RESERVE BANK OF VANUATU

MONETARY
POLICY STATEMENT

MARCH 2025

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1. Statement by the Governor

Global growth is expected to stabilise in 2025, driven by moderate growth in both advanced economies and emerging markets and developing economies (EMDEs). In advanced economies, recovery in consumption is expected to be offset by subdued trade investment activities. Growth in EMDEs is supported by strong domestic demand in their respective economies. Global inflation and trade are expected to remain steady amidst trade policy uncertainty and tighter trade restrictions. New trade tariff policies in the US are expected to lead to further financial tightening prompting the Federal Reserve to contract monetary policy in anticipation of rising inflation. The expected tightening of monetary conditions in the US will mean rising interest rate, leading to strengthening of the USD which are expected to keep financial conditions tighter in the US. Other major central banks have eased policy rates as inflation moves towards targets.

Domestic economic activities remain steady since the September 2024 Monetary Policy Statement (MPS). Recent economic activities have been severely affected by the earthquake in December 2024, leading to the closure of the Central Business District (CBD) in Port Vila which accounts for a large part of business activity. Post-earthquake recovery efforts are anticipated to contribute largely to the positive outlook on economic prospects for 2025 and beyond. However, challenges to growth remain, from natural disasters, domestic labour market constraints, further delays in the resumption of the domestic airline services, further delays in the implementation of the capital budget and prolonged closure of Port Vila’s CBD than expected.

The Government is expected to increase fiscal borrowing in the short to medium term, to address the ongoing fiscal challenges, post-earthquake recovery measures and to accommodate the implementation of the public sector capital projects in 2025 and beyond. These are expected to be financed by both domestic and external financial sources.

In the domestic finance sector, the banking system remains highly liquid, sound, profitable and adequately capitalised on aggregate. Credit risk and persistent issues surrounding correspondent banking relationship (CBR) remain a major risk in maintaining financial stability in the short to medium term.

The Reserve Bank of Vanuatu (RBV) maintained its policy rate at 2.75 percent on the 18th of March 2025, to support economic recovery. This is in addition to the directive issued in January for a six months’ loan moratorium period for borrowers who were directly affected by the earthquake.

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 adjustments as necessary to safeguard macroeconomic stability.

MR 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. It maintains a pegged exchange rate regime as a nominal anchor for monetary stability. Monetary stability is translated as the maintenance of a low and stable domestic prices and adequate level of official foreign 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.

Since the September 2024 MPS, official foreign reserves have remained at adequate levels above the RBV's minimum threshold. In February 2025, official foreign reserves were sufficient to finance approximately 7.4 months of projected imports, driven largely by inflows related to post-earthquake recovery efforts. The outlook for 2025 is positive; the official foreign reserves are anticipated to cover around 8.3 months of imports. Annual inflation was at -0.7 percent in December 2024 quarter, below the RBV's minimum target. Domestic inflation significantly rose above the RBV's inflation target band between September 2022 and 2023, due to both global and domestic price shocks. Global price shocks reflected the prolonged impact of the geopolitical tensions and the pandemic on global food and energy prices. Domestic price shocks reflected mainly the disruption by two cyclones on domestic food supplies and increase in the domestic minimum wage. However, global inflation decelerated in 2024 from tight financial conditions, and from declining global food and energy prices owing to increased global production. In the domestic economy, the absence of supply shocks (in particular cyclones) boosted production of root crops, fruits and vegetables and triggered a decline in local food prices. Given the significant component of food prices in the Consumer Price Index (CPI) basket, its decline and the drop in energy prices were the major driver of disinflation, along with reduced prices of housing utilities, communication and drinks and tobacco.

Excess reserves remained at elevated levels and given ongoing risks to the outlook, the Reserve Bank continued in its tight monetary policy stances. It increased the Statutory Deposit Ratio (SRD) in January 2024 with limited impact on excess reserves; given the level of the increase was only marginal. Additionally, it is undertaking elevated monetary policy sterilization via open market operations (OMO) to reduce excess reserves although the impact is limited by significant monetary financing. On the other hand, official foreign reserves rose significantly towards the end of 2024; owing to inflows associated with post-earthquake recovery initiatives.

In line with these developments, and in light of the impact of the recent earthquake on business activity, the RBV Board, in its meeting on March 18th, 2025, maintained its monetary policy stance, putting it on hold since the September 2024 MPS. The RBV policy rate remained unchanged at 2.75 percent, the Statutory Reserve Deposit (SRD) ratio, 5.5 percent and the Capital Adequacy Ratio (CAR) at 12.0 percent. In January 2025, the RBV issued a directive for a six months' loan moratorium period to assist borrowers who are directly affected by the earthquake. While these decisions were aimed to support post-earthquake recovery, the RBV will ensure that its objectives of price stability, adequacy of official foreign reserves and financial sector stability are maintained in the short to medium term.

3. International Economic Developments and Outlook

Global growth[1] was estimated at 3.2 percent in 2024 slightly lower than 3.3 percent in 2023, though with regional variation and lingering uncertainty. Growth projections for both advanced and EMDEs moderated in 2024. Growth for advanced economies are projected to have been steady at 1.7 percent

[1] IMF October 2024 and January 2025 World Economic Outlook

in 2024, as a stronger US growth and a moderate growth in Euro were accompanied by slowdown in Japan. The annual growth in EMDEs is estimated at 4.2 percent in 2024, as growth projections for China and India have been slower than expected. Global growth has been constrained by heightened economic policy uncertainty, such as policy shifts under newly elected governments in 2024, political instability in some Asia and European countries, geopolitical tensions including the Middle East crises and elevated global trade tensions weakening investment, pushing up debt levels and leading to sluggish productivity growth.

Global inflation eased to 5.7 percent in 2024 (+6.7%: 2023) reflecting in part falling commodity prices, in particular oil prices (- 1.9%: 2024, -16.4%: 2023) offset by increased non-fuel prices (3.7%: 2024, -5.7%: 2023) and the lagged effects of monetary policy tightening. While, goods price inflation has decelerated, services price inflation remained elevated above the pre–COVID-19 averages in many economies, most notably the US and the Euro Area. Global trade growth recovered in 2024 by 3.7 percent (+0.7%: 2023), despite subdued manufacturing growth in few key advanced economies.

3.1 Developments in Vanuatu's main trading partners

The annual real GDP in the US, grew by 2.3 percent in the December 2024 quarter, lower than 3.1 percent in the previous quarter. Consumer spending and higher government expenditures were the main contributors to growth, offset by decreased investment. The US current account deficit further widened to USD 83.8 billion in December 2024 relative to USD 19.2 billion in December 2023. The increased deficit reflected, a surge in imports of goods and services, in particular, consumer and capital goods and, transport services; offsetting the exports of goods and services. The unemployment rate rose 4.1 percent in February 2025, relative to February 2024. Inflation rose 2.8 percent, relative to 3.2 percent in February 2024. Price increases were recorded for, all items less food and energy (+3.1%) and food (+2.6%). The offsets were the fall in prices for energy (-0.2%). The Federal Reserve Bank (Fed) maintained its policy rate at 4.5 percent, with greater confidence that inflation is moving towards the Fed's 2.0 percent targeted band.

Growth in the *Euro Area* expanded 1.2 percent, over the year to the December 2024 quarter, compared to 0.1 percent in the same quarter of the previous year. Increased household consumption (+0.4%), government expenditure (+0.4%) and gross fixed capital formation (+0.6%) were the main contributors to growth, while the offsets were the decrease in exports (-0.1%). Euro unemployment rate remained stable at 6.3 percent, over the year to December 2024. The Euro area recorded a current account surplus in the last quarter of 2024 relative to December 2023; as goods exports (EURO 715 bn), in particular of machinery and vehicles, exceeded imports of goods and services (EURO 680.8 bn). The annual inflation rate recorded 2.3 percent in February 2025, relative to February 2024. The increase in prices were recorded for; services (+1.66%), food, alcohol and tobacco (+0.52%), non-energy industrial goods (+0.14%) and energy (+0.01%). The European central bank (ECB) further reduced its three key policy rates by 25 basis points, effective from 12 March. These are deposit facility, (2.50%) main refinancing operations (2.65%), and the marginal lending facility (2.90%), as inflation is moving towards the bank's targeted inflation band.

In Australia, annual real GDP grew 1.3 percent over the year to the December 2024 quarter, due mainly to increase public and private expenditures, and exports of goods and services. Annual headline inflation eased to 2.4 percent in the December quarter, relative to 2.8 percent in the September 2024 quarter. The most rising prices were recreation and culture (+1.5%) and, alcohol and tobacco (+2.4%) while, the offsets recorded in housing prices (-0.7%) and transport (-0.7%). Australia recorded a current account deficit balance of AUD$12.5 billion in December 2024 quarter, higher than AUD$1.3 billion in December 2023 quarter. This trend reflected a rise in net primary income deficit, which partly offset net surplus in trade in goods and services. The unemployment rate remains stable at 4.1percent in February 2025, relative to 3.7 percent recorded in February 2024. The Reserve Bank of Australia (RBA) cuts interest rates by 25 basis points to 4.1 percent in February 2025. This was the first cut since the 2020 pandemic, as inflation has decelerated towards the midpoint of its inflation target band of 2-3 percent. However, upside risk to inflation remains due to its tight labour market.

In *New Zealand*, the economy rose 0.7 percent in the December 2024 quarter, after a fall of 1.1 percent in the previous quarter. Over the year, growth fell 0.5 percent in December 2024, relative to the year ended December 2023. The contributors to growth were; rental, hiring, and real estate services; retail trade and accommodation; and healthcare and social assistance. On the contrary, the offsets were, fall in construction, and information media, and telecommunications. New Zealand recorded a trade surplus in February 2025, relative to February 2024; as the increase in goods exports (+16 percent) outweighs a slower increase in goods imports (+2.1 percent). The Reserve Bank of New Zealand (RBNZ) further lower its official cash rate down to 3.75 percent in February, as inflation moved towards the bank's inflation target range of 2 percent.

The C*hinese economy* saw a robust growth of 5.4 percent over the year to December 2024 quarter, owing to the stimulus measures[2] which boosted growth. Strong expansion was recorded in; industrial production (6.2%), retail sales (3.7%) and investments, particularly, (primary industries: 2.6% and secondary industries: 12.0%). Additionally, China is beginning to pivot away from its dependence on the property sector, with the digital economy playing an increasingly significant role in economic expansion. However, challenges such as aging population and weak domestic demand remain a risk to growth. China's 2024 annual growth (+5.0%) has met the Governments annual target set at the beginning of each year. Annual inflation declined by 0.7 percent in February 2025, due to decreased prices for food (-3.3%) and non-food (-0.1%), prices for consumer goods (-0.9%) and services (-0.4%). China's urban surveyed unemployment rate remains stable at 5.4 percent, in February 2025 relative to February 2024. In terms of trade balance, China records a trade balance surplus, fuelled by surged in exports of mechanical and electrical products at 8.7 percent, accounting for 59.4 percent, of the total value of its exports.

4. Outlook for the International Economy

Global growth is expected to slow even further given the trade tensions between major advanced economies. While new tariff rates have taken toll across the US, China, Europe, Mexico and Canada; local prices in those countries are likely to pick up, forcing major central banks to re-price their perceived risks about inflation outlook. The new tariffs are likely to push up local prices and affecting household level of disposable income, with pass through of high prices so that suppliers maintain the level of margin. With major central banks holding off their current easing, the current global development is likely to translate into tighter monetary conditions in these countries. The IMF January outlook projected advanced economies to grow by 1.9 percent in 2025 and 1.8 percent in 2026 as recovery in consumption is offset by subdued investment, due to trade policy uncertainty. Growth in EMDEs is anticipated to expand by 4.2 percent for 2025 and 4.3 percent for 2026, reflecting strong domestic demand for EMDEs excluding China.

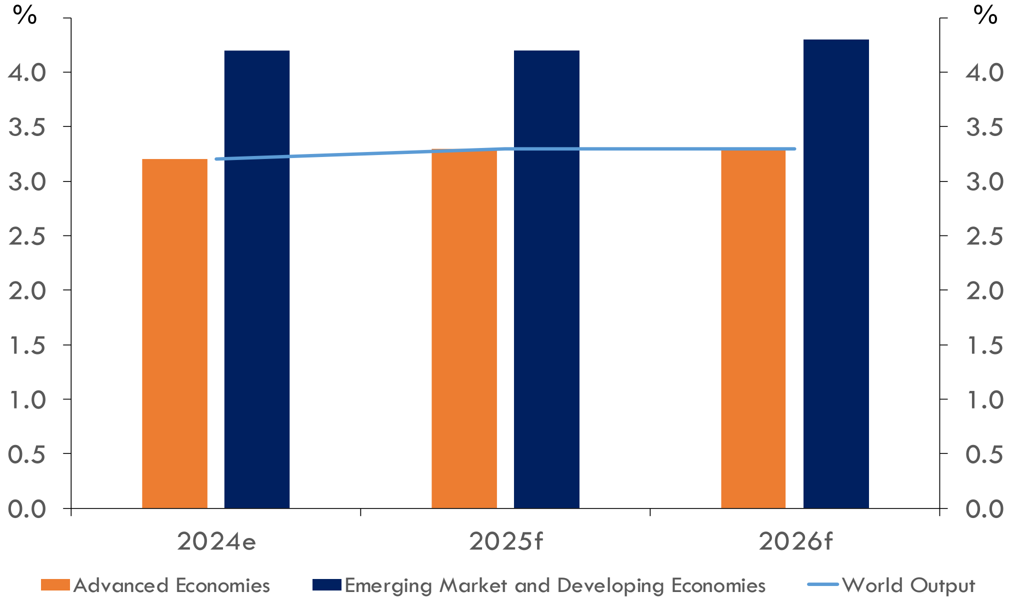
According to the IMF and the World Bank, the challenges to global growth projections remains; from heightened policy uncertainty and adverse trade policy shifts, geopolitical tensions, climate related

[2] The fiscal measures introduced in September 2024 were aimed to address slowing economic growth, a struggling property market, weak consumer confidence, and potential deflationary pressures, with a focus on boosting consumption and stabilizing key sectors.

natural disasters and policy generated disruptions to the ongoing disinflation process could interrupt the path to easing monetary policy, with implications for fiscal sustainability and financial stability.

Global inflation is projected to ease further to 4.2 percent and 3.5 percent in 2025 and 2026, respectively. Downward trend in inflation is expected to reflect the gradual cooling of the labour markets combined with the anticipated decline in energy prices, as expected headline inflation move towards central bank targets. Growth in world trade volume (goods and services) is estimated to remain steady at 3.2 percent and 3.3 percent in 2025 and 2026, respectively; owing largely to trade policy uncertainty and tighter trade restrictions expected to harm trade investment.

Figure 1: Global Economic Growth
(Annual growth in percent)



Source: International Monetary Fund, January 2025 World Economic Outlook

5. Domestic Economic Developments and Outlook

Domestic economic activities remain steady since the September 2024 MPS. The services sector, in particular tourism related services are slowly recovering from the impacts of the Air Vanuatu voluntary liquidation and recently the destruction caused by the earthquake in December 2024. Inflows via the Citizenship by Investment (CBI) program have picked up towards the second half of 2024, as due diligence processes from appropriate authorities completed; thus, added to improved Government revenue. The Government has implemented less than half of its capital budget projects in 2024, thus contributed slightly to growth in investment. The persistent domestic labour shortages from high demand for seasonal workers remain a drag on growth in all sectors of the economy.

Recent economic activities were severely affected by the earthquake in December 2024, leading to the closure of Port Vila's CBD; until the current month (March 2025). Businesses on the island of Efate, in particularly, Port Vila have been somewhat affected. Recent Business Expectation Survey (BES)[3] results indicated that businesses in all economic sectors perceived the economy to have been subdued (negative), as their business performance were weak during the current period[4]. On a net basis,

[3] The Business Expectation Survey (BES) was conducted from 17 February to 28 February 2025
[4] Current period is from October 2024 to March 2025

businesses perceived a negative overall growth performance (-2%), of which the agriculture, forestry and fisheries sector (-9%), the industry sector (-2%) and the services sector (-1%).

The spending contribution to growth gradually improved from the September 2024 MPS. Consumption, have picked up owing to recovery in the tourism sector, increased remittances, increased export earnings, earthquake relief packages and increased contribution of Non-Profit Institution Serving Households (NPISH). Similar recent indicators pointed to improved investment and exports and reduction in imports.

5.1. Economic activities by production

Since the *September 2024 MPS*, the Macroeconomic Committee maintained its growth estimate for the agriculture, forestry and fisheries sector at 2.3 percent in 2024.

Recent partial indicators, and the BES findings indicated slow growth in this sector. Production of Vanuatu's major tradeable commodities rose in the September 2024 quarter relative to the same period a year ago, except coffee. Copra and cocoa production rose significantly by 27.6 percent and 86.2 percent owing to favourable weather conditions and from rise in domestic producers' price per tonne. Cattle production, represented by the total number of cattle slaughtered surged 2.8 percent; similarly, the average carcasses weight per kilo increased by 6.1 percent. Kava exports strengthened significantly by 52.0 percent, implying favourable external demand for Vanuatu kava. In contrast, coffee exports contracted 17.8 percent indicating inadequate domestic coffee production, despite an increase of 23.8 in the annual average price of coffee in 2024. Recent proxy indicators from commercial banks data shows that lending to the fisheries sector expanded (+97.9%), while lending to other two sectors agriculture and forestry contracted by 3.4 percent and 16.9 percent.

The closure of Port Vila's CBD had a significant impact on crop and animal production. A few businesses within the accommodation and food services sector located in the CBD have remained closed and factory machines and equipment (beef and fish production) were damaged by the earthquake. The BES findings indicated that during the period from October 2024 to March 2025, businesses sentiment within the agriculture, forestry and fisheries sectors perceived weak growth in income, and lower net sales (-20%) relative to the past six months. Business within this sector reported stagnant growth in profitability, employment level and capital investment.

The industry sector is expected to have grown 2.2 percent in 2024. Growth continued to be driven by ongoing infrastructure projects such as the Vanuatu Climate Resilient Transport Projects (VCRTP), Pentecost, Ambae and Tanna Road projects, the Vanuatu Inter-Islands Shipping Support Projects (South Paray Wharf), the Vanuatu Energy Access Projects (extension of electricity grid in Santo), the Sarakata hydro power extension, Norsup Airport extension projects, Teouma bridge construction and the Luganville Urban Road projects.

Simultaneously, the spill-over effects associated with the ongoing construction of public infrastructure projects have spurred growth in other subsectors, in the mining and quarrying, electricity and water and private sector construction.

BES findings showed that businesses within the construction sector have recorded increased demand for construction activities for post-earthquake recovery and from the private sector, majority by seasonal workers. Other partial indicators have indicated positive trend. Imports of cement rose by a significant 43.5 percent in the September 2024 quarter compared to the same quarter in 2023. Commercial banks' lending to the construction sector grew by 40.0 percent and 24.5 percent, each; over the year to January 2025. The mining and quarrying sector saw an annual reduction (-5.8%) in credit.

Energy consumption a partial indicator for electricity consumption (public utilities sector) rose by 10.5 percent in the September 2024 quarter relative to the same quarter of 2023. Annual increase in energy consumption were recorded for Port Vila (+11.2%), Luganville (+10.5%) and Malekula (+12.1%). Tanna in contrast recorded a decline (-9.7%). This is in line with the annual increase (+24.5%) in lending to the public utilities sector by banks in January 2025.

Activities in the manufacturing sector have slowly expanded reflecting increased in domestic demand and the recovery in tourist arrivals. BES findings have shown that businesses closed immediately after the earthquake until the end of 2024, due to damaged machineries and equipment. However, businesses have fully recovered and operated on full capacity a month after the earthquake. Few businesses are now focusing on production for export (in particular alcoholic and non-alcoholic beverages). The proxy indicator, from commercial banks' lending shows that credit to the manufacturing sector rose by 9.9 percent over the year to January 2025.

Growth in the services sector was projected at 3.0 percent in 2024. Since the September 2024 MPS, this sector, in particular tourism related services, such as transport and accommodation and food services are slowly recovering from the voluntary liquidation of Air Vanuatu in May 2024.Though the impact on domestic airline route still remains. The closure of the CBD in December 2024, further aggravated the recovery progress. Other services sub-sectors are expected to have continue to perform.

Total visitors' arrivals for 2024 contracted by 27.8 percent relative to 2023. Both air arrivals and day visitors declined by 23.3 percent and 29.2 percent, respectively. Since the liquidation until December 2024, seven international carriers (Fiji Airways (7 days a week), Virgin Australia (5-7 days), Solomon Airlines (5 days), Air Niugini (1 flight per week), Qantas (3 times a week) and Air Caledonia (2 times a week) and Jet star (4 times per week)) are currently providing weekly services to Port Vila, of which one airline has extended its international services to Santo. The closure of the CBD affected mainly cruise ship/day visitors' arrivals; air arrivals have recovered in the first two months of 2025. Air arrivals increased 23.1 percent for the year to February 2025, compared to the same period in 2024. In contrast, the number of cruise ship arrivals have declined significantly (-78.1%) in the first two months of 2025, relative to the same period of last year. Overall, the number of visitor arrivals were still down (-68%) for the year to February 2025, relative to the level recorded for the year to February 2024.

The BES findings indicated steady growth in retail and wholesale trade as majority of businesses were relocated from the CBD. Motor vehicle retail trade was slow, reflected by a decline in imports of motor vehicle transport 41.8 percent in the September 2024 quarter, relative to September 2023 quarter.

There is a high demand for professional, technical and scientific services in particular engineers and insurance technicians; to assist in post-earthquake impact assessment and related disaster response efforts, though on a net basis a steady growth was reported.

The Information and communication sub-sector have expanded due to the addition of star link network in late December 2024. Postal services in terms of domestic mails have increased (+15.3%) in the September 2024 quarter, compared to the same period of the previous year. However, overall postal services were down (-8.8%) in 2024, relative to September 2023 quarter, attributed mainly by the decline in inbound (-5.7%) and outbound (-18.2%) international mails, relative to September 2023 quarter.

On a net basis majority of businesses who participated in the BES have indicated steady growth in finance and insurance sub-sector in the current period. Recent developments include; increased private sector credit, earthquake relief packages provided by commercial banks to their customers; inflow of insurance from the Pacific Catastrophe Risk Insurance Company (PCRIC) in December 2024.Services provided by this subsector continued as businesses have relocated outside of the CBD. Few financial institutions have encountered loss in revenue from uncollected rents as properties are either demolished or closed

Real estate businesses have reported improvement in business performance compared to the past six months. The BES findings reported more new subdivision for residential and commercial leases in suburban and rural areas. Furthermore, relevant authorities have confirmed high property sales, in particular transfer of leases for both commercial and residential land.

Crude indicators of credit from commercial banks have been mixed for the year to January 2025. Expansion in credit were noted for the following services sector; transport sector (+46.3%) and professional & other services (+33.1%). While the following sectors recorded decline in credit; tourism (-18.5%), communication (-99%) and entertainment & catering (-15.7%). The level of credit extended to the distribution (wholesale & retail) remain virtually unchanged as previous year's level.

5.2. Economic activity- by expenditure

Since the September MPS, the contribution of spending growth gradually improved, owing to increased consumption, investments, exports and reduction in imports.

Partial indicators of domestic consumption indicated gradual growth in 2024 relative to 2023; Value Added Tax (VAT) collections - a very closed proxy for overall consumption rose 2.3 percent for the year to December 2024. Government consumption, represented by compensation of employers rose 11.3 percent for the year to December 2024, though use of goods and services declined by 1.7 percent. Majority of the proxy indicators for private consumption has also risen relative to previous year's level. Businesses in Port Vila reported positive net sales of their goods and services in the current period. Credit to other resident sector (personal loans) rose by 17.3 percent over the year to January 2025.Post earthquake relief assistance provided to households by their respective employers and Non-profit Institution Serving Households (NPISH) have further boost domestic consumption in recent months.

Growth in Government investment is in line with the trend in public infrastructure projects (abovementioned under industry sector). Recent proxies of private sector investment revealed increasing trend relative to previous year's level. Business who participated in the BES revealed a net expansion (+22%) in capital investment in the current period, despite damaged to durable equipment caused by the earthquake. From the banking sector, lending to businesses grew 8.3 percent over the year to January 2025. Household and land purchases a partial indicator of household investment remained weak (-3.3%) over the year to January 2025.

Latest crude indicators of durable equipment have shown upward trends. Imports of machineries and transport equipment also rose 4.0 percent for the year to the September 2024 quarter. While private motor vehicle registration in Port Vila and Luganville went up 12.5 percent during the September 2024 quarter relative to same quarter of the previous year.

Exports of goods recorded an annual growth of 49.9 percent in the September 2024 quarter. Increased earnings were recorded for cocoa (+590.1%), kava (+52.0%), sawn timber (+67.4%), coconut meal (+61.4%). The offsets were copra (-63.8%), coconut oil (-22.3%), beef (-48.6%) and coffee (-17.8%).

On a net basis business who participated in the BES indicated positive trends in exports of goods during the current period. Exports from the agriculture, forestry and fisheries sector are in line with the upward trend in exports of tradeable goods, already mentioned. Exports from the manufacturing sector are mainly alcoholic drinks and other value-added food and spices products. Recent indicators showed that exports of services, in particular visitor arrivals increased by 58.5 percent in February 2025 relative to February 2024.

The latest data shows an annual reduction in goods imports value by 1.7 percent in the September 2024 quarter. Similarly, imports of services is estimated to have declined (-16%), attributed to less payments via travel, telecommunications and business sectors abroad. However, businesses who participated in the BES have revealed surge in imports of goods and services payments. Despite reduction in imports of goods and services and improved exports, the overall current balance remains in deficit during the September 2024 quarter.

5.3. Fiscal developments

The Government recorded a net operating surplus of VT2,459.7 million for the year to December 2024. However, after netting out VT4,497.0 million in net acquisition of non-financial assets resulted in the recurrent fiscal deficit of VT2,037.5 million (-2.8% of GDP) for the year to December 2024, relative to a deficit of VT2,141.1 million (-3.0% of GDP) in 2023. The Government resorted to domestic borrowing[5] to finance these deficits. All major revenue items have performed and exceeded 50 percent of their 2024 budget target. Value Added Tax (VAT) reached 67.7 percent of its budget target; excise (98.4 percent); taxes on international trade and transaction (88.8 percent) and the honorary Citizenship Program (85.6 percent). Budget support also exceeded its annual budget target of VT182 million to record VT 1,289.4 million. All expenditure categories are within their 2024 budget targets, except interest rates, special and acting allowances and other expenses have exceeded their budget targets. However, the government's capital expenditures have increased by 48 percent to reach VT4,497.0 million; but this was only about 26 percent of the total planned capital expenditure (worth VT17,062.8 million) for 2024. It is also worth noting that the government has reallocate part of the planned capital budget to finance fiscal challenges faced throughout the year, such as; the voluntary liquidation of Air Vanuatu and outstanding claims of the Vanuatu Teachers Union members.

Donor inflows via grants have exceeded its 2024 budget target (106 .6%); reflecting mainly the inflow of funds for immediate recovery after the devastating effects of the earthquake in December 2024. In terms of fiscal financing, the Government issued VT4,928.6 million worth of domestic bonds and repaid VT1,046.0 million. Furthermore, it repaid VT1,461.4 million worth of external loans at the end of December 2024. The outstanding level of Government bonds (domestic) reached VT16,592.5 million at the end of February 2025.

5.4. Monetary and Financial developments

The annual growth in money supply surged 9.6 percent for the year to December 2024. Money growth was attributed to strong increases in both net foreign assets (NFA) (+8.2%) and domestic credit (+13.7%). The upward trend in NFA reflected, in particular, inflows of disaster related funds. Both net credit to the Government and private sector attributed to the growth in domestic credit. The increase or deterioration in the Governments net credit position reflected the ongoing fiscal challenges encountered by the Government during the year. This has led the Government to continue to withdraw its deposits with both the commercial bank and the RBV and resort to overdraft financing with the RBV. Growth in private sector credit grew strongly by 7.6 percent, owing to pick up in private investment and consumption amidst the recovery in the economy.

Reserve money recorded a year-on-year growth of 2.9 percent to VT58,459.4 million in January 2025, owing to increases in currency in circulation (CIC) (+16.1%) and Statutory Reserve Deposits (SRD), (+6.9%). Excess reserves though were reduced by 2.4 percent year-on-year, the level remained high at VT32,683.0 million.

[5] Domestic borrowing via issuing of Government bonds and resorting to overdraft financing at the RBV

The banking sector is adequately capitalized as the overall Capital Adequacy Ratio (CAR) recorded 23.3 percent over the year to December (24.1%:2023) above the minimum CAR of 12 percent. The downside risks to the banks' capital included high non-performing loans (NPL), losses and high risk weighted assets. Underlying profits (before tax and provisions) recorded VT1.2 billion during the final quarter of 2024, higher by 43.2 percent in the same quarter of 2023. Net income (after tax and provisions) decreased by 16.9 percent over the year to record VT505.6 million at the end of December 2024. The annual growth in provisioning expense picked up significantly by 349.6 percent to VT688.1 million in the December 2024 quarter. The upward trend was attributed to increasing NPLs, as banks efforts to safeguard against anticipated credit risks/defaults following the aftermath of the earthquake. Private sector credit is picking up, though high concentration (56.2 percent) is for personal sector.

In general, NPLs decreased by 16.5 percent to VT12.8 billion (VT15.3 billion: Dec-23), though increases were still noted in higher risk categories (doubtful and loss loans). The share of NPL to total loans decreased to 14.8% (19.6%: Dec-23). Specific provisions increased by 1.7 percent over the year to the December 2024 quarter: to VT3.1 billion. This reflected increases in the high risks loans categories, whilst general provisions increased 12.6 percent to VT3.2 billion, owing to anticipated increase in credit impairments.

Total industry's liquidity is maintained at adequate levels, however continues to be unevenly distributed. On the 4th of March 2025, total liquid assets holdings stood at VT43.9 billion, compared to VT46.3 billion over the same period last year. The Liquid Asset Ratio (LAR) is positioned as at 48.6 percent at 4th March 2025, (53.3% Mar-23), which is well above the minimum regulatory threshold of 5.0 percent.

5.5. Domestic price development

Annual deflation was registered for two consecutive quarters in 2024; in the September 2024 quarter (-1.5%) and the December 2024 quarter (-0.7%). The deceleration in prices follows the improved global financial conditions supported by appropriate monetary policy intervention locally. Inflation has exceeded the RBV's upper target range throughout 2023, thus triggered the average annual inflation to rise to 11.3 percent, from 6.7 percent in 2022. Relative to the September 2024 MPS, inflation has receded from the high peaks in 2023; as global financial conditions have eased, global disinflation continued, annual average international commodity prices have declined by 2.7 percent in 2024, and the easing of inflation of Vanuatu's main trading partners (Australia and New Zealand). Domestically, in the absence of shocks in 2024 combined with the tightening monetary policy environment has strengthened the value of the vatu on average against AUD and NZD led to cheaper imports from these countries. These attributed largely to the deflation over the second half of 2024.

According to the Vanuatu Bureau of Statistics (VBOS), deflation in the December 2024 quarter was more pronounced in Port Vila with its index falling (-1.4%), offset by rises in price indexes in Luganville and Lenakel by 1.6 percent and 3.1 percent, respectively. The following expenditure categories contributed to the deflation during the December 2024 quarter; food (-1.6 percent), alcoholic drinks and tobacco (-0.6%), housing utilities (-3.3%), and communication (-9.4%). Majority of the falling prices were driven by downward price movements of fruits and vegetables, wines and spirits, electricity, and water supply charges. The underlying annual inflation declined by 1.2 percent in December 2024 quarter. The findings of the BES also support these trends, a majority (51%) of businesses indicated to have maintained their prices in the current period and 38 percent recorded a small increase. The remaining 10 percent of businesses indicated small to large increase in prices.

5.6. External conditions and official reserves

Vanuatu's current account balance (CAB) has further deteriorated in 2024 by -VT14.5 billion (-VT1.5 billion: 2023). This worsening balance reflected the deterioration in balance on trade in services, following the voluntary liquidation of the national airline in May 2024, down from the improved growth in 2023, following the reopening of international borders. The trade in goods balance recorded a lesser deficit compared to 2023, reflecting easing global inflation and lower energy and non- energy price indices. Both the income accounts have slowed in 2024 relative to 2023. The primary income balance further improved reflecting increased investment income placed abroad and stable growth compensation of employees (COE). The secondary income balance has improved reflecting higher Government transfers.

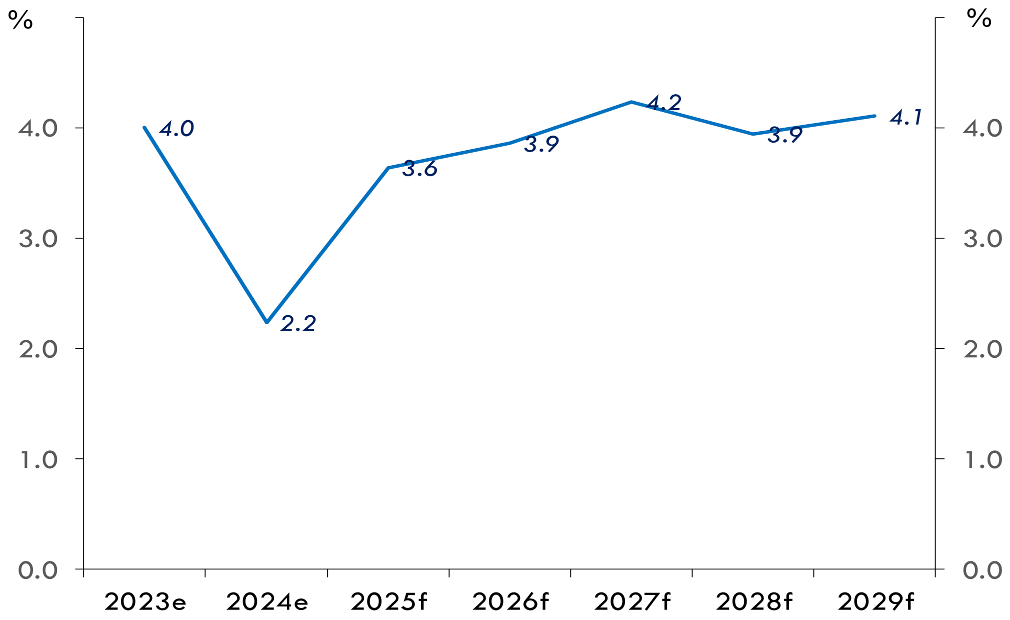
Official foreign reserves are estimated at VT75.5 billion in February 2025 (VT72.6 billion: Jan 2025). Majority of the inflows are related to post disaster recovery funds. The level of the current foreign reserves is estimated to cover at least 7.4 months of projected imports, above the Reserve Bank's minimum threshold of 4.0 months.

Since the September 2024 *MPS*, Central Banks of Vanuatu's main trading partners have either kept or cut interest rates as inflation is moving towards their respective targets. During the first three months of 2025, the US Federal Reserve Bank have kept interest on hold, while the European Central Bank and Reserve Bank of Australia and the Reserve Bank of New Zealand have adopted accommodative policy stances through interest rates cuts (refer to international developments abovementioned). Most economic fundamentals and those of Vanuatu's main trading partners have greatly influenced the movement of Vanuatu's Vatu in 2024. In February 2025, the Vatu continue its trend by appreciating against the USD, NZD and EURO; while depreciating against the AUD. On average, the Vatu strengthened against the USD by 0.8 percent and weakened against the AUD by 0.3 percent.

6. Outlook for the Domestic Economy

Post-earthquake recovery efforts are already underway with anticipation to contribute largely to the positive outlook on economic prospects for 2025 and beyond. The Macro-Economic Committee (MEC) during its meeting in March maintains its 2025 growth forecast at 3.6 percent as previous forecast (January 2025) and 3.9 percent for 2026. The main assumptions attributing to this forecast are; increasing post-earthquake reconstruction efforts to start later this year, the opening of the CBD in the second quarter, the Government stimulus package to be rolled out in the second quarter, large inflows anticipated from bilateral and multilateral development partners for reconstruction efforts and the realisation of the Government capital projects this year. Similarly, business who participated in the BES have expressed stronger growth of 4 percent in their business performance in the second quarter of 2025; of which net positive growths indicated for the industry (+4%) and Services (+5%) sectors, outweighing net negative growth for the agriculture, forestry and fisheries sector (-4%). These recovery efforts are expected to drive stronger domestic demand which will generally lead to higher imports.

Figure 2: Domestic GDP Growth Forecast
(Annual growth in percent)



Source: Vanuatu Bureau of Statistics, Macroeconomic Committee Forecast- March 2025

6.1. Economic Outlook- by production

Growth outlook for the agriculture, forestry and fisheries sector is positive at 2.4 percent in 2025 and 3.1 percent in 2026. On average this sector is expected to expand by 3.3 percent over the medium term. All subsectors have projected slow growths. On a net basis business who have participated in the BES indicated stable growth.

The current favourable performance in crop production and tradeable commodities is projected to continue in 2025, against a backdrop of favourable weather conditions, increased domestic prices for green copra[6]and increasing global demand. The offsets are; the implementation of kava export levy tax and further reduction in global agriculture commodity prices for 2025. Production of local root crops, fruits and vegetables are expected remain stable due to relocation of businesses in the accommodation and food services sector. Overall, the vulnerability of this sector to natural disaster and the persistent domestic labour constraint is an ongoing risk to outlook.

Animal production is expected to moderate, though recent indicators pointed to a positive trend in beef production, the supply to the domestic market is expected to be slower this year owing to damage of storage facilities in the abattoir on Efate. Higher freight charges on international carriers remain a great concern for beef exporters. Similarly, poultry production is expected to slow due to extensive damage to the farm infrastructure which reduces domestic supply of poultry products. The other contributing factor includes the competitive environment with cheaper imported poultry products. Domestic supply of beef and poultry is expected to be steady as majority of businesses within the accommodation and food services sector have relocated outside of the CBD.

Growth in the forestry and fisheries sector are anticipated to remain weak. For forestry, logs bound for exports in 2025 were harvested during the past year. Commercial fishing is affected due to the

[6] Vanuatu Copra and Cocoa Exports (VCCE) 18VT/Kg (2024) to VT25/Kg (2025); Vanuatu Basket 12VT/Kg (2024), VT18/kg (2025)

extensive damage done on the factory's infrastructure. Subsistence fishing is expected to remain the same as last year's level.

The industry sector is expected to expand by 8.9 percent in 2025 and 8.3 percent in 2026. An average growth of 5.0 percent is anticipated over the medium term. The major drivers are the implementation of the Government's capital projects planned for this year, including other projects such as the ADB evacuation centres and the renovation and reconstruction of damaged and demolished Government and private sector buildings in the CBD. The boost in construction activities is expected to have spill-over effects to other subsectors such as mining and quarrying and water and electricity sectors and private sector construction. In addition to recovery efforts, the BES findings indicated a positive outlook for private sector construction due to high demand, in particular from seasonal workers. Prospects for the manufacturing sector are also favourable, due to relocation of handicraft markets and a positive outlook for exports of alcoholic beverages and value-added products to meet increasing international demand.

The growth prospects for the services sector is positive with 3.9 percent for 2025 and 3.7 percent, for 2026. An annual average growth of 4.1 percent is expected over the medium term. Each subsector performance looks positive though slow. The relocation of business towards the end of 2024, reopening of the CBD during the second quarter, recovery in tourist numbers this year is anticipated to boost growth performance in the services sector, in particular tourist related services such as accommodation and food services, transport, wholesale and retail and information and telecommunication sectors. Furthermore, the introduction of star link network in late 2024 is expected to broaden the coverage of telecommunication services going forward while the restriction in bus permits on Efate since 2021 is expected to slow motor vehicle sales.

Professional, Scientific, Technical and Administrative Services sector is expected to increase due to high demand for these services, in particularly engineers and architects, geoscientists to support the post-earthquake recovery efforts.

Finance and insurance sector is projected to continue to expand in 2025 in line with recovery efforts, in particular the Government banking facility recovery package expected to be implemented in the second quarter of 2025.

The real estate sector is expected to continue to increase in 2025; due to number of new subdivisions and increasing demand for land by both locals, of which majority are seasonal workers and non-residents.

6.2. Economic outlook- by expenditure

Based on recent developments consumption and investment will drive economic activities in 2025. Though offset by stronger imports for post-recovery efforts, a leakage in growth.

Household consumption is anticipated to further increase in 2025 in line with the Government fiscal stimulus, the roll out of the Government Remuneration Tribunal (GRT), continuous inflows of remittances (seasonal workers abroad), expected hiring of workers when reconstructions begin and payout associated with teachers' claims. Government consumption is expected to increase following the increase in Government budget in 2025. The increase relief supplies by NPISH will continue to support the livelihood of communities, maintaining consumption growth in the next nine months.

For 2025, investment is projected to rise further owing to the reconstruction of Government and private sector buildings and implementation of the Government capital budget planned for this year. Durable equipment is expected to expand in line with the net change in stock (more reconstruction and replacement than demolition) for manufacturing businesses and all damaged buildings in the CBD.

Exports of goods is expected to grow at a steady rate in 2025, reflecting current favourable weather conditions that boost production of tradeable goods and increasing international demand. Similarly, majority of business in the industry and the agriculture anticipated increased exports in the nine months ahead. The industry sector (mainly manufacturing) expected robust net increase (83%) in exports, agriculture forestry and fisheries sector (+17%). Exports of services is in line with the recovery in t air arrivals expected this year.

Imports of construction materials are expected to heightened to accommodate for post recovery efforts. The BES results also indicated that on a net basis, businesses expected an increasing trend in imports, in particular the industry sector, (+47%), services sector (+59%), agriculture, forestry and fisheries sector anticipated a net reduction in imports (-6%) in the subsequent nine months. Imports of services is expected to increase in line with technicians/technical expertise to assist with post-earthquake recovery measures. These developments are expected to worsen the negative trade in goods balance over the next nine months.

6.3. Risks to the growth outlook

The downside risk to the growth outlook are; increase frequency of natural disasters, persistent domestic labour constraint, CBD remains closed for longer than expected, delays to capital budget implementations, diversion of capital budget to fund other areas and further delay in resumption of domestic airline route network. The upside risk to growth is for tourism recovery to be quicker than expected.

6.4. Fiscal outlook

The Government is expected to increase its borrowing in the short to medium term, to address the ongoing fiscal challenges, post-earthquake recovery measures and to accommodate the implementation of the public sector capital projects in 2025 and beyond.

6.5. Monetary and financial outlook

Money growth is projected to be driven by both NFA and domestic credit in 2025. Domestic credit is expected to moderate, since inflows as Government transfers is expected to counterbalance the anticipated increase in domestic borrowing. Furthermore, growth in private sector credit is expected to be modest this year. Growth in net foreign assets is projected to moderate in 2025; as huge inflows is anticipated for the post-earthquake recovery will be offset by high imports payments for construction materials. The RBV will continue to monitor growth in money supply and implement appropriate policy measures to ensure money growth remains sustainable.

The domestic banking sector is expected to remain sound, profitable and adequately capitalised in the short to medium term though individual banks face ongoing challenges. The deterioration in asset quality is anticipated to improve as the economic environment continues to recover. Furthermore, the full impact of COVID-19 related pandemic on asset quality is yet to be determined.

While stability is expected to continue in short to medium term, downside risks remain such as increasing NPLs as well as slower than expected recovery in the tourism sector. Overall, credit risk remains the major risk on the asset side of the bank's balance sheet. The persistent issues surrounding correspondent banking relationship (CBR) remains a major concern in maintaining financial stability in the short to medium term.

6.6. Inflation outlook

Based on current development Vanuatu's headline inflation is forecasted to rise above the zero (0) percent bench mark in the next two quarters but will remain within the RBV target band of 0-4 percent throughout 2025. The main assumptions behind these forecasts are: i) *steady increase in food prices:* reflecting projected decline in global food prices by 5.0 percent in 2025[7], local prices remain volatile reflecting seasonality of crops; ii) *stable prices in drinks and tobacco*: reflecting recovery of domestic production and local supply of local alcoholic and non-alcoholic beverages; declining global non energy prices; iii) *increasing housing utilities prices:* reflecting high rental prices due to high demand for accommodation following the destruction of earthquake on private and Government buildings in the CBD, the offset is declining global energy prices and iv) *transport prices to remain high:* reflecting high international shipping and freight costs, air fares remain high, though shipping fees are expected to remain stable; the offsets are declining global energy prices, and the reduction in domestic fuel to continue. The average fuel price decreased by 7.4 percent in the March 2025 quarter relative to the same period of 2024. Tropical cyclones, the intensification of the war in middle East and the European conflicts, have led to high shipment costs; which remain major upside risks to the forecasts.

Overall, the Vanuatu's exchange rate regime continues to act as a nominal anchor for domestic inflation. Inflation in major trading partners have weakened in 2024 and will continue to ease towards their respective target band this year. Keeping other factors constant, imported inflation is expected to follow the same trend.

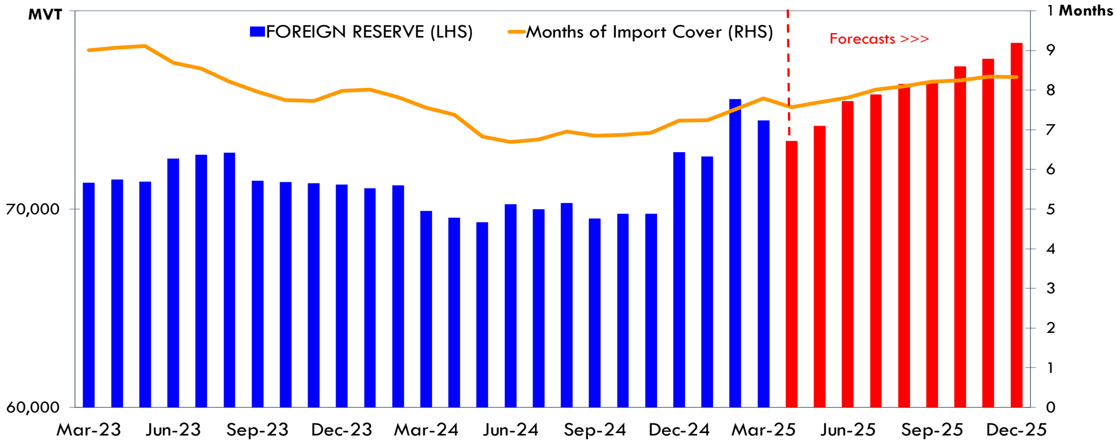
6.9. External conditions and official reserves outlook

The current account balance (CAB) is projected to worsen (-VT7.8 billion) in 2025, though a slight improvement from 2024. The key driver is the anticipated improvement in trade in services balance, driven by the recovery in air arrivals; trade in goods balance is expected to worsen due to higher imports estimated for post recovery construction materials. The secondary income balance is expected to surge in 2025 owing to inflows of funds via post-earthquake recovery and public infrastructure projects, including, non-life insurance claims. The primary income balance is expected to remain stable in 2025, reflecting stable or easing global interest rates on investments, supported with high demand for seasonal workers abroad.

Inflows via post-earthquake recovery initiatives and remittances are expected to sustain the level of foreign reserves in 2025. Based on latest developments the level of foreign reserves is expected to reach VT78.3 billion at the end of 2025 and would be adequate to finance approximately 8.3 months of imports. The down side risks to this outlook include higher payments of Governments obligation abroad and higher import payments if recovery process fast tracks this year.

[7] World Bank Global Economic Prospects January 2025

Figure 3: Foreign Reserves and Months of Import Cover
(Levels, monthly data)



Source: Reserve Bank of Vanuatu

Since the September 2024 MPS, global financial conditions have remained largely accommodative; however, the ongoing geopolitical tensions, trade wars, and growing recession fears, may led to a weaker USD, relative to the major foreign currencies this year. With these developments, the Vatu is forecasted to strengthen against the USD and weaken relative to the Euro, NZD, AUD from the second quarter of 2025 to the first quarter of 2026[8].

With all else held constant, the appreciation in the relative value of Euro, NZD and AUD against the Vatu, would imply that import payments denominated in these currencies would be expensive, higher external debt repayments denominated in these currencies thus broaden trade balance deficit. The offsets are improved/favorable export earnings and higher investment earnings denominated in these currencies.

With all else held constant, the expected depreciation of the USD relative to the Vatu, would imply that imports denominated in USD would be cheaper, thus would be translated to ease domestic price pressures, external debt repayments denominated in USD are expected to be lower. However, tourism earnings, remittances and income received from investment in USD will be low.

7. Monetary Policy Stance

Since the September 2024 *MPS*, domestic inflation has eased substantially, falling below the RBV's lower target band of 0 percent during the September and December quarters. However, it is expected to return within the target levels in the June 2025 quarter. Keeping other factors constant, the ongoing elevated level of excess reserves remains a risk due to the recent pick up in private sector credit, and the ceasing of the loan moratorium for Banks in June. Official foreign reserves improved recently after having exhibited declining trends over the past year, reflecting high cost of imports. Inflows for post-earthquake recovery initiatives is a key driver to increase in official foreign reserves. However, challenges remain if the reconstruction process experience quicker turnaround; running down the level of reserves than initially anticipated. Ongoing fiscal challenges remain a risk to both inflation and official foreign reserves. The domestic financial sector is sound, profitable and adequately capitalised

[8] Source: Financial Markets Department (using Bloomberg Composite forecast as of the 9th April 2025)

though respective banks faces internal challenges. Similarly, the outlook is positive, though persistent accumulation of NPLs and CBR issues remains a challenge in the short to medium term.

With the abovementioned developments, the RBV Board of Directors noted that inflation will revert to the inflation target band at the end of 2025. Similarly, official foreign reserves will remain adequate until the end of 2025. The Board acknowledged the impact of the recent earthquake on monetary policy and financial sector stability, thus judged that maintaining the neutral monetary policy stance is appropriate to assist domestic economic recovery.

During its meeting on the 18th of March 2025, the Board agreed to maintain the current monetary policy stance, by maintaining the RBV rediscount/policy interest rates at 2.75 percent, the Statutory Reserve Deposit ratio at 5.50 percent, the Capital Adequacy Ratio at 12 percent and to continue with its open market sale; as in the September 2024 MPS.

The Board noted that the RBV will continue to monitor international and domestic economic developments and make necessary policy adjustments wherever appropriate.