



# RESERVE BANK OF VANUATU

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## **Press Statement** **“Interest Rates in Vanuatu”** **March 10, 2017**

### **Introduction**

- First and foremost, the Reserve Bank of Vanuatu (RBV) acknowledges the recent exchanges on social media on interest rates in Vanuatu, and other issues, but will focus more on interest rate in this press conference. We know there are a lot of specific policy areas which have been discussed in social media and I believe the Bank has made attempts from time to time to address them; it’s sad that no one bothers about their coverage for public consumption.

The outline for today’s press conference will be as follows:

1. Background discussion on interest rate
2. Role the RBV—financial stability
3. Redressing the perception—credit access vs interest rate spread
4. Empirical studies on interest rates and its determinants in Vanuatu
5. RBV policy actions to address interest rates
6. Why Financial Inclusion
7. Conclusion

### **1. Interest Rate**

- Interest rate is a cost of capital or funds that the lending institutions charge on their lending to the borrowers or customers. It’s the price that a borrower pays for accessing credit or capital in the form of a loan. The monies that financial institutions (or deposit-taking institutions) loan to the public are solicited (or mobilized) from public in the form of deposits. In mobilizing those deposits from the public, the financial institutions pay a fee also known as deposit interests. The difference between weighted averages of the two rates is known as “interest rate spread”. In most instances, the use of interest rate spreads is a more appropriate variable to use, when assessing interest rate differentials against, say, our comparator countries.

## **2. Role of Reserve Bank—financial stability**

- By virtue of the fact that the financial institutions are using depositors' monies to lend out to the public, they have a responsibility (a duty of care) to ensure that the funds are invested in viable and sound projects to be able to meet their costs, including paying interests on that liability—the public funds. The Reserve Bank as a supervisory authority is charged to oversee among many other roles that the business activities of the lending financial institutions are conducted within certain standards—again to safeguard the depositors' monies. This is known as prudential guidelines or policies. For your information, 80% to 90% of depositors' monies compose the funding bases of the lending institutions in Vanuatu. That is why their protection is paramount.
- Conversely, the Reserve Bank has among other objects, the legal mandate “...to foster financial conditions conducive to the orderly and balanced economic development of Vanuatu”. We satisfy this role by managing monetary and exchange rate policies on behalf of the Government.
- All in all, the Reserve Bank constantly performs a balancing act between requiring the lending institutions to adhere to prudent management norms, while encouraging them to do business through adopting an accommodative monetary policy stance since TC PAM. Over and above all these, the Reserve Bank is vested with additional legal roles to ensure that financial stability prevails at all times. Financial stability is but the most fundamental aspect of our mandate to safeguard the interest of the people and depositors of this nation. Needless to say that this “protection” is important for our international trade.
- Failure of a bank, if systemically important, can undermine the stability and integrity of the whole financial system. This can lead to economic distress as seen in recent world financial crisis.

## **3. Redressing the perception**

- There seems to be a mix-up where people are using the “Interest Rate spread” interchangeably to imply “Credit Access”. Thus, we strongly feel it is more fitting to

redress this social media disquiet or concern more as a “*Credit Access*” than “*Interest Rate*” per se.

- The reason being that the majority of interest rate spread determinants in Vanuatu (according to empirical studies) may take time to address. We believe credit access is a more inclusive issue as the majority of the population is affected by access to finance and should therefore be addressed through our financial inclusion program, and eventually influence the final pricing of loan products. This therefore brings the other different sectors of the economy into the picture—including but not limited to, the government, the central bank, the commercial banks, non-financial institutions and customers—both present and potential.

#### 4. Empirical studies on interest rate spreads and its determinants

- For public to be tauntingly implying on social media that the Reserve Bank has done nothing on interest rate would be an understatement on our part. I would therefore like to refute those assertions or claims as incorrect and misleading. On the other hand, we are not trying to be unnecessarily defensive of what is being exchanged on social media.
- I am pleased to say that both the Reserve Bank of Vanuatu and the International Monetary Fund (IMF) had carried out separate and independent studies on interest rate spread to statistically or empirically prove the explanations for high interest rate spreads. It’s the most credible undertaking to be done, rather than “eye-balling” and “guesstimating” on the plausible causes.
- Interestingly, the two studies have converged in their findings that the robust, and statistically significant determinants of interest rate spreads are: (i) ***economic size*** (measured by GDP), i.e., the higher level of sophistication, the greater opportunities for diversification, economies of scale is available in larger, high-income countries reduce spreads; (ii) ***high cost structure*** erodes real value of the rate spreads, prompting banks to raise rate spreads, (iii) ***quality of banks’ balance sheets*** , non-performing loans, lower spreads in stronger banking systems (NPLs in 2014/15 was high), and (iv) ***banking sector concentration***, greater competition reduces spreads.

- With the studies, these are no longer hypothesis or theories but hard facts and evidence identified through statistically tested empirical studies. We now have a rough idea what is behind the interest rate spreads in Vanuatu.
- The studies did one worthy favor by identifying the sort of measures that could help reduce the spreads, such as:
  - (i) Improving macroeconomic stability to reduce uncertainty, a target that RBV and MFEM always emphasize;
  - (ii) Strengthening of banks' balance sheets, Reserve Bank ensures there is better regulation and supervision of the system, but, on the other hand, issues like subdued economic growth and disasters happen;
  - (iii) increasing competition in the banking system, Vanuatu has obvious natural limits in terms of the size of the economy—however, RBV is exploring ways to promote specialized purpose vehicles (SPVs), including credit unions to address some of those development finance gaps; and
  - (iv) Improving economic institutions, clear property rights (land tenure), appropriate collateral regimes (we have a secured transaction registry in place which is yet to function), and strong contract enforcement.
- So we can now say we know there are issues there for the authorities to address in order to mitigate that interest rate spread.
- The most ideal approach would be for the institutions concerned to first address their respective impediments or barriers; taking note of the fact that some of the barriers are naturally related, like the small size nature of the economy.

### **5. RBV Actions to Address Interest Rates**

- In addressing the high interest rates structure, the RBV has conducted the following policy implementation to try and address the interest rates challenges in the country :-
  1. Lower the Discount Rate to link it with the RBV notes. The current Discount rate is RBV note rate plus 100 basis points to 2.85% - This rate is offered to commercial banks should they wish to borrow from the Reserve Bank of Vanuatu to support

their liquidity needs. The same rate is reflected in the Government's borrowing from the Reserve Bank of Vanuatu.

2. The Bank also introduced two facilities to the public via the financial institutions at 1.5 percent, to be on-lend at 5.0 percent. These facilities are geared towards import substitutions and to exports-oriented sectors.
3. The Bank further injects liquidity into the system by reducing its statutory reserve deposits from 7% to 5%. This has increase further liquidity in the system. Theoretically, this policy measure should immediately reduce interest rates in the market. This is not the case in Vanuatu where the transmission mechanism is weak.
4. RBV has also reduced its Liquid Assets Requirements to allow banks to have more liquidity to lend, however, consumer confidence appears to be weak which has influenced low credit growth.

### **Why Financial inclusion**

- As we now hold the view that credit access is a more inclusive agenda as the majority of the population is affected by access to finance and should therefore be addressed through our financial inclusion program, and eventually influence the final pricing of loan products. Let me say something on Financial Inclusion.
- Financial inclusion is an initiative to deliver financial services (savings or deposit services, payment and transfer services, credit and insurance) that is affordable and accessible to those that are unbanked, including the disadvantaged and low income people.
- RBV is doing the following:
  - Conducted a survey on financial access and demand for financial services in 2016
  - Conducted an SME survey in 2016
  - It will review legislation and regulation on use and delivery of financial services to strengthen client and data protection and a consumer complaint desk
  - It is about to undertake a national policy strategy framework which will set the national framework on financial inclusion including supporting Small and Medium Enterprises (SMEs) in Vanuatu to develop and ensure financial access to the sector

- It is about to sign an MOU with the Ministry of Education Incorporate so that financial education can be incorporated in the Vanuatu core school curriculum. It will also undertake programs to ensure adults have access to financial literacy education
- It is about to sign an MOU with the Ministry of Agriculture, Forestry, Fisheries and Biosecurity to ensure that support and training to SMEs in the Agri-business can be channeled through their programs
- It is about to sign an MOU with the Ministry of Commerce, Cooperatives and Tourism to ensure that support and training to SMEs can be channeled through their programs
- It has committed to putting in place policies to support access for SMEs targeting 30% of women in Vanuatu
- It has made commitment to half the number of households without access to basic financial services partly through a financial literacy strategy
- It is currently developing a Payment System Act to ensure a safe and credible payment system and assist in financial inclusion agenda
- RBV has written to the World Bank requesting their assistance to draw up a strategy or policy framework in addressing the CODB.

## **5. Conclusion**

- In concluding, I must say that those last points on financial inclusion seem to support the Reserve Bank's view now that addressing the perception from the interest rate spread standpoint will take time as backed by the determinants that are proven to be statistically significant in influencing the spread, such as economic size, high costs structure, quality of bank assets and banking sector concentration.
- The argument we started with to redress the concern as one of "Credit Access" by seriously pursuing it via financial inclusion programs is the most effective way that will eventually address the interest rate spread. At the same time, the other different sectors of the economy should be brought into the picture—including but not limited to, the government, the central bank, the commercial banks, non-financial institutions and customers—both present and potential.

Thank you

**Simeon Malachi ATHY**  
Governor