The release of the March 2024 Monetary Policy statement (MPS) has been delayed due to unforeseen circumstances impacting the approval to release, which are beyond the control of the RBV. The next MPS will be issued at the end of September 2024.

Reserve Bank of Vanuatu

Half-Yearly Monetary Policy Statement

March 2024

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1. Statement by the Governor

Global growth is projected to slow to 3.1 percent in 2024, similar to 2023. According to the International Monetary Fund (IMF), these lower forecasts reflected the lagged and persistent effects of restrictive monetary policies, restrictive credit conditions, weak global trades and withdrawal of fiscal supports. The IMF projected growth in advanced economies to ease slightly in 2024 before accelerating in 2025, while emerging market and developing economies are expected to experience stable growths through 2024 and 2025. Fuel and non-fuel commodity prices are projected to decline in 2024 and 2025 as global production increased, which is expected to push down global headline inflation from an estimated 6.8 percent (annual average) in 2023 to 5.8 percent in 2024.

Domestic economic growth is expected to pick up in 2024 relative to 2023. Growth will be broad based, led by the industry and services sectors while a slower growth is anticipated for the agriculture sector. In terms of expenditure, growth will be driven largely by investments and net export of services. Real consumption remained moderate and is significantly affected by high and persistent inflation.

The Government operated a financial surplus of VT2,383.6 million in 2023, while projected to pursue an expansionary fiscal policy in 2024; owing to the implementation of the capital projects starting this year and beyond. However, the Government is yet to roll out its plan capital budgeting so far this year and has been continuously resorting to bond creation due to challenges in operational cash flow. Government revenue performance is projected to increase in line with the anticipated pickup in economic activities. This is supported by expected receipts from donor support and transfers.

The domestic banking sector on aggregate; has remained liquid, sound, profitable and adequately capitalised despite the uneven distribution of liquidity. Poor performance in asset quality remains a challenge but projected to improve as economic activities pick up. Overall, the domestic financial sector is expected to remain sound in the short to medium term.

The Reserve Bank of Vanuatu (RBV) gradually tightened monetary policy by increasing the volume of RBV notes issued in October 2023 and raise its Statutory Reserve Deposit (SRD) ratio in January 2024. The exchange rate regime has continued to help cushion the pass-through of import prices to domestic inflation. The combined impacts of this tightening economic conditions are likely to slow down economic output over the first half of 2024.

The RBV will continue to monitor international and domestic macroeconomic environments, macro prudential and financial developments in the coming months and will make necessary policy changes as necessary to safeguard macroeconomic stability.

RESERVE BANK OF VANUATU

AUGUST LETLET
Governor
Reserve Bank of Vanuatu

2. Objectives of Monetary Policy

The RBV is responsible for the formulation and implementation of monetary policy in Vanuatu. The RBV maintains a pegged exchange rate regime as a nominal anchor for monetary stability in Vanuatu. Monetary stability could be translated to maintaining domestic prices low and stable and adequate foreign level of reserves to meet the country's external obligations. More specifically, the RBV ensures that the annual inflation rate is kept within a target range of 0 - 4 percent and official foreign reserves are sufficient to finance a minimum of 4 months of projected import cover.

Foreign reserves have remained well above the RBV minimum threshold of 4.0 months of import cover in 2023 and in the first two months of 2024. Foreign reserves were projected to remain sufficient at around 7.6 months of import cover at the end of 2024. Inflation, on the other hand, had exceeded the RBV's upper target of 4.0 percent in 2023. However, it is forecasted to return to within the RBV's target range at the end of the year. The RBV has undertaken several measures to counteract the inflationary pressures. In October 2023 the RBV tightened its open market operations and increased the SRD ratio in January 2024. The RBV will gradually tighten its monetary policy stance in 2024 to counteract the lag and persistence effects of inflation.

3. International Economic Developments and Outlook

The pace of global growth slowed in 2023 amid the lingering effects of the pandemic, Russia's invasion of Ukraine, tighter credit conditions, and the cost-of-living crisis. According to the International Monetary Fund[1], the global economy grew by 3.1 percent in 2023, 0.4 percentage points slower from 3.5 percent in 2022. Inflation has decelerated from its 2022 peak, owing to tight monetary conditions by central banks to keep inflation expectations anchored. Tight financial conditions have also led to restrictive lending in 2023, resulting in high mortgage costs, challenges for firms refinancing their debt, tighter credit availability and weaker business and residential investment. Short-term policy interest rates have been declining since the second half of 2023 due to easing inflation; however, long-term borrowing costs remained high, which has added to rising government debt.

Economic growth in the United States (US) and several major emerging market and developing economies have picked up in the second half of 2023, owing to increases in government and private sector spending in these respective economies. However, in some economies such as the Euro area, growth remain subdued, reflecting weak consumer spending, the persistent effects of high energy prices, and weak manufacturing and business investment. Similarly, low-income economies continued to witness substantial output losses relative to pre pandemic levels amidst the high borrowing costs.

Growth in global international trade was weak in 2023, attributed to declining trade in goods due to weak global industrial production. Trade in services has continued to recover slowly from the effects of the pandemic.

The average world prices of most commodities fell in 2023 reflecting moderating demand, but remained above pre-pandemic levels. Crude oil prices were volatile in 2023, but have eased to average $83/bbl, down from $100/bbl in 2022. Despite the conflict in the Middle East, the decline in prices largely reflected increased production from Iran and the US, which offset production cuts by the OPEC+. Prices of natural gas and coal have eased significantly in 2023 due to a reduction in energy demand from countries in Europe, as they maintained gas inventories above 90 percent of their storage capacity. Metal prices declined by 10 percent in 2023 owing to slow demand from major economies, particularly China, reflecting the persistent weakness in its property sector. Food prices contracted by

[1] World Economic Outlook Update, January 2024

9.0 percent in 2023 reflecting abundant supplies of grains. Rice prices; however, rose by 27 percent in 2023 due to restriction on exports of non-basmati rice from India, the world's top rice exporter.

3.1 Developments in Vanuatu's main trading partners

Economic activity in the US has increased at a solid pace, at an annual growth of 3.2 percent in the December quarter of 2023, slower than 4.9 percent over the year to the third quarter of 2023. Growth was driven by consumer spending, exports, state and local government spending, non-residential fixed investment, federal government spending, and residential fixed investment. These were partly offset by a decrease in private inventory investment. Job gains have moderated and unemployment rates have remained low, despite increasing to 3.9 percent in February 2024, from 3.6 percent in the previous year. Inflation has eased but remained elevated. Annual inflation registered 3.2 percent in February 2024, slightly above 3.1 percent for the year to January 2024, reflecting high food prices. The Federal Reserve (Fed) raised its policy interest rates to 5.50 percent from 5.25 percent in its meeting in January 2024.

The Australian economy expanded by 1.5 percent over the year to December 2023. The main drivers were Government spending and private business investment. Annual inflation continued to decelerate to 4.1 percent in the December quarter 2023 from 5.4 percent over the year to September 2023. This marked the fourth consecutive quarter of lower annual inflation from the peak of 7.8 percent in the December quarter 2022. The unemployment rate remained at 3.9 percent in January 2024, similar to December 2023. In February 2024 the Reserve Bank of Australia (RBA) left the official cash rate unchanged at 4.35 percent.

Growth in the Euro area remained stable at an annualised 0.1 percent in the fourth quarter of 2023, a similar level as in the third quarter. GDP rose by 0.4 percent for 2023 as a whole, slower than 3.4 percent in 2022. Stagnant growth in the Euro area reflected weak household consumption and external demand. Restrictive financing conditions to counteract inflation has continued to exert downward pressure on growth, though government consumption and investment were positive. Annual inflation in the Euro area eased to 2.8 percent in January 2024, down from 2.9 percent in December 2023, below 8.6 percent recorded in January 2023. The unemployment rate in the Euro area registered 6.0 percent in January 2024, stable compared with December 2023 and down from 6.1 percent in January 2023. The European Central Bank (ECB) kept the interest rates on the main refinancing operations, the marginal lending facility and the deposit facility at 4.50 percent, 4.75 percent and 4.00 percent, respectively, on its meeting on the 7th of March 2024.

The New Zealand economy expanded by 1.3 percent over the year to September 2023. This expansion reflected growths in the primary and services sector, household final consumption expenditure and stronger exports of goods and services. Growth in imports of goods and services have slowed. Inflation in New Zealand rose 4.7 percent over the year to December 2023, lower than 5.6 percent recorded over the year to September 2023. The Reserve Bank of New Zealand (RBNZ) held its official interest rates at 5.5 percent in February 2024, since May 2023. The unemployment rate reached 4.0 percent at the end of the December quarter 2023 up by 0.6 percentage points from the December quarter 2022.

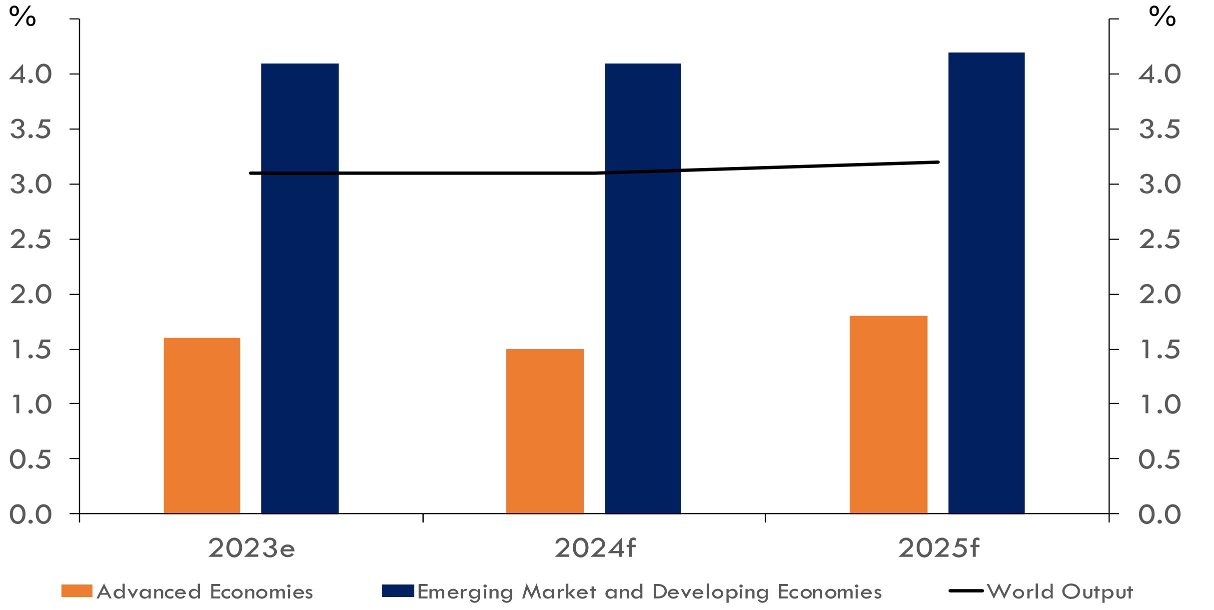
In China, GDP expanded by 5.2 percent year-on-year to December 2023, exceeding the official growth target. Growth largely reflected a rebound in the industry and services sectors and a resurge of consumption following the lifting of COVID-19 restriction at the beginning of the year. Foreign trade and private investment showed improvement in December 2023. The national consumer price Index (CPI) rose by 0.2 percent in 2023 from the previous year, though year-on-year inflation for December

2023 decreased by 0.3 percent. China's unemployment rate eased to 5.2 percent in 2023, from 5.5 percent in 2022.

4. Projection for the International Economy

The IMF projected global growth to remain at 3.1 percent in 2024 as in 2023, before increasing moderately to 3.2 percent in 2025. Growth projections both for 2024 and 2025 remained below the historical (2000-2019) annual average of 3.8 percent, as a result of restrictive monetary policies, withdrawal of fiscal support as well as low underlying productivity growth. Growth in advance economies were projected to ease slightly in 2024 before increasing in 2025, reflecting recovery in the Euro area and a moderation of growth in the US economy. Emerging market and developing economies are expected to witness stable growth through 2024 and 2025 considering regional differences.

Figure 1: World Economic Growth
(Annual Growth in Percent)



Source: International Monetary Fund, January 2024 World Economic Outlook

World trade was forecasted to expand by 3.3 percent in 2024 and further by 3.6 percent in 2025. However, growth rate remained below its historical average of 4.9 percent. Growth in global trade will continue to be affected by rising trade distortions and geo-economic fragmentation.

Commodity prices are projected to decline in 2024 and 2025. The annual average oil prices and nonfuel commodity prices were projected to fall by about 2.3 percent and 0.9 percent in 2024, respectively.

The IMF projected policy rates to remain at current levels for the Federal Reserve and the ECB. Global headline inflation was forecasted to decline from an estimated 6.8 percent in 2023 (annual average) to 5.8 percent in 2024 and 4.4 percent in 2025. Inflation in advanced economies was projected to decelerate faster, by 2.0 percentage points in 2024 to 2.6 percent. Inflation in emerging markets and developing economies was projected to ease by 0.3 percentage points, to 8.1 percent.

4.1. Growth Projections for Vanuatu's major trading partners

Growth in the US is forecasted to expand at a slower pace of 1.7 percent in 2025; owing to the lagged effects of monetary policy tightening, gradual fiscal tightening, and a softening in labour markets slowing aggregate demand. According to the Federal Reserve monetary policy report for March 2024, inflation has eased significantly over the past year, though remaining above the Federal Open Market Committee's (FOMC)[2] objective of 2.0 percent. The FOMC is strongly committed to returning inflation to its 2.0 percent objectives, but will need to carefully assess incoming data, the evolving outlook, and the balance of risks prior to considering any changes for the federal funds rate.

Growth in the Euro area is expected to slowly recover from 0.9 percent in 2024 to 1.7 percent in 2025, owing to strong household consumption. Due to fading cost pressures associated with the impact of the ECB's monetary policy tightening, the ECB projected inflation[3] to average 2.3 percent in 2024 and 2.0 percent in 2025.

The Chinese economy is projected to grow by 4.6 percent and 4.1 percent in 2024 and 2025, respectively; due to policy restructure by diverting more spending towards domestic demand, especially increase government spending on capacity building against natural disasters. The IMF forecast inflation rate at 1.7 percent in 2024, due to continuing weak domestic demand. This is slower than the inflation rate target of 3.0 percent.

Australia's GDP is projected to reach 1.4 percent in 2024 and 2.1 percent in 2025. Inflation in Australia continued to slow and is expected to return to the RBA's inflation target range of 2 to 3 percent in 2025 and to reach its midpoint in 2026[4]; prompting the RBA to leave its official cash rate at 4.35 percent. The deceleration in inflation reflected goods price inflation while services price inflation remains high; but expected to moderate at a gradual pace. This is due to continued excess demand in the economy and strong domestic cost pressures, both for labour and non-labour inputs.

The IMF[5] projected New Zealand's growth rate at 0.8 percent in 2024. The projected slow growth reflected weakening domestic demand linked to monetary tightening, rising mortgage payments, and lower real disposable income. The RBNZ projected headline inflation to continue to decelerate over the medium term. Annual headline CPI inflation is assumed to return to within the Monetary Policy Committee's 1 to 3 percent target band by the September 2024 quarter, and to the 2.0 percent midpoint by the end of 2025[6]. Therefore, the RBNZ also maintained its official cash rate at 5.5 percent.

5. Domestic Economic Developments and Outlook

The domestic economy was estimated to have grown by 3.0 percent in 2023 from an estimated growth of 2.8 percent in 2022. Growth was largely driven by the industry and services sectors; while growth in the agriculture sector remained weak due to the negative impacts of three cyclones in 2023. In terms of expenditure, investment and net export of services were the main driver of growth. Real consumption continued to be affected by the persisting high inflation.

5.1. Economic activities by production

The agriculture sector was estimated to have slightly declined by 0.9 percent in 2023 from 2.5 percent in 2022. This contraction was due to the negative impact of the cyclone[7] on crop production. Findings

2 https://www.federalreserve.gov/monetarypolicy/2024-03-mpr-summary.htm

3 European Central Bank macroeconomic projections March 2024

4 Statement on Monetary Policy March 2024, Reserve Bank of Australia

5 The International Monetary Fund, Regional Outlook Asia and the Pacific, May 2023

6 Reserve Bank of New Zealand monetary policy statement February 2024

7 SevereTropical Cyclones Judy and Kevin in March 2023 and Lola in October 2023.

from the 2024 first economic assessment[8] indicated that activities within the agriculture, forestry and fisheries sector have gradually improved in 2023. Production of the main exports commodities has strengthened due to high domestic and international demand, in particular for kava, coffee, beef and fish. Sandalwood production has increased due to large number of trees destroyed during the cyclones. The increase in cocoa production was attributed to the increase in the domestic price for cocoa. Growth in the fisheries sector was reflected by the increase in registration of international fishing vessels during the year.

Growth in the industry sector remained robust but slower, growing by 4.6 percent in 2023, than the 4.9 percent growth registered in 2022. Construction activities were largely driven by ongoing infrastructure projects and private sector constructions. These projects contributed to a rise in quarrying, as reflected in the increase in issuance of business permits relating to quarrying extraction. Growth in manufacturing remains positive, owing to an increase in number of handicraft business permits issued and an exceptional revenue performance in sales of alcoholic and non-alcoholic beverages. The expansion in utilities production with three (3) new water supply projects in Malekula, Pentecost and Santo and two (2) new electricity grid in Malekula and Santo have also added to growth in this sector.

The services sector continued to expand by 4.6 percent in 2023, higher than 3.2 percent in 2022. Accommodation and food services have increased significantly, hotels have recorded strong revenue performance due to rebound in tourists from Australia and New Zealand. Tourism activities have reached 60 percent from the pre-pandemic level in Port Vila and 40 percent outside of Port Vila. Retail businesses have strengthened, driven by inflow of remittances, recovery in domestic activities, cyclone relief support and the increase in minimum wage. Similarly, vehicle sales remained high despite high shipping related costs. The transport sector performed well during the year, private airlines have reported high demand for charter flights from Non-Profit Institution Serving Households (NPISH), Government and tourists. The performance of Air Vanuatu9 has been moderate, its international flights are still 25 percent below pre-pandemic levels, while domestic flights were 19 percent below pre-pandemic level. Real estate activities have increased, driven by high demand for land by residents including seasonal workers and foreign investors. Other services such as information and communication and finance and insurance have also improved as a majority of businesses within these sectors have reported profits in 2023. The expansion in social services have also added to growth in this sector, in particularly, the outreach of health and sanitation programs funded by development partners.

5.2. Economic activities- by expenditure

In terms of growth by expenditure, growth in 2023 was largely driven by strong growths in investment and exports of services (tourism) as borders have opened. Growth in consumption is moderate as real consumption continued to be weakened by a persistent high level of inflation.

Though growth in real consumption is weak, consumption continued to be sustained by significant inflow of remittances, cyclone relief support, and recovery in economic activities. Partial indicators of consumption have remained positive thus added to growth. Value Added Tax (VAT) collections for the year to December 2023 had exceeded its budget estimate by 113.2 percent. In terms of Government consumption, use of goods and services and compensation of employees have remained within their respective budget targets for the year to December 2023. Credit to other resident sectors (personal loans) continued to be strong, recording an annual growth of 25.2 percent in January 2024.

Growth in the partial indicators of investment were estimated to have been weak in 2022, yet growing at a modest pace in 2023. This improvement reflected the ongoing economic recovery. Majority of

8 Economic Assessment conducted in February-March 2024 in Port Vila

9 This was the situation during the first three months of 2024. Air Vanuatu entered into liquidation on the 9th of May 2024.

these investments were public sector construction activities such as; the ongoing major government infrastructure projects (tar sealed and concrete roads) and the construction of new government buildings in Port-Vila (Department of Finance, presidential palace, etc) and outer islands as result of the government decentralization policy. Similarly, growth in the partial indicators of private sector investment have remain slow. Findings from the economic assessment shows that approximately fifty (50) percent of businesses reported no changes in capital investments from the second half of 2023 to early 2024. Roughly forty (40) percent of businesses recorded a moderate increase in capital investments, while less than ten (10) percent reported large increases in capital investment. From the banking sector, private sector investment, represented by credit to businesses and to household and land purchases (household investment), declined 2.3 percent and 3.7 percent in January 2024, relative to January 2023, respectively.

Growth in exports of goods has slowed in 2023, with kava remaining the main export earner, followed by cocoa and coffee. All other export products have declined relative to the previous year. Slow growth in exports reflected high freight and shipping costs, high competition in export markets and volatility in domestic prices, for instant kava. Exports of services is estimated to grow strongly in 2023 due to the return of tourists and via remittances from seasonal workers. On the other hand, imports of goods and services have remained relatively high due to continuous high domestic demand for goods and services to support economic recovery.

5.3. Fiscal developments

The Government maintained a positive fiscal balance in 2023, reflecting good performance of recurrent revenue exceeding the 2023 budget target. This largely reflected the recovery in the domestic economy, the resumption of tourism activity and spending of remittances. VAT, excise tax and taxes on international trade have exceeded their respective 2023 budget targets while taxes on property, budget support and other revenues fell short of their 2023 budget targets. Inflows of grants from development partners were lower than anticipated. The Government continued to exercise expenditure management control as recurrent expenses remained within budget target for the year to December 2023.

5.4. Monetary and financial developments

Domestic monetary conditions have been accommodative to growth. Domestic liquidity, in particular excess reserves of commercial banks, continued to build up as the Reserve Bank maintained an easing monetary policy stance. Growth in money supply remained steady in 2023 and January 2024. Money growth was largely determined by domestic credit, in particular increases in both net claims on the central government and private sector credit (PSC). Growth in net foreign assets has moderated, reflecting slow global conditions and high import payments. The Government's net credit position with the banking system deteriorated over the year to December 2023 and in January 2024. This largely reflected the rise in the Government's domestic borrowing[10] and the withdrawal of Government deposits with both the RBV and commercial banks during the year. The level of outstanding Government bonds rose by 7.8 percent from 2023 to February 2024. PSC recorded an annual growth of 3.7 percent in January 2024, owing to ongoing economic recovery. Personal loans remained the main driver for the annual growth in private sector credit while loans and advances to non-financial corporation remain weak.

The banking industry's underlying profits (before tax and provisions) rose 5.0 percent from the December quarter 2022 to the end of December 2023. The annual growth in net income (after tax and

10 Government domestic borrowing is mainly by issuance of government bonds

provisions) decreased by 5.9 percent at end of December 2023, reflecting high level of provisioning. In January 2024, non-performing loans (NPLs) continued to increase by 26.0 percent relative to January 2023. Both specific and general provisions decreased. The downtrend in general provisions (allocated) reflected the recovery in the domestic economy. Total industry's liquidity has been maintained at adequate levels; however, it remained unevenly distributed. The liquid asset ratio (LAR) recorded 50.6 percent at end of March 2024, higher than the minimum requirement of 5.0 percent.

5.5. Domestic price development

Annual headline inflation reached 5.3 percent in the March quarter of 2024, lower than 7.0 percent (December quarter) and 11.6 percent (March quarter). Despite the decelerating trend, prices have remained high compared to pre-covid levels. The Port Vila index surged to 5.3 percent, Luganville and Lenakel[11] indexes rose by 5.1 percent and 5.8 percent, respectively. The movement in prices reflected the persistent lagged effect of high global food and energy prices as well as high imports and transport related costs. Higher prices of household supplies, food, education, clothing and footwear, drinks and tobacco, health and miscellaneous were the main drivers of inflation during the March quarter.

Underlying annual inflation rose by 7.4 percent in the March quarter 2024, lower than 8.4 percent recorded in the December quarter 2023. This implied that in general, the price level (excluding volatile prices of food and energy) in Vanuatu has slowed.

5.6. External conditions and official reserves

The Vanuatu current account balance (CAB) is projected to have improved by 78 percent in 2023, from a deterioration recorded in 2022. The expected improvement reflected a positive growth on trade in services (reflecting the inbound visitors' arrivals). The rising demand for seasonal workers and high global interest rates[12] have contributed to improvement in the primary income balance. The strong performance in the secondary income balance was driven by personal transfers, budget support and receipts via the citizenship by investment program. The offset was high imports financing witnessed throughout 2023 compared to 2022, amidst domestic recovery and high energy prices.

The annual average growth in official reserves slowed by 0.7 percent in 2023 relative to 0.8 percent in 2022, reflecting high imports financing; as domestic production (goods and services) being insufficient to meet rising domestic demand. Official foreign reserves remained sufficient to finance approximately 8.0 months of import cover in February 2024, well above the Reserve Bank's minimum threshold of 4.0 months.

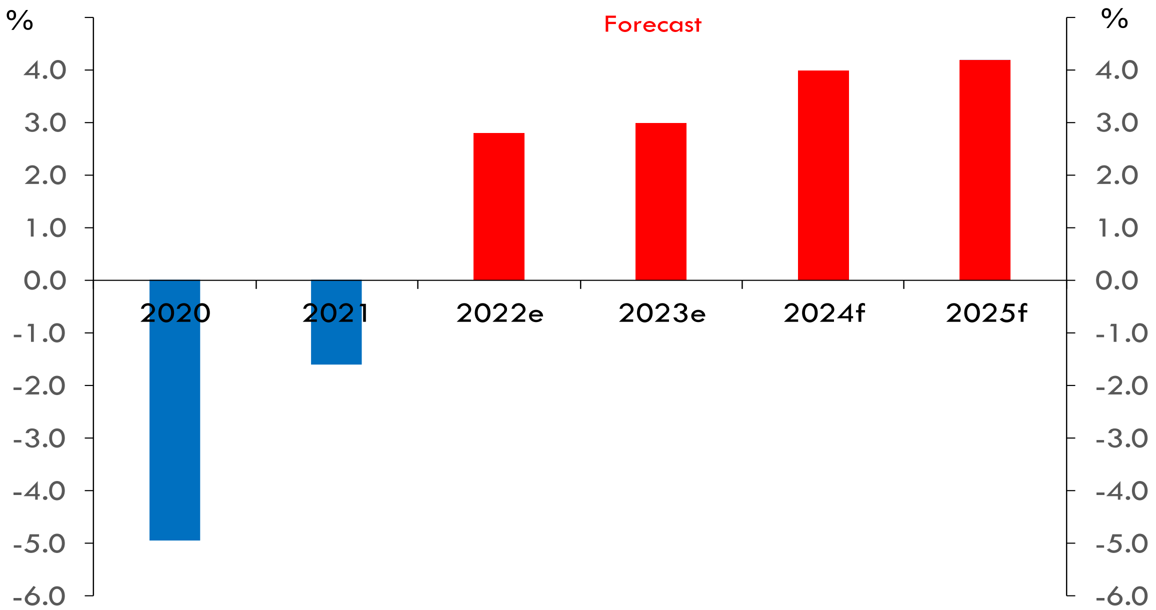
6.0 Outlook for the Domestic Economy

The domestic economy continued to recover from the persistent impacts of the global price shocks, acceleration in domestic inflation and the three cyclones in 2023. According to the Macro-Economic Committee's (MEC) projections in April 2024, the domestic economy will expand by 4.0 percent in 2024 and 4.2 percent in 2025. Growth will be broad based, led by the industry and services sectors and to a lesser extent the agriculture sector. In terms of expenditure, growth is projected to be driven by investment, export of services and consumption will remain moderate in 2024.

11 Lenakel price index is published for the first time in March 2024 CPI

12 Related to Vanuatu's major investment partner countries

Figure 2: Domestic GDP Growth
(Annual Growth in Percent)



Source: Vanuatu Bureau of Statistics, Macroeconomic Committee Forecast- April 2024

6.1. Economic Outlook- by production

Growth in the agriculture sector is expected to recover by 2.7 percent in 2024 and further to 2.6 percent in 2025. Growth is projected to be driven by increased production of crops and livestock to meet domestic demand and international markets, such as kava, coffee, cocoa, timber, beef and fish. The main risks to these forecasts are vulnerability of this sector to the impact of natural disasters and climate change. Growth is projected to pick up over the short to medium term, once the Government infrastructure projects to enable market access are completed.

The industry sector is projected to expand by 6.8 percent in 2024 and 9.8 percent in 2025, as ongoing government infrastructure projects are implemented. These includes, road projects in South Santo, Tanna, Pentecost and Ambae and the Vanuatu Inter-Island Shipping support project. In addition, new projects such as the extension of Pekoa Airport runway, the water rehabilitation project in Luganville, the resealing of core road networks, upgrading of local airports and the construction of other new government building projects in other provinces begin. The mining and quarrying, water and electricity sectors are projected to grow in line with these projected construction activities. Growth in the manufacturing sector is expected to remain positive consistent with the Government's policy priorities to boost value addition. Private sector construction activities are also ongoing which will also add to overall growth in the sector.

Growth in the services sector is projected at 4.6 percent in 2024 and 2025, respectively, from ongoing recovery in the tourism sector, remittance inflows and continuing expansion of activities of existing service providers. The current projected increases in agriculture production and construction activities will spur further growth in accommodation and food services, retail businesses and sales of motor vehicles. The transport sector was projected to increase, to accommodate for increasing tourist numbers. Cruise arrivals are projected to increase significantly in 2024 compared to 2023. Hotels have projected numbers to be higher in 2024 relative to 2023 based on pre-bookings. However, operational and financial issues surrounding Air Vanuatu's international air service remain the major risk to air arrivals and the tourism sector generally in 2024[13]. New tourism investment undertakings are expected to be implemented and the Vanuatu Tourism Office is planning to host four (4) major marketing events to attract international visitors. Information and communication services and activities of the finance and insurance sectors are projected to be positive in 2024, in line with the recovery in domestic activities. Real estate businesses have projected a high turnover for 2024 from ongoing increase in demand for land and real estate property.

Health services activities will continue to perform well over 2024, as more outreached in health activities will be carried to all provinces by the Non-Profit Institutions Serving Households.

6.2. Economic outlook- by expenditure

Growth in consumption is projected to remain positive in 2024, although weak in real terms due to the persistent high inflation. Consumption levels will be sustained via the current uptrend in economic activities, projected pick up in private sector credit to households, higher VAT collections, continuous remittances inflow to households and income received from employment.

Investment will remain the main driver for economic growth, and expected to be largely driven by construction activities, as noted above under the industry sector outlook. Current private sector plans to increase capital investments will further add to growth in construction activities. Durable equipment is projected to increase due to plans to lease and purchase new aircrafts for Air Vanuatu[14] and private airlines, respectively.

Kava and cocoa exports are projected to remain strong this year, owing to high international demand and favourable domestic prices. Coffee exports are projected to improve, while export commodities such as fish, sandal wood, cocoa and beef remain stable. High freight and shipping costs and international competition remain the main challenges for the export sector. Imports of food and non-food items including constructions materials are projected to continue rise to accommodate for the increasing economic activities.

Exports of services in terms of visitor arrivals are forecasted to be higher than the previous year as noted previously. Imports of services are projected to increase owing to the increase in the number of foreign workers as domestic labour markets remain constrained.

6.3. Risks to growth outlook

Overall, the risks to the economic growth outlook is tilted to the downside. Within the agriculture sector, these include a continuing spread of the coconut rhinoceros beetle, the impact of climate change, and the entry of competitors in the international market for kava. Growth forecasts in the industry and services sectors are highly prone to risks associated with Air Vanuatu's financial and operational issues[15], land disputes and any delays in the implementation of public sector projects. In addition, the impact of climate change and natural disasters such as cyclones and El Nino/La Nina, political instability, shortage of skilled and unskilled labour force, persistency in high levels of inflation, high shipping and freight costs, high borrowing costs and cyber security, remain major risks to overall output.

13 Refer to foot note 9

14 Refer to foot note 9

15 Refer to foot note 9

6.4. Fiscal outlook

The Government is projected to pursue an expansionary fiscal policy in 2024, to accommodate for the expected implementation phase of the public sector capital projects in 2024 and beyond. Fiscal revenue, particularly in revenue items such as VAT, is expected to perform exceptionally this year owing to the projected increase in economic activities and the implementation of new VAT monitoring system. Furthermore, inflows via donor support such as cash and aid in kind will continue in 2024 which should add to a favourable revenue performance this year. The Government is expected to issue a total of VT6,227.6 million worth of domestic debt and approximately VT3,000 million in external debts in 2024. Overall, the government has estimated to receive a total (donor, budget support, new bond issuance and recurrent) of VT77,623.0 million in revenues to fund its total appropriation of VT77,623.0 million; in order to achieve a balanced budget in 2024.[16]

6.5. Monetary and financial outlook

Money growth is projected to be driven by domestic credit in 2024, owing to the expansionary fiscal policy of the Government and a pickup in domestic credit in line with increasing economic activities. Growth in net foreign assets is projected to be steady throughout the year, reflecting slower global economic conditions and demand for high imports to support growth. The RBV will continue to monitor growth in money supply and implement appropriate policy measures to ensure money growth remains sustainable.

The general outlook for the domestic banking sector is positive. Overall, the banking system remains highly liquid, sound and adequately capitalized. Non-performing loans (NPL) has increased from past periods and remain a concern but projected to improve as the economic activities continue to pick up. On average, the banking sector has also been well provisioned for asset impairment; though individual banks continue to face on-going challenges. Credit risk, continuing issues in correspondent banking relationship (CBR) due to de-risking, and corporate governance concerns remain a major risk to maintaining financial sector stability in the short to medium term.

6.6. Inflation outlook

Vanuatu's overall headline inflation is forecasted to gradually ease over the months ahead and will fall within the Reserve Bank's internal target (0-4 percent) over the remaining quarters of 2024. The current forecasts show headline inflation recording 3.7 percent, 2.4 percent, 3.3 percent in June, September and December 2024 quarters, respectively, indicating that annual average inflation is projected to slow from 11.3 percent in 2023 to 4.7 percent in 2024. However, upside risks to these forecast remains.

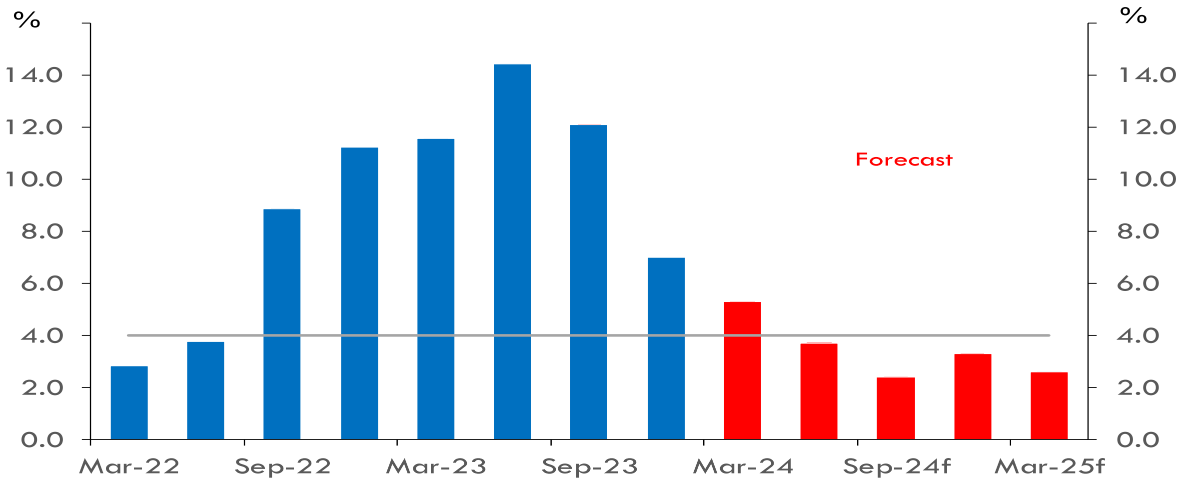
The main drivers underlying the inflation forecasts are disinflation in global inflation rates, amidst tightening monetary policies and the unwinding supply side issues. Domestic factors include steady growth in domestic food inflation expected in 2024, though price levels remain elevated. The Price Monitoring and Consumer Affairs (PMCA) has introduced the use of scales to determine prices of root crops, fruits and vegetables in Port Vila central market. This policy measure is projected to ease food inflation in Port Vila. Scales will be introduced to markets in other towns, namely Luganville and Lenakel in the second quarter of 2024[17]. The Department of Agriculture is embarking on a policy to encourage commercial farming, which would address supply constraints, and lower prices of root crops, fruits and vegetables in the near to medium term. Overall growth in food inflation in 2024 is projected to be in line with domestic demand and development in external fuel prices and import costs. Domestic fuel

16 2024 Government Budget Book.

17 Confirmed by CEO of PMCA in the Vanuatu Daily Post, 14 December 2023

prices have eased and the majority of retail businesses expect growth in import prices to be steady or lower in 2024 relative to 2023.

Figure 3: Vanuatu Consumer Price Index
(Percent change, quarterly data)



Source: Vanuatu Bureau of Statistics, Reserve Bank of Vanuatu staff Forecast

Prices of housing and utilities are projected to moderate in 2024, reflecting the current easing in international energy prices[18] and domestic fuel prices. However, prices have remained high compared to the pre-COVID period. Utility and rent prices are projected to remain elevated owing to increasing demand from rising population and urbanization. Furthermore, the expansion in renewable sources of energy, though with relatively smaller impact,[19] will also add to reducing electricity prices this year in respective areas where there is use of renewable energy.

Transport prices are projected to ease in 2024, following the current trend in international and domestic energy prices. The domestic prices reflected the reduction in excise and duty on fuel imports initiated by the Government in 2023. The average domestic fuel prices have reduced significantly in March 2024[20] to VT183/litre, lower by 27 percent from the 2023 peak price of VT249/litre. The ease in domestic average fuel price is likely to led to steady prices for public transport. The offset is projected for air transport for this year, owing to Air Vanuatu's[21] ongoing issues. Prices of motor vehicles is anticipated to remain elevated, reflecting high shipping and stevedoring costs and high demand for new vehicles.

Prices of drinks and tobacco, clothing and footwear, household supplies and miscellaneous are projected to be steady following the moderate trend in import prices.

6.7. Price expectation of businesses[22]

The sentiment of the majority of business houses in the recent economic assessments expect costs to be lower, in line with the projected easing of inflation in 2024. The majority (52%) of business houses expect business operation costs to be stable or lower in 2024 relative to 2023. More than 50 percent (64%) of business had no plans to increase prices of their goods/services and also expect them to

18 IMF WEO, January 2024

19 Around 74% of electricity in Vanuatu is generated by diesel and 26% by non-renewable energy. Source: Utility Regulatory Authority (URA) monthly energy report October 2023

20 Source: Department of Energy and RBV fuel survey

21 Refer to foot note 9

22 Results from business expectation survey which covers 25 major businesses in Port Vila (Feb-Mar 2024)

remain stable in 2024. More than 50 percent (67%) of businesses project import prices to ease or remain steady this year, relative to 2023.

6.8. Risks to inflation forecasts

The current forecast and outlook on inflation are prone to a number of upside and downside risks. The upside risks, likely to push prices higher than forecast if they were to occur, include;

- Intensification of geopolitical tensions particularly in the Middle East and continuing or intensification of the Red Sea attacks on international cargo shipping which could disrupt supply chains and trigger further increases in global food and commodity prices.
- The disruption of domestic food supply chains from events such as natural disasters.
- Changes in government policies, such as further increase in import duty and excise tax to raise revenue.

The downside risks, likely to contribute to lower domestic inflation include;

- That a positive supply response can emanate from the implementation of the commercial farming policy of the Department of Agriculture, Livestock, Forestry and Fisheries. A positive food supply response is forthcoming from expected and recent increase in investment[23] in the agriculture sector through the citizenship by investment program which can reduce food prices over the short to medium term.
- That domestic fuel prices are reduced faster than the current forecast. This will link to lower domestic transports prices and ultimately lower local food prices.

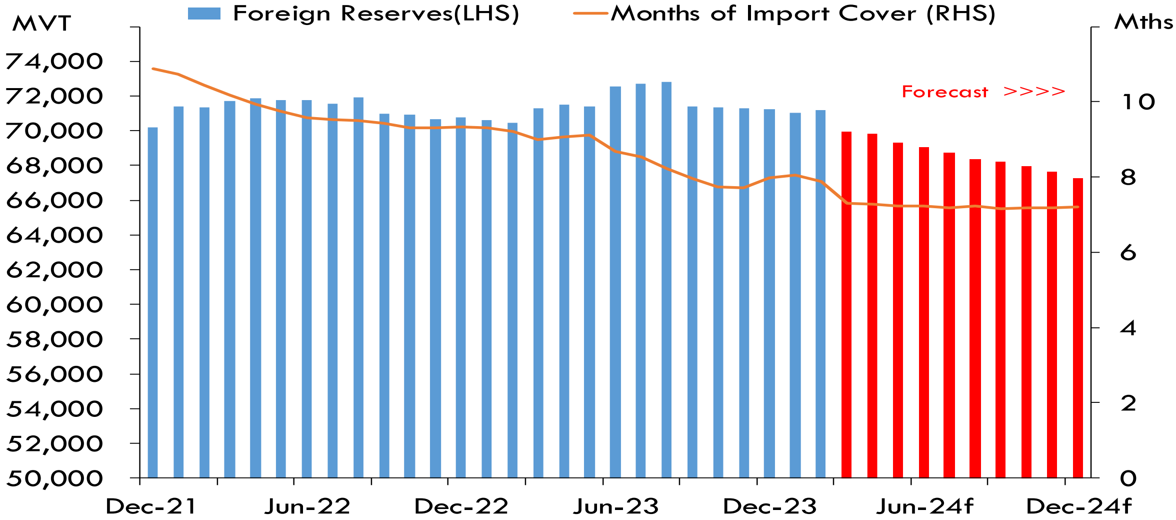
Vanuatu's pegged exchange rate regime has helped anchor inflation for the past four decades. With the current and projected easing in global inflation, domestic inflation is projected to ease this year, though price levels have remained high relative to pre-pandemic levels. The RBV, is mindful of its objective of anchoring inflation, it will continue to closely monitor inflationary pressures in the economy and take necessary measures to ensure inflation returns to its target band in the short to medium term.

6.9. Official reserves outlook

Vanuatu's foreign reserves are projected to slightly decline but will remain above the RBV's minimum target range over the short to medium term. Main sources of inflows include; Government revenue from abroad, primary income receipts and exports of goods and services and the main sources of outflows were to finance the import of goods and services and Government obligations abroad (external debts and other payments). Foreign reserves are forecasted to cover approximately 7.6 months of imports at the end of 2024. The downside risks to this forecast includes; prolong high import payments, high external debt repayment, unscheduled Government external payments, disruptions to Government receipts from abroad and political instability.

23 New investment attached to the citizen by investment program in 2024

Figure 4: Foreign Reserves and Months of Import Cover (Levels, monthly data)



Source: Reserve Bank of Vanuatu Staff Forecast

The overall trade balance is projected to continue to improve in 2024 owing to a significant improvement in trade in services, with an offset in trade in goods balance; reflecting high imports associated with the pickup in economic activities. The income balance is projected to remain in surplus owing to an increase in the number of seasonal workers abroad, the expected improvement in receipts from development partners in terms of budget support, infrastructure projects, citizenship by investment programs, other Government priorities and external financing.

7.0 Monetary Policy Stance

Official foreign reserves have remained adequate and projected to remain sufficient in the short to medium term. Domestic inflation accelerated significantly and entrenched, exceeding the RBV's target band in 2023. It is projected to ease toward the upper end of the target band in 2024. The Government's expansionary policy and pick up in private sector credit has continued to add to consumption. These will further increase the pressures on domestic inflation and foreign reserves outlook. The past monetary policy conditions have assisted to contribute to a large build up in excess reserves in the banking system. In order to maintain monetary and macroeconomic stability, the RBV began to tighten monetary policy in the latter part of 2023. It has effected two monetary policy changes, including the gradual tightening of the open market operations in October 2023 and increase in the SRD ratio in January 2024.

In terms of monetary policy objectives, inflation is estimated to ease closer to the upper target band at the end of 2024 and projected foreign reserves will remained sufficient to finance about 7.6 months of import in 2024.

The RBV will continue to monitor international and domestic economic developments and their likely impact on its policy settings and will make further changes as and when appropriate.