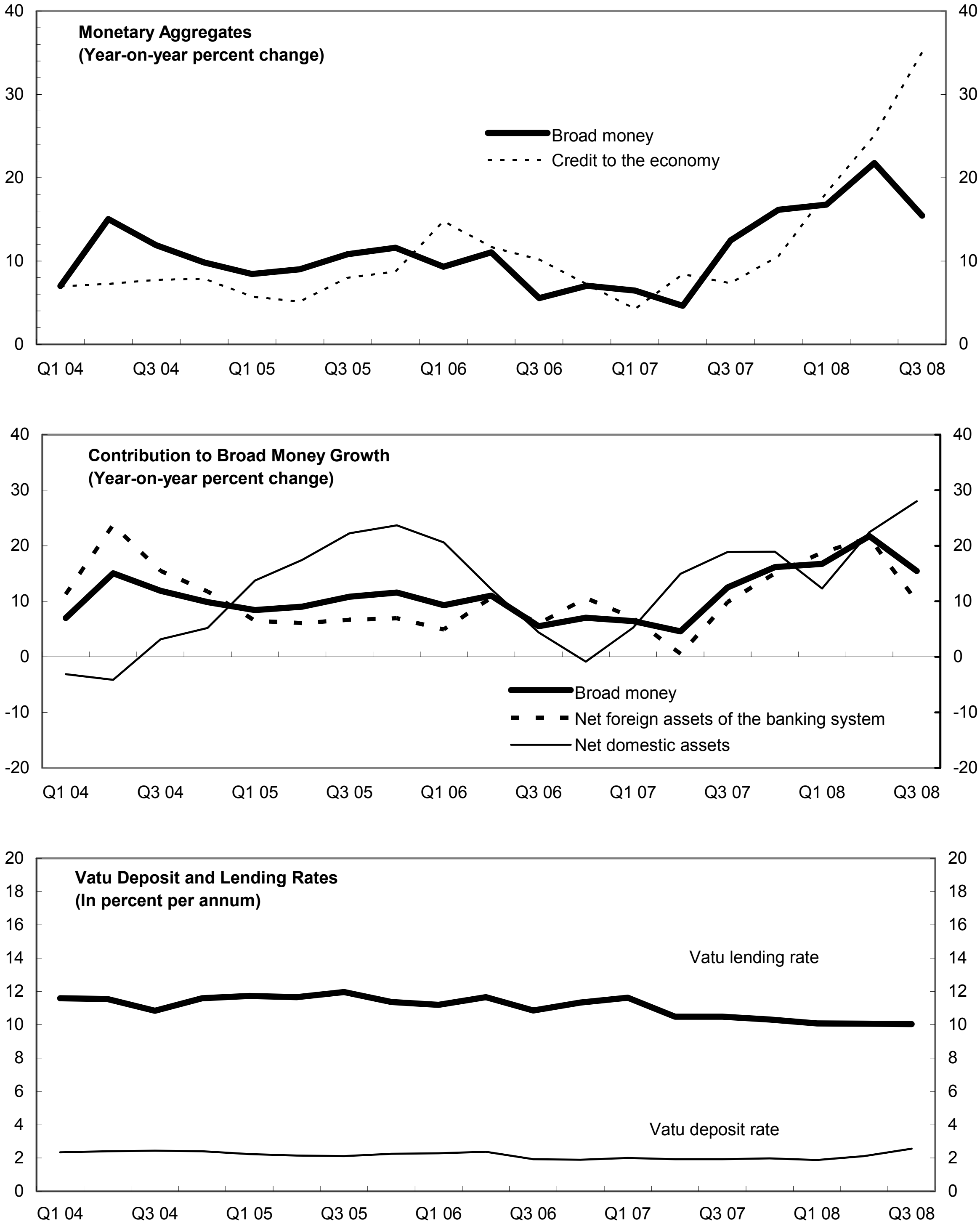
Figure 3. Vanuatu: External Sector Developments, 2002–08



Sources: Vanuatu authorities; and IMF staff estimates.

1/ Agricultural exports include beef, cocoa, coconut oil, copra, kava, and timber.

Figure 4. Vanuatu: Monetary and Financial Indicators, 2004–08



Sources: Vanuatu authorities; and IMF staff estimates.

Table 1. Vanuatu: Selected Economic and Financial Indicators, 2004–09

Nominal GDP (2007): US$507 million
Main exports: Tourism, kava, beef
GDP per capita (2007): US$2,218
FDI (2007): US$33 million
Public debt (2007): 20 percent of GDP
Foreign public debt (2007): 70 percent of total public debt

	2004	2005	2006	2007	2008	2009
					Est.	Proj.
Output and prices (annual percentage change)						
Real GDP	5.5	6.5	7.4	6.8	6.6	3.0
Nominal GDP	7.8	9.6	13.8	13.1	11.7	7.4
Consumer prices (period average)	1.4	1.2	2.0	3.9	4.8	4.3
Consumer prices (end period)	0.8	1.9	1.9	4.1	5.8	3.5
Government finance (in percent of GDP) 1/						
Total revenue and grants	21.5	21.7	21.8	23.1	28.6	26.6
Revenue	19.1	19.8	19.9	21.3	21.8	19.9
Tax	17.1	17.6	17.7	18.9	19.7	18.3
Nontax	1.9	2.2	2.3	2.3	2.1	1.6
Grants 2/	2.5	1.9	1.9	1.9	6.8	6.6
Total expenditure	20.7	19.7	21.3	22.9	26.4	26.6
Current expenditure	18.6	17.9	19.0	20.2	19.6	19.6
Of which: wages and salaries	11.1	10.5	11.2	12.2	12.1	11.5
Capital expenditure	2.0	1.8	2.2	2.7	6.7	7.0
Overall balance	0.9	2.0	0.5	0.3	2.2	0.0
Money and credit (annual percentage change)						
Broad money (M4)	9.8	11.6	7.0	16.1	13.2	...
Net foreign assets	11.7	6.9	10.5	15.0	9.0	...
Domestic credit	7.9	8.7	7.2	10.6	36.7	...
Credit to private sector	9.6	16.3	9.7	12.3	43.3	...
Interest rates (in percent, end of period) 3/						
Deposit rate (vatu deposits)	2.4	2.3	1.9	2.0	2.6	...
Lending rate (vatu loans)	11.6	11.4	11.3	10.3	10.0	...
Balance of payments						
Current account (in millions of U.S. dollars)	-16.5	-27.5	-17.1	-30.0	-42.3	-33.4
(In percent of GDP)	-5.0	-7.4	-4.1	-5.9	-7.4	-6.0
Of which: tourism exports (in millions of U.S. dollars)	74.8	85.6	92.4	118.0	160.9	139.5
Merchandise exports, f.o.b. (in millions of U.S. dollars)	38.1	38.1	37.7	29.7	41.7	37.1
(Annual percentage change)	43.3	0.1	-1.1	-21.3	40.7	-11.2
Merchandise imports, f.o.b. (in millions of U.S. dollars)	106.7	124.7	134.4	167.9	239.1	216.0
(annual percentage change)	22.9	16.9	7.7	25.0	42.4	-9.7
Gross official reserves (end of period)						
In millions of U.S. dollars	62.1	67.6	105.1	119.6	115.2	135.3
In months of corresponding imports of goods 4/	5.8	5.4	7.8	7.1	4.8	6.3
In months of next year's imports of goods 4/	5.0	5.0	6.3	5.0	5.3	6.3
External debt						
External debt (in percent of GDP) 5/	24.2	19.8	16.7	14.1	14.1	14.4
External debt service 6/	1.6	3.1	1.4	1.3	1.3	2.4
Exchange rates (period average)						
Exchange rate regime: officially pegged to an undisclosed basket of currencies						
Vatu per U.S. dollar (period average)	111.9	109.2	110.5	102.4	101.3	…
Real effective exchange rate (average, 2000=100)	100.2	100.3	100.7	101.1	100.3	…
(Annual percentage change, - depreciation)	0.3	0.1	0.4	0.4	-0.8	…
Memorandum items:						
Nominal GDP (in billions of vatu)	36.9	40.4	45.9	52.0	58.1	62.4

Sources: Vanuatu authorities; and IMF staff estimates and projections.

1/ 2007–08 figures are based on the authorities' budget estimates, with adjustments by staff.
2/ Includes Millennium Challenge Account (MCA) project grant since 2006.
3/ Weighted average rate of interest for total bank deposits and loans. 2008 data are as of September.
4/ Imports values are on c.i.f. basis.
5/ Medium- and long-term public debt only.
6/ In percent of exports of goods and nonfactor services.

Table 2. Vanuatu: Central Government Fiscal Operations, 2004–09

(In percent of GDP, unless otherwise indicated)

	2004	2005	2006	2007	2008	2009	
			Prelim.	Prelim.	Proj.	Budget	Proj.
Total revenue and grants	21.5	21.7	21.8	23.1	28.6	23.9	26.6
Revenue	19.2	19.9	19.9	21.3	21.8	20.9	19.9
Tax 1/	17.1	17.6	17.7	18.9	19.7	19.2	18.3
Taxes on properties	0.3	0.4	0.5	6.5	1.2	0.8	0.4
Goods and services	10.8	11.2	11.4	11.6	11.9	11.7	11.7
International trade	6.0	6.0	5.8	6.5	6.6	6.6	6.2
Nontax	1.9	2.2	2.3	2.3	2.1	1.6	1.6
Capital revenue	0.2	0.1	0.0	0.0	0.0	0.0	0.0
Grants 2/	2.3	1.7	1.9	1.9	6.8	3.0	6.6
Total expenditure and net lending	20.7	19.7	21.3	22.9	26.4	23.0	26.6
Total expenditure	20.7	19.7	21.3	22.9	26.4	23.0	26.6
Current expenditure	18.6	17.9	19.0	20.2	19.6	19.6	19.6
Of which :							
Wages and salaries 3/	11.1	10.5	11.2	12.2	12.1	11.5	11.5
Purchases of goods and services	3.6	3.7	3.5	4.5	4.3	4.0	4.0
Interest payments	1.0	0.9	0.7	0.6	0.6	0.9	0.9
Transfers	2.3	2.2	3.0	2.1	2.1	2.6	2.6
Capital expenditure	2.0	1.8	2.2	2.7	6.7	3.4	7.0
Overall balance	**0.9**	**2.0**	**0.5**	**0.3**	**2.2**	**0.9**	**0.0**
Financing	-0.9	-2.0	-0.5	-0.3	-2.2	-0.9	0.0
Foreign financing (net)	-0.5	-1.3	-0.4	-0.4	1.5	1.3	1.3
Concessional borrowing	-0.5	-1.3	-0.4	-0.4	1.5	1.3	1.3
Commercial borrowing	0.0	0.0	0.0	0.0	0.0	1.0	0.0
Domestic financing (net)	-0.4	-0.7	-0.1	0.1	-3.7	-2.2	-1.3
Domestic market borrowing (net)	0.0	-0.4	-0.5	-0.2	-0.7	-0.1	-0.1
Other domestic borrowing (net)	-0.4	-0.3	0.4	0.3	-3.1	-2.1	-1.2
Memorandum items:							
Public debt	33.7	28.1	23.4	19.8	18.5	17.3	17.3
Domestic	9.5	8.2	6.8	5.7	4.4	2.9	2.9
External 4/	24.2	19.8	16.7	14.1	14.1	14.4	14.4

Sources: Vanuatu authorities; and IMF staff estimates and projections.

1/ Net of tax rebate for import duties paid by UNELCO.

2/ Cash grants only. MCA is not included in 2009 in the authorities' budget, as it will be directly disbursed to contractors.

3/ Annual increases in wages and salaries generally reflect trends in public sector employment. Wages and salaries were increased by an additional 20–25 percent in July 2006.

4/ A newly contracted loan of VT 3.3 billion is equally allocated to three years 2008–10.

Table 3. Vanuatu: Balance of Payments, 2004–09

(In millions of U.S. dollars, unless otherwise indicated)

	2004	2005	2006	2007	2008	2009
					Prel.Est.	Proj.
Current account balance	**-16.5**	**-27.5**	**-17.1**	**-30.0**	**-42.3**	**-33.4**
Trade balance	-68.6	-86.6	-96.7	-138.3	-197.4	-178.9
Merchandise exports (f.o.b.)	38.1	38.1	37.7	29.7	41.7	37.1
Merchandise imports (f.o.b.)	-106.7	-124.7	-134.4	-167.9	-239.1	-216.0
Services balance	56.4	65.2	74.5	109.9	126.1	112.7
Receipts	121.9	139.0	145.9	185.1	221.7	193.9
Of which: travel	74.8	85.6	92.4	118.0	160.9	139.5
Payments	-65.5	-73.8	-71.3	-75.2	-95.6	-81.2
Income	-18.7	-26.0	-20.3	-27.7	-13.0	-4.3
Receipts	27.1	27.7	31.8	36.1	32.9	28.5
Payments	-45.8	-53.7	-52.1	-63.8	-45.9	-32.8
Current transfers (net)	14.4	19.9	25.3	26.1	42.0	37.1
Of which: Official current transfers (net) 1/	20.6	19.8	22.1	24.8	38.5	34.4
Capital and financial account	**50.5**	**40.2**	**56.3**	**54.7**	**69.4**	**53.4**
Capital account	3.4	15.1	25.2	30.4	20.6	16.5
Of which: Official capital transfers (net)	7.2	10.2	6.0	6.9	9.6	8.5
Financial account	47.1	25.1	31.1	24.3	48.8	37.0
Foreign direct investment	19.1	12.6	42.9	33.4	33.5	27.3
Portfolio investment	0.9	-1.4	-0.8	1.5	7.7	1.5
Other investment	27.2	13.9	-11.0	-10.6	7.6	8.1
Net errors and omissions	-16.3	-2.4	-1.7	-10.3	-31.4	0.0
Overall balance	**17.7**	**10.3**	**37.5**	**14.4**	**-4.3**	**20.0**
Financing 2/	-17.7	-10.3	-37.5	-14.4	4.3	-20.0
Of which: Change in net official reserves of the RBV (-, increase)	-17.7	-5.8	-37.5	-14.4	4.3	-20.0
Memorandum items:						
Gross official reserves (in millions of U.S. dollars)	62.1	67.6	105.1	119.6	115.2	135.3
(In months of next year's imports of goods) 3/	5.0	5.0	6.3	5.0	5.3	6.3
Exports of goods (annual percentage change)	43.3	0.1	-1.1	-21.3	40.7	-11.2
Imports of goods (annual percentage change)	22.9	16.9	7.7	25.0	42.4	-9.7
Current account balance (in percent of GDP)	-5.0	-7.4	-4.1	-5.9	-7.4	-6.0
Exchange rate (vatu per U.S. dollar, period average)	111.9	109.2	110.5	102.4	101.3	...

Sources: Vanuatu authorities; and IMF staff estimates and projections.

1/ The pick up in 2008 reflects a jump in MCA disbursements.

2/ In 2005, includes debt forgiveness.

3/ Imports values are on c.i.f. basis.

Table 4. Vanuatu: Monetary Survey, 2002–08

	2002	2003	2004	2005	2006	2007	2008			
							Mar	Jun	Sep	Dec
	(In millions of vatu; end of period)									
Net foreign assets	24,744	24,679	27,575	29,488	32,596	37,497	37,990	40,036	38,069	40,878
Monetary Authorities 1/	4,703	4,738	6,413	7,351	10,964	11,623	11,469	11,465	11,688	12,814
Commercial banks	20,042	19,942	21,162	22,138	21,632	25,874	26,520	28,571	26,380	28,063
Net domestic assets	10,265	10,050	10,572	13,074	12,959	15,411	15,871	18,185	19,631	18,995
Domestic credit	14,921	15,709	16,943	18,423	19,748	21,834	24,066	26,373	28,688	29,843
Claims on government (net)	1,320	1,129	955	-162	-697	-1,110	-1,571	-1,915	-2,370	-3,010
Claims on municipalities	2	5	6	13	13	17	13	16	18	13
Claims on nonfinancial public enterprises	334	16	29	27	81	67	71	71	72	72
Claims on private sector	13,265	14,558	15,953	18,545	20,351	22,860	25,553	28,201	30,969	32,768
Other items (net)	-4656	-5658	-6371	-5349	-6,789	-6,422	-8,195	-8,188	-9,057	-10,848
Total broad money	35,009	34,729	38,148	42,563	45,555	52,908	53,860	58,221	57,699	59,873
Narrow money	5,666	5,872	6,557	7,425	8,969	10,781	10,514	11,826	11,874	11,447
Currency outside banks	1,916	2,108	2,490	2,691	3,156	3,570	3,283	3,674	3,672	3,756
Demand deposits (vatu)	3,750	3,764	4,067	4,734	5,813	7,211	7,231	8,151	8,202	7,691
Quasi-money	29,343	28,857	31,590	35,138	36,586	42,128	43,346	46,396	45,826	48,425
Time and savings deposits (vatu)	7,245	7,810	9,261	11,313	13,049	15,384	15,857	17,590	18,521	19,617
Demand deposits in foreign currency	5,859	6,304	6,176	6,615	6,798	7,716	7,847	7,931	7,266	8,565
Time and savings deposits in foreign currency	16,240	14,743	16,153	17,210	16,739	19,027	19,642	20,875	20,038	20,244
	(Annual percentage change)									
Net foreign assets	-6.0	-0.3	11.7	6.9	10.5	15.0	18.7	21.4	9.9	9.0
Net domestic assets	10.4	-2.1	5.2	23.7	-0.9	18.9	12.3	22.4	28.0	23.3
Domestic credit	12.0	5.3	7.9	8.7	7.2	10.6	18.2	25.1	35.0	36.7
Net claims on government	87.2	-14.5	-15.4	-117.0	329.1	59.3	92.6	122.9	166.1	171.1
Private sector credit	7.9	9.8	9.6	16.3	9.7	12.3	21.2	29.0	40.4	43.3
Total broad money	-1.7	-0.8	9.8	11.6	7.0	16.1	16.8	21.7	15.4	13.2
Narrow money	11.4	3.6	11.7	13.2	20.8	20.2	15.7	19.2	12.6	6.2
Quasi-money	-3.9	-1.7	9.5	11.2	4.1	15.1	17.0	22.4	16.2	14.9
Vatu broad money	13.0	6.0	15.6	18.5	17.5	18.8	17.7	23.9	21.5	18.7
Foreign currency deposits	-8.6	-4.8	6.1	6.7	-1.2	13.6	15.9	19.6	9.4	7.7
Memoranda items:										
Foreign currency deposits (in millions of vatu)	22,098	21,047	22,329	23,825	23,536	26,744	27,489	28,806	27,304	28,809
(In millions of U.S. dollars)	159	172	200	218	213	261	271	284	269	284
(In percent of total deposits)	66.8	64.5	62.6	59.8	55.5	54.2	54.4	52.8	50.5	51.3
Velocity										
Narrow money	5.6	5.8	5.6	5.4	5.1	6.2	6.8	6.5	7.0	7.8
Vatu broad money	2.5	2.5	2.3	2.2	2.1	2.5	2.7	2.6	2.7	2.9
Total broad money	0.9	1.0	1.0	0.9	1.0	1.3	1.3	1.3	1.4	1.5
Credit to private sector/total credit	88.9	92.7	94.2	100.7	103.1	104.7	106.2	106.9	107.9	109.8
Credit to private sector (in percent of GDP)	41.5	42.6	43.3	45.9	44.3	44.0	49.2	48.6	53.3	52.5

Sources: Vanuatu authorities; and IMF staff estimates and projections.

1/ Reserve Bank of Vanuatu and small treasury foreign exchange operations.

Table 5. Vanuatu: Medium-Term Baseline Scenario, 2004–13

					Est.	Projections				
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Output and prices (annual percentage change)										
Real GDP	5.5	6.5	7.4	6.8	6.6	3.0	3.5	4.2	4.5	4.5
Nominal GDP	7.8	9.6	13.8	13.1	11.7	7.4	6.6	7.3	7.6	7.6
Consumer prices (period average)	1.4	1.2	2.0	3.9	4.8	4.3	3.0	3.0	3.0	3.0
Balance of payments (in millions of U.S. dollars)										
Current account balance 1/	-16.5	-27.5	-17.1	-30.0	-42.3	-33.4	-31.9	-36.4	-41.7	-47.8
(In percent of GDP)	-5.0	-7.4	-4.1	-5.9	-7.4	-6.0	-5.3	-5.5	-5.9	-6.3
Trade balance	-68.6	-86.6	-96.7	-138.3	-197.4	-178.9	-178.6	-188.3	-202.8	-218.5
Merchandise Exports, f.o.b.	38.1	38.1	37.7	29.7	41.7	37.1	37.6	39.9	42.3	44.8
(Annual percentage change)	43.3	0.1	-1.1	-21.3	40.7	-11.2	1.5	6.0	6.0	6.0
Merchandise Imports, f.o.b.	-106.7	-124.7	-134.4	-167.9	-239.1	-216.0	-216.3	-228.2	-245.1	-263.4
(Annual percentage change)	22.9	16.9	7.7	25.0	42.4	-9.7	0.1	5.5	7.4	7.4
Service balance	56.4	65.2	74.5	109.9	126.1	112.7	118.4	133.9	143.3	153.2
Gross official reserves (end of period)										
In millions of U.S. dollars	62.1	67.6	105.1	119.6	115.2	135.3	159.0	181.2	199.4	213.7
In months of corresponding imports of goods 3/	5.8	5.4	7.8	7.1	4.8	6.3	7.4	8.0	8.1	8.1
In months of next year's imports of goods 3/	5.0	5.0	6.3	5.0	5.3	6.3	7.0	7.4	7.6	7.6
Central government budget (in percent of GDP)										
Revenue and grants	21.5	21.7	21.8	23.1	28.6	26.6	26.3	23.1	22.9	22.7
Revenue	19.1	19.8	19.9	21.3	21.8	19.9	20.1	20.3	20.3	20.3
Grants	2.5	1.9	1.9	1.9	6.8	6.6	6.2	2.8	2.6	2.4
Total expenditure	20.7	19.7	21.3	22.9	26.4	26.6	25.9	22.6	22.7	22.5
Current expenditure	18.6	17.9	19.0	20.2	19.6	19.6	19.3	19.4	19.7	19.7
Capital expenditure	2.0	1.8	2.2	2.7	6.7	7.0	6.6	3.2	3.0	2.8
Overall balance	0.9	2.0	0.5	0.3	2.2	0.0	0.4	0.5	0.2	0.2
Public debt	33.7	28.1	23.4	19.8	18.5	17.3	15.8	14.2	13.0	11.9
Domestic debt (in percent of GDP) 2/	9.5	8.2	6.8	5.7	4.4	2.9	1.1	1.0	1.1	1.2
External debt (in percent of GDP) 2/	24.2	19.8	16.7	14.1	14.1	14.4	14.7	13.2	11.9	10.7
External debt-service ratio 3/	1.6	3.1	1.4	1.3	1.3	2.4	1.7	1.6	1.5	1.4
GDP in current prices (in billions of vatu)	36.9	40.4	45.9	52.0	58.1	62.4	66.5	71.4	76.8	82.7

Sources: Vanuatu authorities; and IMF staff estimates and projections.

1/ Including official transfers.
2/ Medium- and long-term public debt only.
3/ Imports values are on c.i.f. basis.

Table 6. Vanuatu: Social Indicators 1/

		Same Region/Income Group	
	Vanuatu	East Asia and Pacific	Lower-Middle Income
Population			
Total population (millions)	0.2	1,899	2,277
Growth rate (percent annual)	2.5	0.9	0.9
Urban population (percent of population)	23.9	42.4	47.3
Total fertility rate (births per woman)	3.8	2.0	2.1
GNI per capita (in U.S. dollars)	1,690	1,856	2,038
Current public expenditure			
Health (in percent of GDP)	2.8	1.8	2.2
Education (in percent of GDP)	9.5	3.5	4.8
Net primary enrollment			
(In percent of age group)	88	93	93
Male	88	93	93
Female	87	93	92
Immunization rate (percent 12–23 months)			
Measles	99	89	90
Diptheria/Pertussis/Tetanus (DPT)	85	89	89
Life expectancy at birth (years)			
Total	70	71	71
Male	68	69	69
Female	72	73	73
Mortality			
Infant (per thousand live births)	30	24	27
Under 5 (per thousand live births)	36	29	36

Sources: World Bank, *World Development Indicators* (2008); and Millennium Development Goals.

1/ Figures represent latest single year of data over the years 2000–06.

Table 7. Vanuatu: Vulnerability Indicators, 2004–09
(In percent of GDP, unless otherwise indicated)

	2004	2005	2006	2007	2008	2009 Proj.
Financial sector indicators						
Public debt	33.7	28.1	23.4	19.8	18.5	17.3
Broad money (percent change, 12-month basis) 1/	9.8	11.6	7.0	16.1	13.2	...
Private sector credit (percent change, 12-month basis) 1/	9.6	16.3	9.7	12.3	43.3	...
Nonperforming loans (as share of total loans)	13.3	19.5	16.4	12.5	10.6	...
Share of deposits in broad money (percent)	93.5	93.7	93.1	93.7	93.3	...
Share of foreign currency deposits in total deposits (percent)	62.6	59.8	55.5	54.9	54.0	...
External indicators						
Exports of goods (annual percentage change, in U.S. dollars)	43.3	0.1	-1.1	-21.3	40.7	-11.2
Imports of goods (annual percentage change, in U.S. dollars)	22.9	16.9	7.7	25.0	42.4	-9.7
Current account balance (excl. official transfers)	-11.3	-12.8	-9.4	-10.8	-14.1	-12.2
Capital and financial account balance	15.3	10.9	13.5	10.8	12.1	9.6
Of which: Inward foreign direct investment	5.8	3.4	10.3	6.6	5.8	4.9
Gross official reserves (in millions of U.S. dollars)	62.1	67.6	105.1	119.6	115.2	135.3
(In months of corresponding imports of goods) 2/	5.8	5.4	7.8	7.1	4.8	6.3
(In months of prospective imports of goods and services)	5.0	5.0	6.3	5.0	5.3	6.3
(In percent of broad money)	17.3	17.8	24.6	22.6	21.7	…
Foreign liabilities of Reserve Bank of Vanuatu (in millions of U.S. dollars)	1.9	2.2	2.3	2.7	1.9	…
Foreign currency exposure of Reserve Bank of Vanuatu 3/	3.4	3.5	3.4	3.0	2.3	…
Foreign assets of commercial banks (in millions of U.S. dollars)	263.4	260.7	276.1	321.8	272.1	…
Foreign liabilities of commercial banks (in millions of U.S. dollars)	64.8	63.6	68.0	85.0	80.7	…
Foreign currency exposure of commercial banks 3/	24.6	24.4	24.6	26.4	29.7	…
Total external debt (in percent of GDP) 4/	24.2	19.8	16.7	14.1	14.1	14.4
(In percent of exports of goods and nonfactor services)	52.4	40.3	39.2	34.1	27.6	34.5
External debt-service (in percent of exports of goods and nonfactor services)	1.6	3.1	1.4	1.3	1.3	2.4
Exchange rate (vatu per U.S. dollar, end of period)	106.5	112.3	106.5	99.9	112.6	…

Sources: Vanuatu authorities; and IMF staff estimates and projections.

1/ Change in percent of end-of-period broad money.
2/ Imports values are on c.i.f. basis.
3/ Foreign currency exposure is defined to be foreign currency liabilities as a percentage of foreign currency assets.
4/ Medium- and long-term public debt only.

APPENDIX I. VANUATU: PUBLIC AND EXTERNAL DEBT SUSTAINABILITY[1,2]

This appendix summarizes the debt sustainability analysis (DSA) for Vanuatu using the framework for low-income countries. Vanuatu's public debt has been declining on average, reflecting strong growth performance, successful fiscal consolidation, and large aid inflows which eschewed the need for borrowing. As a result, most debt burden indicators under the baseline scenario are below their indicative thresholds. This analysis suggests that Vanuatu's public debt dynamics are sustainable and the country faces a low level of debt distress.

I. INTRODUCTION AND BASELINE

Reflecting strong growth and fiscal surpluses over the last few years, Vanuatu's total public sector debt stock is estimated to have declined to 18½ percent of GDP in 2008 from 28 percent of GDP in 2005. The ratio of external debt to GDP fell from over 30 percent in 2000 to 13¾ percent in 2007, inching up a little to 15¾ percent in 2008, due to a new bilateral loan. This DSA presents the projected path of Vanuatu's external and public sector debt burden indicators, and draws some conclusions on the forward-looking sustainability of debt.

Vanuatu's DSA builds on the baseline scenario assumptions presented in Box I.1. It assumes real GDP growth rate of about 4½ percent on average over the medium term, inflation of about 3 percent, and modest fiscal surplus. The baseline assumes no additional external borrowing other than the new bilateral loan contracted in 2008.[3] The authorities are strongly committed to fiscal consolidation and do not anticipate the need to borrow given donor flows.

II. EXTERNAL DEBT SUSTAINABILITY

External debt stood at 15¾ percent of GDP in FY2008, down from over 20 percent in FY2005 (Table I.1a, Figure I.1). The government took on a new loan in 2008 to expedite improvements in IT-related infrastructure. Under the baseline scenario, the NPV of external debt is projected at 10½ percent of GDP in 2008 (below the indicative threshold based on the CPIA rating which assumes Vanuatu to be a weak reformer).[4] This ratio is expected to fall to

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[1] In light of the low debt-to-GDP ratios, this DSA was prepared by Fund staff only.

[2] Data on state enterprise and provincial government debt are not available. Therefore, the public debt sustainability analysis is limited to central government debt data.

[3] It is a bilateral loan of about US$27 million at 2 percent interest, with a 5-year grace period and 20-year maturity.

[4] The average World Bank's Country Policy and Institutional Assessment for the period 2005–07 classifies Vanuatu as a poor performer. The corresponding debt distress thresholds are NPV of debt-to-exports (100 percent), GDP (30 percent), and revenues (200 percent), and debt service in percent of exports (15 percent) and revenues (25 percent).

9¼ percent by FY2013 and further in the medium term. The NPV of debt-to-exports and revenue ratios increase somewhat in 2009–10, but declining thereafter. All the ratios (including PPG debt service in percent of exports and revenue) remain well below their respective indicative thresholds as shown.

The alternative scenarios and bound tests indicate that external debt sustainability is sensitive to an exchange rate shock (Table I.1b, Figure I.1). If growth is assumed to be at its historical average, the NPV of debt-to-GDP ratio falls, reflecting the strong performance of the last five years. Among the various stress tests, bound test 6 (30 percent nominal depreciation of the exchange rate) results in the largest increase in the NPV of debt-to-GDP ratio, which jumps to 18 percent in 2009–10, then declines gradually. None of the stress tests cause any breaches in the thresholds.

III. Public Debt Sustainability

Vanuatu's public debt has declined from over 40 percent of GDP in 2002 to 18½ percent of GDP in 2008, reflecting the authorities' commitment to fiscal consolidation (Table I.2a). The NPV of debt-to-GDP is expected to decline from 14½ percent at end-2008, to 10¾ percent in 2013, and further to around 1 percent by end-2028.

Public debt is sensitive to exchange rate changes, given the dominance of external debt in total public debt. Compared to 2008, a one-time 30 percent real depreciation of the exchange rate would raise the NPV of public debt-to-GDP by 6 percent age points in 2009, mirroring the impact on external debt, and fall gradually thereafter. A sizable growth shock in 2009–10 (economy is assumed to contract by 11½ percent in two years compared to the baseline) will likely have a lasting effect over the medium term. The baseline scenario is more favorable than the historical one, reflecting the success of government's fiscal consolidation efforts and commitment to continue this in the future. The other factors have a modest impact on the NPV of debt-to-GDP.

IV. Staff Assessment

Assuming Vanuatu continues to make steady progress in reducing its public debt burden, as it has done in the past few years, public debt sustainability should be manageable. While several indicators show that the economy's debt is low, debt remains somewhat vulnerable to a major shock in the exchange rate. Also, changes in GDP growth in particular affect the debt dynamics. Given that both growth and balance of payments are driven by tourism, the external environment, especially the current global environment does pose a challenge. Therefore, the authorities must remain committed to bringing down the external debt further to reduce vulnerabilities. Going forward, improved coordination with donors to align their plans with authorities' development objectives can help to mobilize/use aid inflows more effectively.

Box I.1. Assumptions for the Medium-Term Baseline Scenario

Real GDP growth is projected to average 4½ percent over the medium term as further structural reforms, including improvements in infrastructure, boost productivity. After moderating in 2009–10, tourism is expected to grow at a somewhat more moderate pace than in the last few years.

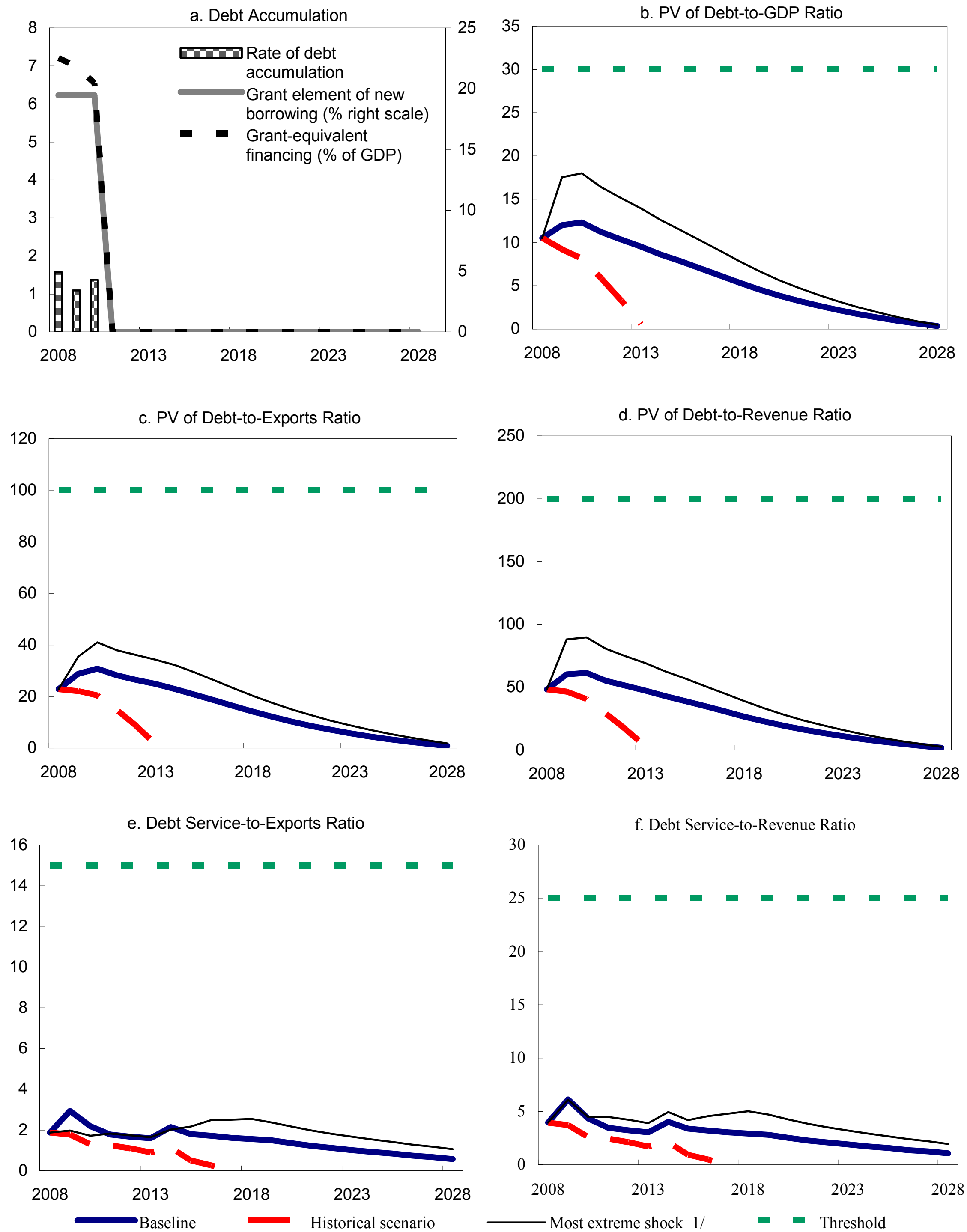
Inflation is projected at around 3 percent over the projection period. With a transaction-based exchange regime providing an effective inflation anchor, inflation has been on average 2½ percent in the recent five years.

The overall fiscal balance is projected to register an average surplus of ¼ percent of GDP over the medium term given the recent strong fiscal performances supported by authorities' commitment to a sound fiscal policy. This envisages a modest fiscal expansion (in the current expenditure) in the near term, but assumes that the authorities limit expenditures as a share of GDP after 2012.

The current account deficit is expected to decline in 2009−10 as import prices are expected to fall (around 5 percent of GDP) while economic activity will slow with some lags from the global economy, but is expected to widen to about 6½ percent by 2014, due mainly to a substantial pick up in tourism-related imports financed by FDI inflows. The real effective exchange rate is assumed constant.

Aid inflows are assumed to remain stable. FDI related to tourism and real estate is expected to increase significantly. With these developments, reserve cover is projected to remain around six months of projected imports by 2014.

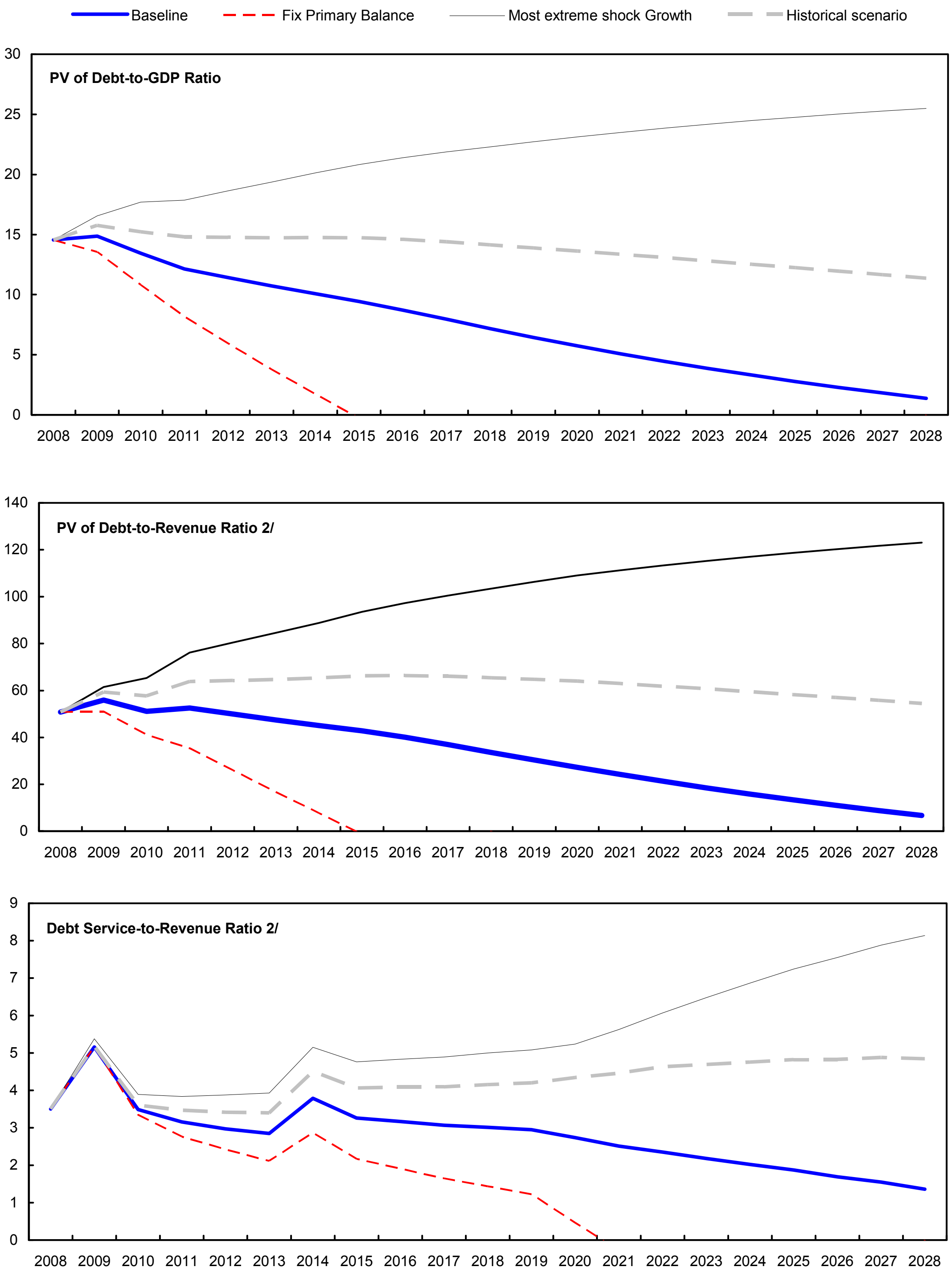
Figure I.1. Vanuatu: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2008–28 1/



Source: IMF staff projections and simulations.

1/ The most extreme stress test is the test that yields the highest ratio in 2018. In figure b. it corresponds to a nondebt flows shock; in c. to a nondebt flows shock; in d. to a nondebt flows shock; in e. to a nondebt flows shock and in picture figure f. to a nondebt flows shock.

Figure I.2. Vanuatu: Indicators for Public Debt under Alternative Scenarios, 2008–28 1/



Sources: Country authorities; and IMF staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2018.

2/ Revenues are defined inclusive of grants.

Table I.1a. Vanuatu: External Debt Sustainability Framework, Baseline Scenario, 2005–28 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 2/	Standard Deviation 2/	Est.	Projections								
	2005	2006	2007			2008	2009	2010	2011	2012	2013	2008–2013 Average	2018	2028	2014–2028 Average
External debt (nominal) 1/	**20.4**	**16.1**	**13.7**			**15.7**	**14.4**	**14.4**	**13.2**	**11.9**	**10.6**		**5.3**	**0.5**	
Of which : public and publicly guranteed (PPG)	20.4	16.1	13.7			15.7	14.4	14.4	13.2	11.9	10.6		5.3	0.5	
Change in external debt	-2.7	-4.3	-2.4			1.9	-1.3	0.0	-1.2	-1.4	-1.2		-0.9	-0.2	
Identified net debt-creating flows	-1.0	-5.9	-3.6			0.7	0.7	0.7	0.4	0.8	1.2		3.4	6.2	
Non-interest current account deficit	**6.8**	**3.6**	**5.5**	**3.3**	**3.5**	**6.9**	**5.3**	**4.9**	**5.3**	**5.6**	**6.0**		**6.9**	**7.8**	7.2
Deficit in balance of goods and services	5.8	5.3	5.6			12.4	12.0	10.0	8.3	8.4	8.6		8.6	8.6	
Exports	47.9	44.1	42.3			46.0	41.7	39.9	39.7	39.0	38.4		37.8	37.8	
Imports	53.7	49.5	47.9			58.4	53.6	49.9	47.9	47.4	47.0		46.4	46.4	
Net current transfers (negative = inflow)	-5.4	-6.1	-5.1	-4.4	2.3	-7.3	-6.7	-5.4	-3.5	-3.2	-3.0		-2.1	-1.0	-1.7
Of which : official	0.0	-0.8	-0.2			-0.6	-0.5	-0.5	-0.4	-0.4	-0.4		0.0	0.0	
Other current account flows (negative = net inflow)	6.4	4.4	5.0			1.8	0.0	0.3	0.4	0.5	0.5		0.3	0.2	
Net FDI (negative = inflow)	**-5.9**	**-7.8**	**-6.6**	**-6.7**	**1.1**	**-5.8**	**-4.9**	**-4.2**	**-4.6**	**-4.5**	**-4.5**		**-3.4**	**-1.6**	-2.8
Endogenous debt dynamics 3/	**-1.9**	**-1.7**	**-2.5**			**-0.4**	**0.3**	**0.0**	**-0.3**	**-0.3**	**-0.3**		**-0.1**	**0.0**	
Contribution from nominal interest rate	0.6	0.5	0.4			0.4	0.8	0.4	0.3	0.2	0.2		0.2	0.0	
Contribution from real GDP growth	-1.3	-1.3	-0.9			-0.8	-0.5	-0.5	-0.6	-0.6	-0.5		-0.3	0.0	
Contribution from price and exchange rate changes	-1.2	-0.9	-2.0			…	…	…	…	…	…		…	…	
Residual (3–4) 4/	**-1.7**	**1.6**	**1.2**			**1.2**	**-2.0**	**-0.7**	**-1.6**	**-2.1**	**-2.5**		**-4.3**	**-6.4**	
Of which : exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 5/	...	...	10.3			10.5	12.0	12.3	11.2	10.3	9.5		5.3	0.3	
In percent of exports	...	...	24.3			22.8	28.8	30.8	28.2	26.4	24.8		14.1	0.9	
PV of PPG external debt	**...**	**...**	**10.3**			**10.5**	**12.0**	**12.3**	**11.2**	**10.3**	**9.5**		**5.3**	**0.3**	
In percent of exports	**...**	**...**	**24.3**			**22.8**	**28.8**	**30.8**	**28.2**	**26.4**	**24.8**		**14.1**	**0.9**	
In percent of government revenues	**...**	**...**	**48.4**			**48.2**	**60.2**	**61.2**	**55.0**	**51.0**	**47.2**		**26.5**	**1.6**	
Debt service-to-exports ratio (in percent)	**4.0**	**2.1**	**1.9**			**1.9**	**2.9**	**2.2**	**1.8**	**1.7**	**1.6**		**1.6**	**0.6**	
PPG debt service-to-exports ratio (in percent)	**4.0**	**2.1**	**1.9**			**1.9**	**2.9**	**2.2**	**1.8**	**1.7**	**1.6**		**1.6**	**0.6**	
PPG debt service-to-revenue ratio (in percent)	**9.5**	**4.7**	**3.8**			**3.9**	**6.1**	**4.4**	**3.5**	**3.2**	**3.1**		**2.9**	**1.1**	
Total gross financing need (Billions of U.S. dollars)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.1	
Non-interest current account deficit that stabilizes debt ratio	9.5	7.9	7.8			5.0	6.6	4.9	6.4	7.0	7.3		7.8	8.1	
Key macroeconomic assumptions															
Real GDP growth (in percent)	6.5	7.4	6.8	2.3	5.0	6.6	3.0	3.5	4.2	4.5	4.5	4.4	4.5	4.5	4.5
GDP deflator in US dollar terms (change in percent)	5.4	4.7	14.2	5.0	7.8	6.0	-6.2	5.0	5.0	3.0	3.0	2.6	3.0	3.0	3.0
Effective interest rate (percent) 6/	2.8	3.0	3.2	3.0	0.2	3.7	5.1	3.2	2.0	1.9	2.0	3.0	2.7	4.7	3.3
Growth of exports of G&S (US dollar terms, in percent)	10.7	3.6	17.0	5.5	13.1	22.7	-12.3	4.0	8.8	5.9	5.9	5.8	7.6	7.6	7.5
Growth of imports of G&S (US dollar terms, in percent)	15.3	3.6	18.2	6.9	12.0	37.7	-11.2	1.1	5.1	6.5	6.6	7.6	7.6	7.6	7.5
Grant element of new public sector borrowing (in percent) 7/	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Government revenues (excluding grants, in percent of GDP) 8/	19.9	19.9	21.3			21.8	19.9	20.1	20.3	20.3	20.2		20.1	20.1	20.1
Memorandum items:															
Nominal GDP (Billions of U.S. dollars)	0.4	0.4	0.5			0.6	0.6	0.6	0.7	0.7	0.8		1.1	2.3	

Source: IMF staff simulations.

1/ Due to data constraints, it includes only public external debt.
2/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
3/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.
4/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
5/ Assumes that PV of private sector debt is equivalent to its face value.
6/ Current-year interest payments divided by previous period debt stock.
7/ Defined as grants, concessional loans, and debt relief.
8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table I.1b. Vanuatu: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2008–28

(In percent)

	Projections											
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2028
PV of Debt-to-GDP Ratio												
Baseline	10	12	12	11	10	10	9	8	7	6	5	0
A. Alternative Scenarios												
A1. Key variables at their historical averages in 2008–28 1/	10	9	8	6	3	1	...	...	...	...	...	...
A2. New public sector loans on less favorable terms in 2008–28 2/	10	12	13	11	11	10	9	8	7	7	6	1
B. Bound Tests												
B1. Real GDP growth at historical average minus one standard deviation in 2009–10	10	13	14	13	12	11	10	9	8	7	6	0
B2. Export value growth at historical average minus one standard deviation in 2009–10 3/	10	10	13	11	11	10	9	8	7	6	6	0
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2009–10	10	12	13	12	11	10	9	8	7	6	6	0
B4. Net nondebt creating flows at historical average minus one standard deviation in 2009–10 4/	10	15	16	15	14	13	12	11	10	9	8	1
B5. Combination of B1-B4 using one-half standard deviation shocks	10	9	8	7	7	6	5	5	4	4	3	0
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	10	18	18	16	15	14	13	11	10	9	8	0
PV of Debt-to-Exports Ratio												
Baseline	23	29	31	28	26	25	23	21	19	16	14	1
A. Alternative Scenarios												
A1. Key variables at their historical averages in 2008–28 1/	23	22	20	15	8	1	...	...	...	...	...	...
A2. New public sector loans on less favorable terms in 2008–28 2/	23	29	32	29	27	26	24	22	20	18	16	3
B. Bound Tests												
B1. Real GDP growth at historical average minus one standard deviation in 2009–10	23	29	31	28	26	25	23	21	18	16	14	1
B2. Export value growth at historical average minus one standard deviation in 2009–10 3/	23	23	34	31	29	27	25	23	21	18	16	1
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2009–10	23	29	31	28	26	25	23	21	18	16	14	1
B4. Net nondebt creating flows at historical average minus one standard deviation in 2009–10 4/	23	35	41	38	36	34	32	29	26	23	20	2
B5. Combination of B1-B4 using one-half standard deviation shocks	23	20	19	17	15	14	12	11	10	8	7	0
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	23	29	31	28	26	25	23	21	18	16	14	1
PV of Debt-to-Revenue Ratio												
Baseline	48	60	61	55	51	47	43	39	35	31	27	2
A. Alternative Scenarios												
A1. Key variables at their historical averages in 2008–28 1/	48	46	40	29	16	3	...	...	...	...	...	...
A2. New public sector loans on less favorable terms in 2008–28 2/	48	61	63	57	53	49	44	41	37	33	30	5
B. Bound Tests												
B1. Real GDP growth at historical average minus one standard deviation in 2009–10	48	63	69	62	57	53	48	44	39	34	30	2
B2. Export value growth at historical average minus one standard deviation in 2009–10 3/	48	52	62	56	52	48	44	40	36	32	28	2
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2009–10	48	58	64	57	53	49	44	40	36	32	28	2
B4. Net nondebt creating flows at historical average minus one standard deviation in 2009–10 4/	48	74	81	74	70	65	60	55	49	44	38	3
B5. Combination of B1-B4 using one-half standard deviation shocks	48	45	41	36	32	29	25	22	20	17	15	0
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	48	88	90	81	75	69	63	57	51	45	39	2

Source: IMF staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and nondebt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table I.2a. Vanuatu: Public Sector Debt Sustainability Framework, Baseline Scenario, 2005–28
(In percent of GDP, unless otherwise indicated)

	Actual			Average 2/	Standard Deviation 2/	Est.	Projections								
	2005	2006	2007			2008	2009	2010	2011	2012	2013	2008–13 Average	2018	2028	2014–28 Average
Public sector debt 1/	28.1	23.4	19.8			18.5	17.3	15.8	14.2	13.0	11.8		7.1	1.5	
Of which : foreign-currency denominated	20.4	16.1	13.7			15.7	14.4	14.4	13.2	11.9	10.6		5.3	0.5	
Change in public sector debt	-5.6	-4.6	-3.6			-1.3	-1.3	-1.5	-1.6	-1.2	-1.2		-0.8	-0.4	
Identified debt-creating flows	-3.7	-4.9	-3.9			-2.7	-1.3	-2.0	-1.6	-1.2	-1.2		-0.8	-0.4	
Primary deficit	-2.8	-1.2	-0.9	1.2	3.3	-2.9	-0.9	-0.9	-0.8	-0.5	-0.5	-1.1	-0.5	-0.4	-0.4
Revenue and grants	21.7	21.8	23.1			28.6	26.6	26.3	23.1	22.9	22.6		21.4	20.7	
Of which: grants	1.7	1.9	1.9			6.8	6.6	6.2	2.8	2.6	2.4		1.3	0.5	
Primary (noninterest) expenditure	18.8	20.5	22.2			25.8	25.7	25.5	22.3	22.4	22.1		20.9	20.3	
Automatic debt dynamics	-0.9	-3.6	-3.0			0.1	-0.4	-1.1	-0.8	-0.7	-0.7		-0.4	0.0	
Contribution from interest rate/growth differential	-2.1	-2.2	-1.6			-1.0	0.1	-0.3	-0.5	-0.5	-0.4		-0.2	0.0	
Of which : contribution from average real interest rate	-0.1	-0.2	-0.1			0.3	0.6	0.3	0.2	0.1	0.1		0.1	0.1	
Of which : contribution from real GDP growth	-2.1	-1.9	-1.5			-1.2	-0.5	-0.6	-0.6	-0.6	-0.6		-0.3	-0.1	
Contribution from real exchange rate depreciation	1.3	-1.5	-1.4			1.1	-0.5	-0.8	-0.3	-0.3	-0.2		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g., bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-1.9	0.3	0.3			1.4	0.1	0.5	0.0	0.0	0.0		0.0	0.0	
Other Sustainability Indicators															
PV of public sector debt	...	...	16.1			14.5	14.9	13.5	12.1	11.4	10.7		7.2	1.4	
Of which : foreign-currency denominated	...	...	10.0			11.7	12.0	12.1	11.2	10.3	9.5		5.3	0.3	
Of which : external	...	...	10.0			11.7	12.0	12.1	11.2	10.3	9.5		5.3	0.3	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 3/	...	...	6.1			3.3	4.6	2.8	1.0	1.1	1.2		1.8	1.0	
PV of public sector debt-to-revenue and grants ratio (in percent)	…	…	69.6			50.8	55.9	51.1	52.5	50.0	47.4		33.6	6.7	
PV of public sector debt-to-revenue ratio (in percent)	…	…	75.8			66.8	74.6	67.0	59.8	56.4	53.1		35.7	6.8	
Of which : external 4/	…	…	47.2			53.6	60.2	60.1	55.0	51.0	47.2		26.5	1.6	
Debt service-to-revenue and grants ratio (in percent) 5/	…	5.3	4.3			3.5	5.2	3.5	3.2	3.0	2.9		3.0	1.4	
Debt service-to-revenue ratio (in percent) 5/	…	5.8	4.7			4.6	6.9	4.6	3.6	3.4	3.2		3.2	1.4	
Primary deficit that stabilizes the debt-to-GDP ratio	2.7	3.4	2.7			-1.6	0.4	0.6	0.8	0.7	0.7		0.4	0.0	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	6.5	7.4	6.8	2.3	5.0	6.6	3.0	3.5	4.2	4.5	4.5	4.4	4.5	4.5	4.5
Average nominal interest rate on forex debt (in percent)	2.8	3.0	3.2	3.0	0.2	3.7	5.1	3.2	2.0	1.9	2.0	3.0	2.7	4.7	3.3
Average real interest rate on domestic debt (in percent)	0.1	-2.8	-2.7	-1.3	1.3	-1.9	-0.7	-1.7	-1.1	-0.5	-0.5	-1.1	0.2	2.9	1.0
Real exchange rate depreciation (in percent, + indicates depreciation)	5.8	-7.7	-9.2	-3.5	9.4	8.5	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	2.9	5.9	5.9	3.5	1.7	4.8	4.3	3.0	3.0	3.0	3.0	3.5	3.0	3.0	3.0
Growth of real primary spending (deflated by GDP deflator, in percent)	0.0	0.2	0.2	0.0	0.1	0.2	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Grant element of new external borrowing (in percent)	...	...	...	…	…	19.5	19.5	19.5	...	...	...	...	...	...	...

Sources: Country authorities; and IMF staff estimates and projections.

1/ Includes central government debt.
2/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
3/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
4/ Revenues excluding grants.
5/ Debt service is defined as the sum of interst and amortization of medium and long-term debt.

Table I.2b. Vanuatu: Sensitivity Analysis for Key Indicators of Public Debt, 2008–28

	Projections							
	2008	2009	2010	2011	2012	2013	2018	2028
PV of Debt-to-GDP Ratio								
Baseline	15	15	13	12	11	11	7	1
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	15	16	15	15	15	15	14	11
A2. Primary balance is unchanged from 2008	15	14	11	8	6	4	...	...
A3. Permanently lower GDP growth 1/	15	15	14	13	13	14	16	31
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	15	17	18	18	19	19	22	26
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	15	18	19	17	17	16	11	4
B3. Combination of B1-B2 using one half standard deviation shocks	15	17	18	17	17	17	17	15
B4. One-time 30 percent real depreciation in 2009	15	21	19	17	16	15	11	3
B5. 10 percent of GDP increase in other debt-creating flows in 2009	15	22	20	18	18	17	12	4
PV of Debt-to-Revenue Ratio 2/								
Baseline	51	56	51	53	50	47	34	7
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	51	59	58	64	64	65	65	54
A2. Primary balance is unchanged from 2008	51	51	41	35	26	17	...	...
A3. Permanently lower GDP growth 1/	51	57	54	58	59	60	75	150
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	51	61	65	76	80	85	103	123
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	51	67	72	76	73	69	53	18
B3. Combination of B1-B2 using one half standard deviation shocks	51	64	67	75	76	77	79	74
B4. One-time 30 percent real depreciation in 2009	51	77	71	74	71	68	51	16
B5. 10 percent of GDP increase in other debt-creating flows in 2009	51	82	76	80	77	73	57	20
Debt Service-to-Revenue Ratio 2/								
Baseline	4	5	3	3	3	3	3	1
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	4	5	4	3	3	3	4	5
A2. Primary balance is unchanged from 2008	4	5	3	3	2	2	1	...
A3. Permanently lower GDP growth 1/	4	5	4	3	3	3	4	7
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	4	5	4	4	4	4	5	8
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	4	5	4	4	4	3	3	3
B3. Combination of B1-B2 using one half standard deviation shocks	4	5	4	4	4	4	4	6
B4. One-time 30 percent real depreciation in 2009	4	6	5	5	4	4	4	3
B5. 10 percent of GDP increase in other debt-creating flows in 2009	4	5	4	4	4	4	4	3

Sources: Country authorities; and IMF staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.

INTERNATIONAL MONETARY FUND

VANUATU

Staff Report for the 2009 Article IV Consultation—Informational Annex

Prepared by the Asia and Pacific Department

April 16, 2009

Contents Page

ANNEX I. VANUATU—FUND RELATIONS
(As of February 28, 2009)

I. Membership Status: Joined 9/28/81; Article VIII

II. General Resources Account:	**SDR Million**	**% Quota**
Quota	17.00	100.00
Fund holdings of currency	14.51	85.33
Reserve position in Fund	2.50	14.68

III. SDR Department:	**SDR Million**	**% Allocation**
Holdings	1.30	N/A

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements: None

VI. Projected Obligations to Fund: None

VII. Exchange Arrangements:

Since 1988, Vanuatu has officially maintained an adjustable peg exchange rate arrangement. Currently, the exchange rate of the vatu is linked to a transactions-weighted (trade and tourism receipts) basket of currencies. The weights and composition of the basket, which are not publicly disclosed, are adjusted periodically. The Reserve Bank of Vanuatu (RBV) quotes daily buying and selling rates for the vatu against the U.S., Australian, and New Zealand dollars; the euro; the U.K. pound; and the Japanese yen. The rate in terms of the U.S. dollar as of February 27, 2009 was VT 119.10 per U.S. dollar. The de facto classification is “other managed,” as the composite weights and not disclosed and cannot be confirmed.

Vanuatu has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system that is free of restrictions on payments and transfers for current international transactions.

VIII. Article IV Consultation:

The last Article IV consultation discussions with the authorities were held in Port Vila during November 2006. The Executive Board discussed the staff report and concluded the consultation on February 26, 2007.

IX. OFC Assessments:

The most recent Offshore Financial Center Module II Assessment , conducted by MFD was concluded in May 2006.

X. Technical Assistance from Headquarters (2000–present):

LEG, MCM, PFTAC, and STA have provided technical assistance on anti-money laundering, banking supervision, reserve management, and balance of payments.

XI. Resident Representative: None

ANNEX II. VANUATU—RELATIONS WITH THE PACIFIC FINANCIAL TECHNICAL ASSISTANCE CENTER (PFTAC)[1]

Since 1998, the Center's assistance to Vanuatu has included 31 advisory missions, with a primary focus in banking supervision and statistics. In addition, Vanuatu has sent 36 officials to the Center's regional seminars, workshops, and training courses.

Financial Sector Supervision

PFTAC has provided assistance to the Reserve Bank of Vanuatu (RBV) to assist with the continued strengthening of its supervision of domestic and offshore banks and the provident fund. A the request of the authorities, the PFTAC Financial Sector Supervision Advisor will visit the RBV between April 20 and May 1, 2009 to review the adequacy of banking regulations in relation to current best practices and assess the adequacy of prudential reporting requirements for conducting off-site monitoring and analysis activities. In addition, the advisor responds to ad-hoc requests for assistance. PFTAC also organized peripatetic advisors to assist the Vanuatu Financial Services Commission with the development of a supervisory framework for domestic and offshore insurance companies. PFTAC has also assisted the RBV arrange technical assistance to strengthen the functions of the central bank.

Public Financial Management

AusAid has funded an extensive technical assistance program in budget management. PFTAC has complemented that assistance through advice on prioritization and sequencing of needed reforms, and, in 2003, by training of staff on moving budget reporting to a GFS basis (see below). PFTAC has also been providing advice and assistance through a peripatetic advisor on macroeconomic forecasting and analysis. It has also provided training for line ministry officials on Public Financial Management and costing of projects.

Tax Administration and Policy

There is a potential loss of revenue arising from regional trade agreements and arrangements (PICTA and PACER). In response, PFTAC is assisting the authorities to analyze and consider the possible introduction of an income tax.

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[1] The Pacific Financial Technical Assistance Centre (PFTAC) in Suva, Fiji is a multi-donor technical assistance institution, financed by the IMF, AsDB, AusAID, NZODA, and, until 2001, by the UNDP, with the IMF as Executing Agency. The Centre's aim is to build skills and institutional capacity for effective economic and financial management that can be sustained at the national level. Member countries are: Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tokelau, Tonga, Tuvalu, and Vanuatu.

Economic Statistics

Following a PFTAC review, technical assistance provided by STA in the context of the GDDS/PFTAC project for Pacific Island countries resulted in Vanuatu producing quarterly balance of payments and international investment position statistics consistent with the *BPM5*. The Centre trained staff and developed plans for presenting government finance statistics on the basis of the 2001GFS Manual and for integration of GFS classifications with the budget and accounting systems. Data based on the new standards is nearing completion. PFTAC also undertook a mid-term review of the statistics element of an AusAID/ADB funded institutional strengthening project. PFTAC has provided peer review of national accounts compilation in June 2005 and June 2006. A PFTAC mission was undertaken in December 2008 to review source data to produce GDP by expenditure approach. The mission developed a suitable methodology to produce current and constant 2006 price estimates.

ANNEX III. VANUATU: RELATIONS WITH THE WORLD BANK GROUP

(As of March 2009)

Vanuatu joined the World Bank Group in 1981. In that period, five IDA credits, totaling $18.9 million have been committed, the most recent in 2001. World Bank investments in Vanuatu have covered agricultural extension and training (1983), transportation and education infrastructure (1986), primary and secondary education (1988), affordable housing (1991), and an investment to support education in vernacular languages (2001), which never became effective. All of these are now closed. The Bank has also been the executing agency for a Global Environment Facility adaptation project, and the Bank Group (including both IDA and IFC advisory services) has provided grants for technical assistance to support the Government of Vanuatu's reform efforts.

The Bank Group anticipates significantly scaling up support for Vanuatu over the next few years. Vanuatu is eligible for approximately $11 million in IDA credits under the IDA-15 replenishment period (FY09 to FY11), and this financing has considerable potential to underpin enhanced levels of policy engagement. IFC has also had extensive engagement in providing advisory services to Vanuatu, and engagement may scale up considerably if the government continues with airline privatization (discussed below). World Bank Group assistance to Vanuatu supports the government's own development priorities, and is guided by the Bank's *Pacific Regional Strategy FY06–FY09*, which is shortly to be updated.

The Bank Group's current and planned engagement with Vanuatu is focused on encouraging the access of Vanuatu citizens to regional labor markets, promoting private sector-led growth, and strengthening Vanuatu's disaster preparedness and climate change adaptation efforts.

Enhancing Access to Regional Labor Markets

The Bank's report *At Home and Away,* published in 2006, outlined global evidence that seasonal labor schemes allowing Pacific island citizens temporary access to major economies had scope to both improve the overall welfare of participating Pacific island countries, as well as benefit receiving economies by providing workers for industries experiencing labor shortages.

The New Zealand and Australian governments have announced new Pacific seasonal labor schemes. Vanuatu was selected to participate as one of the countries to be included in the initial round of these schemes—the only country in Melanesia to be included to date. The Bank was requested by the Vanuatu as well as the Australian and New Zealand governments to play a facilitating role in the design and evaluation of this scheme that will involve ni-Vanuatu working in selected horticultural farms in Australia and New Zealand. In combination, the Bank is helping to strengthen the capacity of institutions to regulate, manage, and facilitate these schemes. The Bank Group has also been engaged in efforts to reduce very high transaction costs associated with the transfer of remittances to the Pacific islands, in order to maximize the benefits to the islands from such schemes.

Promoting Private Sector Growth

Investment Climate. IFC's advisory services have assisted the Vanuatu Investment Promotion Authority in developing and implementing an overall strategy to improve the business enabling environment and encourage investment. The Bank and IFC have jointly financed a long-term program of technical assistance, which includes international and local personnel based in Port Vila for an extended period, and the FIRST trust fund is supporting efforts to strengthen regulation and supervision of company and trust service providers.

Utilities. The Bank Group is supporting government efforts to reduce high utility costs through a series of reports and technical assistance. Following a performance and regulatory review of the utilities sector during FY04, the Bank has assisted in the government's National Energy Policy Framework and National Rural Electrification Master Plan. A key focus over the next few years will be Bank support for government's initiatives to reform the telecommunications sector and improve the coverage and quality of services. The entry of new private mobile telephone operators in Vanuatu holds significant potential. The Bank anticipates scaling up efforts throughout the Pacific region, including Vanuatu, to strengthen regulatory capacity to both encourage private sector investment and ensure maximum benefits for countries from the rapid expansion of telecoms services.

Airline Privatization. At the request of the Government, IFC advisory services have completed a study on the potential privatization of Air Vanuatu. With lower fuel prices now reducing pressures on the airline industry, the Government has asked IFC to reactivate support.

Disaster Preparedness and Climate Change Adaptation

The Bank has been the implementing agency for a GEF financed Vanuatu National Adaptation project. Vanuatu has been included in Pacific regional support provided by the Bank, through the Global Fund for Disaster Recovery and Rehabilitation (GFDRR), and has been selected as a priority country for GFDRR Track 2 support, to strengthen the government's disaster preparedness and mitigation efforts.

Supporting Communities

In collaboration with the governments of Vanuatu and Australia, the Bank is currently exploring options to strengthen the delivery of rural services. Through the Justice for the Poor program, grant financing has also been provided to ensure that varying community views can be better incorporated into future program design.

World Bank Group Presence in Vanuatu

The Government of Vanuatu has requested that the Bank Group consider establishing a liaison office in Port Vila, as is being done jointly with the Asian Development Bank in Tonga and Samoa. Given the potential for expanding Bank Group engagement, the Bank is considering options sympathetically in the context of broader FY10 budget planning processes.

ANNEX IV: VANUATU—RELATIONS WITH THE ASIAN DEVELOPMENT BANK[1]
(As of end-December 2008)

The Asian Development Bank's (AsDB) operations in Vanuatu started in 1981. Since joining AsDB, Vanuatu has received nine loans totaling $51.25 million and technical assistance (TA) for 55 projects amounting to $16.36 million. More than 50 percent of the loans were for infrastructure rehabilitation and more than 40 percent of the TA funding was for institutional support and capacity building. There were no ongoing loan projects in the portfolio in 2008, but there are three active TA projects amounting to $2.2 million.

The current AsDB Country Program aims at rapid, inclusive and private sector-led economic growth and directly supports the Government's development priorities—specifically private sector development and employment creation, as reflected in the Priorities and Action Agenda (2006–15). The following are ongoing activities:

- **TA4457-VAN: Secured Transactions (ST) Reform.** The development of ST system for chattels was initiated in November 2005. Promising progress is being made in establishing the legal and regulatory framework - Secured Transactions' Law was passed in April 2008 and efforts are underway to develop a secured transactions registry.

- **TA4856-VAN: Vanuatu Financial Services Commission (VFSC) Institutional and Legal Reforms, initiated in March 2007.** The TA is aimed at reforming the laws and regulations constituting companies, developing a bankruptcy and insolvency framework, developing a company registry reform road map, and provide an assessment of the VFSC to ensure high corporate governance standards and strong supervisory capabilities. The reform bills will be presented to parliament for enactment in 2009 and substantial work is being undertaken in the areas of institutional reform of VFSC.

- **TA7023-VAN: Expanding Access to Financial Services launched in August 2008, supports National Bank of Vanuatu (NBV) in introducing a new business model of bank agents in rural communities beyond the reach of present NBV branches.** Equipped with appropriate technology and communications equipment, these agents will enable much of the presently un-banked rural population to establish and operate savings accounts and utilize account transaction facilities conveniently.

Vanuatu hosts the *Pacific Aviation Safety Office (PASO),* a regional organization established through an AsDB loan that was approved in 2005. From its base in Port Vila, PASO provides safety and security oversight and technical assistance to airlines, regulators, and airports in nine Pacific countries.

[1] Prepared on the basis of input provided by AsDB staff.

In 2008, AsDB, the World Bank, the Australian Agency for International Development, and the New Zealand Agency for International Development (NZAID) initiated a process to improve cooperation in the infrastructure sector in the Pacific Developing Member countries, including Vanuatu, through establishment of the P*acific Region Infrastructure Facility and the Pacific Infrastructure Advisory Center.* These initiatives will provide specialist advice and finance for investments in all infrastructure sectors.

Following the Vanuatu government's Comprehensive Reform Programme Summit in March 2007, NZAID, in cooperation with AsDB, undertook a joint shipping study to evaluate the current inter-island shipping situation, including the current enabling environment and related governance, management and policy and regulatory framework issues. This study was completed in July 2008 with the Council of Ministers endorsing the major recommendations in late 2008. In upcoming years, AsDB in conjunction with NZAID will seek to implement a project that could include options for introducing measures supporting improved shipping services for remote, poorly served outer island communities. In particular, this project may focus on (i) strengthening of the institutional, policy, legislative and regulatory framework for inter-island shipping, (ii) upgrading and rehabilitating wharf and other domestic shipping infrastructure, and (iii) setting up franchise tender scheme to provide services to poorly served locations.

AsDB has recently started an intensive dialogue with the government on economic and sector work for the new *Country Partnership Strategy (CPS) covering 2010–14* to be approved in 2009. AsDB's future CPS will be broader than the current private sector development focus, but the latter will continue to be highly relevant and remain a cornerstone of the expanded strategy. The CPS 2010–14 may focus on the following areas: (i) Inter-Island Shipping Service Reforms, (ii) Continued support in Private Sector Development, (iii) Urbanization of Port Vila, (iv) Promoting Energy Efficiency and Access to Renewable Energy, and (v) Improving the efficiency and effectiveness of infrastructure and service delivery.

Progress in debt reduction in recent years may have increased the government's willingness to consider returning to borrowing in 2009. The AsDB loan allocation for 2009–10 has been set at $11.7 million. Any future lending operations will be based on a thorough debt sustainability analysis, with consideration given to innovative approaches such as loan buy-down mechanisms and the use of co-financing partnerships to reducing financing costs. Flexibility will be important, to allow AsDB to respond to reform opportunities and complement the grant resources of other agencies, especially in transport and infrastructure.

ANNEX V. VANUATU: STATISTICAL ISSUES

As of March 25, 2009

<table>
<tr><th colspan="2">I. Assessment of Data Adequacy for Surveillance</th></tr>
<tr><td colspan="2">General: Data provision has some shortcomings, but are broadly adequate for surveillance. In particular, data on national accounts, government finance and external sector statistics need to be further improved.</td></tr>
<tr><td colspan="2">National Accounts: While there have been improvements in methodology and the development of additional data sources, expenditure-based GDP estimates are not yet available. Also, data are compiled only on an annual basis. Constant price GDP estimates still use 1983 as the base year, although work on rebasing the estimates to 2006 are underway.

Price statistics: The CPI weights are based on 1998 household surveys, and only cover the two urban centers of Port Vila and Luganville. The CPI basket does not reflect the recent structural changes in the consumption basket, for example telecommunication prices and related utilities.</td></tr>
<tr><td colspan="2">Government finance statistics: Budget classification is broadly consistent with the 1986 GFSM. Government operations data include all central government agencies. However, they exclude public enterprises and operations of provincial governments and the two municipalities. The operations of the budget are recorded on a cash plus invoice basis.</td></tr>
<tr><td colspan="2">Monetary statistics: The Reserve Bank of Vanuatu (RBV) reports monthly monetary data, including the accounts of the monetary authorities, commercial banks, and interest rates in its monthly bulletin posted on its website. The RBV also publishes a quarterly report with the coverage of wider financial data including fiscal transactions and financial soundness indicators (e.g., amount of non-performing loans and earnings).</td></tr>
<tr><td colspan="2">External sector statistics: Quarterly and annual balance of payments data are compiled according to The Balance of Payment Manual, Fifth Edition. Trade data have been compiled using customs declaration forms collected from the two shipping ports of entries, Port Vila and Santo. Imported items by air are also captured, but imported goods and services through the post office have not been captured. Data on capital account also needs further improvements. Errors and omissions remain quite large.</td></tr>
<tr><th colspan="2">II. Data Standards and Quality</th></tr>
<tr><td>Participant in the General Data Dissemination System (GDDS) since April 2004.</td><td>No data ROSC is available.</td></tr>
<tr><th colspan="2">III. Reporting to STA</th></tr>
<tr><td colspan="2">Annual GFS data through 1999 have been reported for publication in the GFS Yearbook, using the 1986 GFS format. No sub-annual fiscal data have been reported for publication in IFS since 2001.</td></tr>
</table>

Vanuatu: Table of Common Indicators Required for Surveillance
As of March 25, 2009

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange Rates	Mar. 2009	Mar. 2009	D	D	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Dec. 2008	Feb. 2009	M	M	M
Reserve/Base Money	Dec. 2008	Feb. 2009	M	M	M
Broad Money	Dec. 2008	Feb. 2009	M	M	M
Central Bank Balance Sheet	Dec. 2008	Feb. 2009	M	M	M
Consolidated Balance Sheet of the Banking System	Dec. 2008	Feb. 2009	M	M	M
Interest Rates[2]	Dec. 2008	Feb. 2009	M	M	M
Consumer Price Index	Dec. 2008	Feb. 2009	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	NA	NA	NA	NA	NA
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Sep. 2008	Dec. 2008	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Sep. 2008	Feb. 2009	A	A	A
External Current Account Balance	Dec. 2008	Feb. 2009	Q	Q	Q
Exports and Imports of Goods and Services[6]	Dec. 2007	Feb. 2009	Q	Q	Q
GDP/GNP	2008	Feb. 2009	A	I	I
Gross External Debt	Dec. 2008	Feb. 2009	A	A	A
International Investment Position[7]	Dec. 2008	Feb. 2009	Q	Q	Q

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency, but settled by other means, as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Services data available on an annual basis.

[7] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

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FOR IMMEDIATE RELEASE
May 21, 2009

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2009 Article IV Consultation with Vanuatu

On May 11, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Vanuatu.[1]

Background

Vanuatu's economic performance has remained strong over the past several years. Backed by a booming tourist sector, strong performance of the service sector and aid inflows, growth averaged 6 percent in 2003–08, outperforming most of the other Pacific Island countries (PICs).

Inflation accelerated to 5.8 percent in 2008 from 4.1 percent in 2007, due mainly to higher international food and fuel prices. However, core inflation remained relatively stable. While the current account deficit widened in 2008 reflecting higher imports of food, fuel, and aid-related capital imports, an uptick in aid inflows helped to finance the large import bill. Foreign exchange reserves remain comfortable at about 5½ months of projected imports of goods.

Fiscal performance improved further. The overall fiscal surplus increased to 2.2 percent of GDP in 2008 from a slight surplus in 2007, as higher-than-projected spending on goods and services was more than offset by improved VAT collections and trade taxes. Development expenditure

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

also picked up as the long-awaited donor financing from the Millennium Challenge Account (MCA) began to feed into capital projects. The public debt-to-GDP ratio is estimated to have declined to 18½ percent of GDP in 2008 from over 40 percent in 2002.

Credit growth accelerated in 2008, in part reflecting the entry of a fourth foreign-owned commercial bank in the market. Most bank loans went to the construction and consumer finance sectors. However, a tightening of liquidity conditions in the domestic money market combined with stricter lending standards in light of the deteriorating global economic environment, has led to a slowdown in credit growth in the fourth quarter. That said, banks remain well capitalized and nonperforming loans remain low.

Progress was also made on structural reforms. Most notably, a new Utilities Act aimed at strengthening the regulatory framework was passed in 2007. The Personal Property Securities Act, which broadens the range of assets that can be used as collateral and strengthens the rights of secured creditors, was passed in 2008. In addition, the telecommunications sector was further liberalized and opened to foreign competition.

The global slowdown is likely to affect Vanuatu more than some of the other PICs, given its heavy dependence on tourism. As a result, growth is expected to slow in 2009. However, strong tourist arrivals expected at least for the first few months combined with higher donor disbursements are expected to help alleviate some of the negative impact on growth. In addition, the recent easing in monetary policy and a more accommodative fiscal stance for the 2009 budget would help cushion the impact on growth. Lower international food and fuel prices will likely contribute to lower inflation and narrow the current account deficit, improving the overall external balance.

Executive Board Assessment

Executive Directors welcomed Vanuatu's robust economic performance in recent years, underpinned by strong fiscal and monetary policies. They noted that the impact of the global slowdown on Vanuatu's economy has so far been limited, and acknowledged that adverse effects this year are likely to be largely confined to spillovers via the tourism and foreign direct investment channels.

Directors welcomed the improvement in the fiscal position in recent years. They commended the authorities for their efforts at maintaining a fiscal surplus for five consecutive years and reducing the debt-to-GDP ratio significantly. Directors supported staff's recommendation that, in the event of a sharper-than-expected slowdown, the authorities could provide additional fiscal stimulus, including by expediting pending projects and by further strengthening the social safety net. Directors also emphasized the importance of well coordinated donor support.

Directors underscored that various fiscal structural reforms are needed for a more effective fiscal policy over the medium term. They noted that prioritization of spending is crucial to promoting growth while keeping expenditure pressures manageable. In particular, they emphasized the need to monitor the large public sector wage bill and loss-making public enterprises. In addition, improvements in tax administration and widening the tax base would help finance development expenditure as foreign aid begins to gradually taper off as the economy matures.

Directors agreed that the central bank could cautiously ease the monetary stance if the slowdown is deeper and longer than expected. They saw room for further monetary easing, given the wide interest-rate differentials with major central banks. Nonetheless, Directors stressed that the authorities should be mindful of rapid credit expansion, given the inflation experience of the recent past.

In this context, and building on recent achievements, Directors emphasized that banking supervision should be strengthened further to help preserve a stable and sustainable pro-growth environment. They stressed that supervisors need to be vigilant against a possible worsening of bank balance sheets, and welcomed the authorities' plan to expand central bank supervision to the Vanuatu Agricultural Development Bank. They also saw the need to implement the regulations related to Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) expeditiously.

Directors acknowledged that the current exchange rate regime remains appropriate. They noted that the exchange rate remains broadly in line with economic fundamentals and that the prevailing exchange rate regime provides a useful inflation anchor and has helped the currency to gain credibility.

Directors stressed that further structural reforms should help sustain economic growth in the future. They acknowledged that past reforms had enabled the recent rapid economic growth, and that the authorities had a strong track record and a high degree of credibility for tackling the difficult reforms ahead. Directors particularly emphasized moving ahead with priority reforms related to improving road and port infrastructure, strengthening management and efficiency at public enterprises, and ensuring flexible labor markets.

Directors welcomed the authorities' intention to improve the capacity for statistics. They noted that improvements in key data would help enhance transparency in the economy and aid effective decision making on macroeconomic policies.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Vanuatu: Selected Economic and Financial Indicators, 2004–09

	2004	2005	2006	2007	2008 Est.	2009 Proj.
Output and prices (annual percentage change)						
Real GDP	5.5	6.5	7.4	6.8	6.6	3.0
Consumer prices (period average)	1.4	1.2	2.0	3.9	4.8	4.3
Government finance (in percent of GDP) 1/						
Total revenue and grants 2/	21.5	21.7	21.8	23.1	28.6	26.6
Total expenditure 2/	20.7	19.7	21.3	22.9	26.4	26.6
Current expenditure	18.6	17.9	19.0	20.2	19.6	19.6
Capital expenditure 2/	2.0	1.8	2.2	2.7	6.7	7.0
Overall balance	0.9	2.0	0.5	0.3	2.2	0.0
Money and credit (annual percentage change)						
Broad money (M2)	9.8	11.6	7.0	16.1	13.2	...
Net foreign assets	11.7	6.9	10.5	15.0	9.0	...
Domestic credit	7.9	8.7	7.2	10.6	36.7	...
Balance of payments						
Current account (in millions of U.S. dollars)	-16.5	-27.5	-17.1	-30.0	-42.3	-33.4
(In percent of GDP)	-5.0	-7.4	-4.1	-5.9	-7.4	-6.0
Of which: tourism exports (in millions of U.S. dollars)			92.4	118.0	160.9	139.5
Merchandise exports, f.o.b. (in millions of U.S. dollars)	38.1	38.1	37.7	29.7	41.7	37.1
(Annual percentage change)	43.3	0.1	-1.1	-21.3	40.7	-11.2
Merchandise imports, f.o.b. (in millions of U.S. dollars)	106.7	124.7	134.4	167.9	239.1	216.0
(Annual percentage change)	22.9	16.9	7.7	25.0	42.4	-9.7
Gross official reserves (end of period)						
In millions of U.S. dollars	62.1	67.6	105.1	119.6	115.2	135.3
In months of corresponding imports of goods 3/	5.8	5.4	7.8	7.1	4.8	6.3
Public debt						
Total debt (in percent of GDP)	33.7	28.1	23.4	19.8	18.5	17.3
External debt (in percent of GDP) 4/	24.2	19.8	16.7	14.1	14.1	14.4
External debt service 5/	1.6	3.1	1.4	1.3	1.3	2.4

Sources: Vanuatu authorities; and IMF staff estimates and projections.

1/ 2007–08 figures are based on the authorities' budget estimates, with adjustments by staff.
2/ Includes Millennium Challenge Account (MCA) project grant, which was launched in 2006.
3/ Imports values are on c.i.f. basis.
4/ Medium- and long-term public debt only.
5/ In percent of exports of goods and nonfactor services.

Statement by Christoper Y. Legg, Alternate Executive Director for Vanuatu and Yuong Ha, Senior Advisor to Executive Director
May 11, 2009

Our ni-Vanuatu authorities would like to express their gratitude to staff for the useful and constructive policy advice during their recent visit. They value staff's advice to cope with the impact of the global economic downturn, and also appreciate their continued attention to the structural reforms that will be needed to sustain Vanuatu's strong economic performance over the medium term. In this regard, our authorities also express their gratitude to the Pacific Financial Technical Assistance Center (PFTAC), and the Fund more generally, for the technical assistance received over the years.

Economic Overview

Growth in Vanuatu has been strong over a number of years, averaging 6 percent since 2003, and the economy is estimated to have grown by 6.6 percent in 2008. The key drivers of growth over this period have been tourism and construction, with close links to Australia and New Zealand facilitating activity in these sectors, and with increased disbursements from the Millennium Challenge Account (MCA) contributing to construction growth more recently.

Headline inflation, as in many economies, has been heavily influenced by international food and fuel prices and rose to 6 percent in 2008, compared with the authorities' 0-4 percent target range. However, core inflation has remained relatively contained and second-round effects are expected to be limited. Higher food and fuel prices also contributed to a widening in the current account deficit in 2008, but aid inflows have remained strong and provided sufficient financing to enable foreign reserves to remain at a comfortable level (between 5−6 months imports cover).

The overall fiscal position has continued to improve, with a strong increase in revenues (largely through greater compliance and reform in tax administration) underpinning a surplus of 2.3 percent of GDP for 2008. Consistent with the authorities' fiscal consolidation efforts, the public debt-to-GDP ratio has fallen to below 20 percent, with staff's analysis indicating sustainable debt dynamics and a low risk of debt distress.

The domestic banking system has been unaffected by the financial turmoil, given the limited integration into global financial markets. Credit growth was strong in 2008, mostly financing construction sector activity, but there were initial signs of a slowing in credit growth towards the end of 2008.

Overall, the authorities have overseen a period where economic performance has been impressive by historical standards, and in comparison with other economies in the Pacific region (as reflected in Figure 1 of the Staff Report).

GDP Outlook

Our authorities agree that growth will moderate over 2009 and, after recent downward revisions, now expect growth of around 3½ percent, which is broadly in line with staff's estimate of 3 percent. They agree that a slowing in tourism and FDI-financed construction will dampen growth, but believe that there are a number of factors working in Vanuatu's favour, which may limit the extent of any downside in economic activity.

- Vanuatu is closely linked to the Australian and New Zealand economies—two countries that are expected to be among the better placed to weather the global downturn, given their strong policy performance and robust financial systems. The recession in these two economies is expected to be relatively shallow, with a recovery in 2010.

- While tourism is likely to decline in a depressed economic environment, there are likely to be substitution effects with Australian and New Zealand tourists switching from long haul (U.S., Europe) to short-haul destinations that would favour the Pacific region. Vanuatu is well placed to benefit from this effect, given an increase in airline capacity (such as a new direct route from Melbourne) and a significant trend increase in cruise liner visits in recent years. Vanuatu may also benefit from a redirection of tourists, given the authorities' concerted international marketing strategies and recent political disruptions and adverse weather conditions in some of Vanuatu's key competitor markets. To date, tourist arrivals have held up well.

- The authorities also believe that there could be a significant amount of domestic construction activity waiting in the pipeline, as much of this activity was potentially crowded out during the recent FDI-driven construction cycle.

- The authorities are also preparing contingency fiscal measures that could be implemented quickly, with donors' assistance, in the event of a weaker-than-expected growth.

Fiscal Policy

The 2009 budget projects a reduction in the fiscal surplus, which provides an appropriate counter-cyclical stance to cushion the impact of a slowing in growth. The authorities expect a surplus of 0.9 percent of GDP compared to staff's estimate for a balanced budget. While the authorities note that the revenue target for 2009 is ambitious, they believe it is achievable, given their recent track record and planned enhancements to tax administration, including the introduction of the Large Tax Payer unit.

The fiscal consolidation that has occurred in recent years leaves the authorities well placed to cope with the economic slowdown. The authorities are preparing contingency measures, consistent with staff's advice to better prioritise spending and expedite infrastructure projects in consultation with donors, in the event of a sharper-than-expected downturn. Should revenues prove stronger than staff's estimates, then this would provide greater fiscal space to adopt additional and well-targeted measures.

The authorities are continuing to make steady progress to enhance the budget framework, and the Public Expenditure Financial Management Act was passed in the recent session of Parliament. The authorities are also aware of the need to contain the public wage bill, but stress that there are limits to what can be achieved given the need to provide essential public services to a population that is dispersed across over 80 islands and predominantly engaged in subsistence agriculture.

Monetary Policy

With core inflation remaining relatively stable, the Reserve Bank of Vanuatu (RBV) eased monetary policy in late 2008. With headline inflation expected to fall back into the RBV's 0-4 percent target by the end of 2009, there may be scope for further monetary easing. However, this would require a careful assessment of the impact of last year's exceptionally-strong credit growth and the adverse impact of the global economic slowdown on the domestic economy.

The authorities are aware of the need to enhance the monetary policy operational framework. In particular, they are considering measures to improve the efficiency of the indirect policy instruments and minimise the recourse to direct/prudential instruments for liquidity management purposes.

The authorities agree with staff's exchange rate assessment—maintaining stability in the nominal exchange rate has proven to be an effective nominal anchor, while addressing infrastructure bottlenecks remain key to improving the economy's competitiveness over the medium term.

Financial Sector

The authorities welcome staff's finding that the banking system is well-capitalised and sound. Maintaining banking system stability remains a key priority and the RBV will closely monitor bank balance sheets for signs of deteriorating asset quality in the wake of the recent strong increase in credit growth. The authorities are continuing with efforts to improve supervision, including moving oversight of the insurance sector to the RBV and, as noted in the Staff Report, there are plans to place the Vanuatu Agricultural Development Bank (VADB) under the RBV's supervision with the authorities are well aware of the need to minimise the potential risk that the VADB poses to the budget.

Other

While the authorities have made significant progress in some areas, such as telecommunications and transport, they agree that further structural reforms will be needed to improve the economy's long-term growth prospects. In this regard, they are working closely with donors to upgrade the wharf facilities, and the MCA-financed Ring Road on Efate island is currently underway. Increases in construction costs over recent years have meant that the MCA disbursements will not fully fund all of the projects from the original round-island road programme, but the authorities are seeking donor assistance to cover the remaining funding gaps. More generally, the authorities are working closely with donors to better align aid flows with their key development objectives, particularly in areas of healthcare and education. In this regard, major donor partners have pledged to maintain or increase their development assistance for the next few years.

The authorities have prepared plans to privatise Air Vanuatu and are in engaged in finding suitable investors. They are also aware that management of public enterprises, in general, needs to be improved, given the drain on budget resources.

In relation to the new Employment Act, the authorities have acknowledged the concerns of the business community and signaled that there are likely to be significant modifications to the initial severance pay provisions to ensure an appropriate balance between labour costs and providing an adequate safety net for workers.