1. WORLD ECONOMIC DEVELOPMENTS

Following the strong performance at the beginning of the year, the pace of global economic recovery lost momentum in the second half of 2002. The threat of a war with Iraq and further declines in the global financial markets, especially a sharp fall in equity prices, declining bond yields and further declines in the value of the US dollar have contributed to this slowdown. Economic performances in most of the major economies were weaker than expected. In the US and the Euro Area, the Federal Reserve and the European Central Bank eased monetary policy towards the end of 2002 as inflation pressures were loosing momentum and the downside risks to economic growth failed disappear. However, unlike the developments in the major economies, some smaller economies, especially countries in parts of East Asia, New Zealand and Australia, have registered strong economic growths. According to IMF projections, the world GDP grew by 2.8 percent in 2002.

Real GDP in the United States, according to advanced estimates, has expanded by annual rate of 0.75 percent in 2002. Ensuing a strong third quarter performance, economic growth, as measured by GDP in constant price, decelerated in the fourth quarter of 2002 due to the decline in motor vehicles production from the level reached in the third quarter when low financing rates and other incentives boosted motor vehicle sales. Despite this, private consumption has remained resilient and has, however, been a strong source of growth in the fourth quarter in tune with the federal funds rate cut by 50 basis points in November.

Economic growth in the euro area continued on the upward trend but at a very slow pace. According to preliminary data, the euro zone grew at a rate of 0.8 percent from last year. Private consumptions, as well as a sharp rise in exports, are the main driving forces behind the economic growth in 2002. Early in December, the European Central Bank lowered its minimum bid rate by 50 basis points to 2.75 percent.

The Japanese economy continued to grow in the fourth quarter of 2002 to register a growth of 0.5 percent over the previous quarter. Year-on-year growth recorded 2.0 percent. The export sector continued to rise at a modest pace. Domestic demand, on the other hand, faired well than expected to continuously boost industrial production.

Developing countries, as a group, have performed well in 2002, particularly those countries in East Asia whose performances were better than expectations. The bulk of the growth for these countries was attributable to domestic consumption, while in some others growth was driven by the export sector. On the other hand, countries in Latin America have performed less well than expectations. The economic and financial conditions in many of these countries have remained fragile.

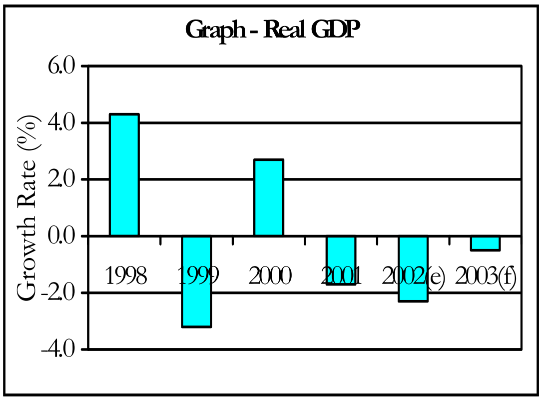
In the region, the Australian economy continues to expand despite the continued weakening of the global economic growth towards the end of year. Associated with the widening of the country's current account deficit, robust growth in domestic demand continued to drive economic growth. With this expansion, the labour market has strengthened causing the unemployment rate to decline significantly. These positive developments have also resulted in relatively high profitability in the business sector. The outlook for the economy in 2003 on aggregate remains positive, but the pace of growth is expected to be slower than in 2002.

As in Australia, the slowdown in the global economic conditions has not impacted much on the New Zealand economy. The economy grew at a good pace, benefiting from strong domestic demand and a rise in export earnings over the preceding two years. In 2003, the economy is forecasted to grow at around 3.0 percent.

2. DOMESTIC ECONOMIC REVIEW

Turning to the domestic front, real economic growth in 2002 was fairly flat. According to estimates, the economy grew by negative 0.3 percent during the year. This development contrasted a negative growth of 2.7 percent recorded in 2001.

Chart 1. Real GDP



Economic activities in 2002 were characterized by slight increases in the agriculture and industry sectors, despite the decline in the services sector. Within the agriculture sector, productions of copra, cocoa and kava have increased with the production of the latter still retaining sharp momentum for the third successive year in 2002. Beef production, on the other hand, registered a decline. In the tourism sector, the total number of visitor arrivals fell.

The annual inflation rate for the year was 2.3 percent as in the previous year. The main expenditure groups contributing to this increase were drinks and tobacco, recreation and transport, particularly air and sea transports.

The external position of Vanuatu deteriorated further in 2002, in reflection of the widening current account deficit. The persisting deficit in the current account resulted from contractions across all accounts, saving income. Trade deficit during the year narrowed by 5.4 percent following a fall in imports. The decline in the services account was partly affected by a fall in inward travel. In the financial account, a surplus was recorded, reflecting an increase in foreign direct investment activities, especially reinvested earnings and other capital injections for the maintenance of existing foreign enterprises. Reflecting the continued deterioration in Vanuatu's external position, the net official reserves registered an outflow of around VT676.9 million.

The government continued to operate a budget deficit in 2002. The deficit which amounted to VT641.8 million was an improvement compared to a huge VT1,254 million deficit achieved in 2001. This improvement from last year was attributed to lower expenditures, mainly development expenditures. In line with the deficit, total outstanding debt rose to VT13.0 billion, of which, 23.9 percent is domestic debt. Domestic debt rose by VT546.2 million from last year, whereas the external debt declined by 2.3 percent.

After it increased last year, total money supply (M4) contracted by 1.7 percent in 2002. This decline was reflected in the fall in NFA by 6.0 percent. Domestic credit, on the other hand, rose by 11.9 percent. The monetary authorities and commercial banks both contributed to the fall in NFA, with declines of 12.5 percent and 4.3 percent, respectively. The increase in domestic credit resulted from the expansion of credit to non-financial public enterprises (NFPE), private sector and net credit to the government.

Developments in interest rates in 2002 have resulted in a narrowing of the spread between the weighted average interest rates for bank loans and the weighted average interest rates for total bank deposit. Movements in deposit interest rates have seen a decline in the weighted average rate of interest for all deposits by 0.1 percentage points. However, a much larger fall in the weighted average rate of interest for bank loans by 1.85 percentage points resulted in the narrowing of the spread. The official interest rates remained unchanged at 6.5 percent.

2.1. REAL SECTOR

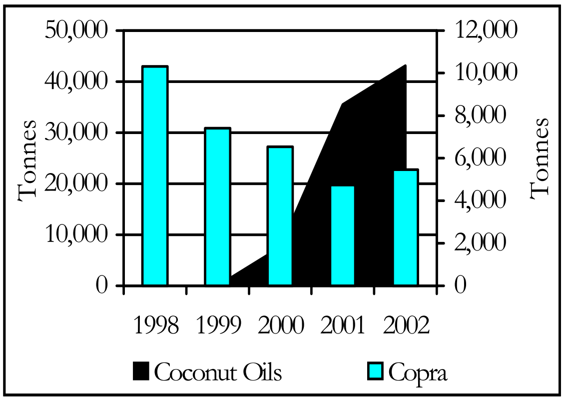
Domestic economic indicators at the end of 2002 indicated a weakening of the economy, despite the increase in copra and cocoa production, which could not offset the overall productive domestic activity. Other sectors that have seen increases in activities are agriculture (1.9 percent), wholesale and distribution (10.6 percent), construction (2.1 percent) and household activities (17.7 percent).

2.1a. Coconut Products

The overall domestic copra production improved by 13.2 percent this year compared to last year. The upsurge in production followed the increase in average world copra price in 2002 by 24.1 percent higher than 2001 couple with the domestic price fixed at VT25,000. This price incentive motivated the copra production to increase to 22,721 tonnes, as compared to 19,725 tonnes in 2001.

The production trend over the period depicted in Chart 2 recorded copra production bottoming out in 2001 to record the lowest production for the five-year period following a persistent decline between 1998 to 2000. The main cause for this decline could not solely be associated with neither the average world copra market price nor the average domestic price. It is believed that the close proximity to the Vanuatu Commodities Marketing Board (VCMB), ideal accessibility to sea transportation, and ease of immediate gain. the major producing areas, which implies, had changed, centering on only four islands in the northern part of the country, of which Malekula, Santo, Aore and Malo are part. The VCMB agents in the islands responsible for purchasing copra from the farmers ceased to operate, thus, harming production from northern and central regions.

Chart 2. Copra and Coconut oil production

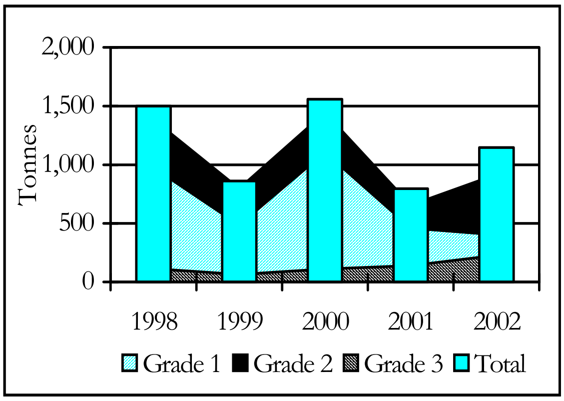


The export of copra has been declining as virtually all copra production is absorbed by the Coconut Oil Products Vanuatu Limited (COPV). Since 2000, coconut oil production for exports registered 1,812 tonnes, increasing to 8,516 in 2001 and in 2002 it recorded 10,347 tonnes. The world average market price for coconut oil has also improved to USD421.00 in 2002 versus a level as low as USD318.20 recorded in 2001.

2.1b. Cocoa

Total cocoa production in 2002 increased by 44.2 percent from 795.4 tonnes in 2001 to 1,146.6 tonnes.

Chart 3. Cocoa Production



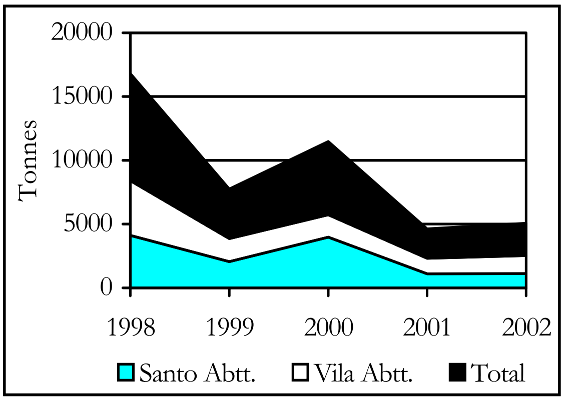
The unrest in Ivory Coast, the main cocoa producer, had affected the production of cocoa, resulting in soaring global demand towards the end of 2002. The increased demand heaved the price of the commodity by 39.9 percent from the previous year.

Domestic cocoa prices offered by VCMB to producers, however, remained unchanged over the period, at VT112,500 per tonne for grade 1, VT97,500 per tonne for grade 2 and VT70,500 per tonne for grade 3.

2.1c. Beef Production and Export

Overall beef production continued to portray a general decline since 1998 in 2002 registering 19.6 percent compared to the previous quarter.

Chart 4. Beef Production



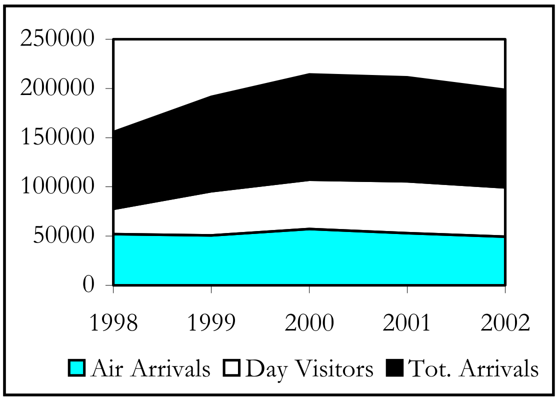
The down ward trend observed since 1998 remained persistent. However, it is anticipated that in 2003 a turn around will become eminent when new oversea markets are established in Australia and New Zealand.

2.1d. Tourism

Featuring declines by 6.4 percent for day visitors and 7.2 percent for those arriving by air, tourist arrivals fell in 2002.

Tourist visiting Vanuatu in 2002 placed Australia at the top with over 29,000 followed by New Zealand (7,253) and New Caledonia (4625) of which most are Vanuatu citizens returning for holidays and others visiting friends in Vanuatu.

Chart 5. Visitor Arrivals

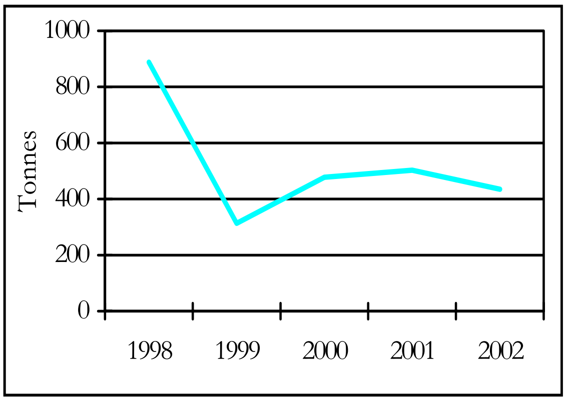


The current state in the tourism sector was due to a number of factors, which included weakening of Australian dollar against the Vatu, as well as a strengthening in the tourism sectors in the two major tourist destinations in the Pacific, Fiji and French Polynesia.

2.1e. Kava

Kava exports recorded 1,226 tonnes this period, as compared to 935 tonnes exported in the previous period. However, the price has fallen resulting in a 15.6 percent drop in revenue.

Chart 6. Kava production for exports

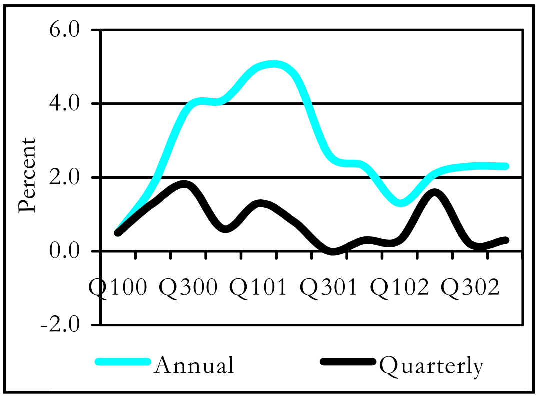


Kava production destined for exports has successively been increasing for the past four years since, peaking in 1998 (749 tons with a unit price of VT1,185,581 per tonne) with the following year dropping to 334 tonnes and since then the price per unit volume has been declining, hitting the lowest at VT354,812 this period.

2.1f. Inflation

The annual inflation rate for 2002 (measured as percentage changes in consumer price indices over the fourth quarters) registered 2.3 percent, like in 2001. Of the two urban centers, Port Vila accounted for 2.4 percent, while Luganville registered 1.3 percent.

Chart 7. Inflation



The expenditure item groups that influenced the rate during the year included drinks & tobacco (7.3 percent), recreations (3.8 percent) and transport & communications (7.5 percent).

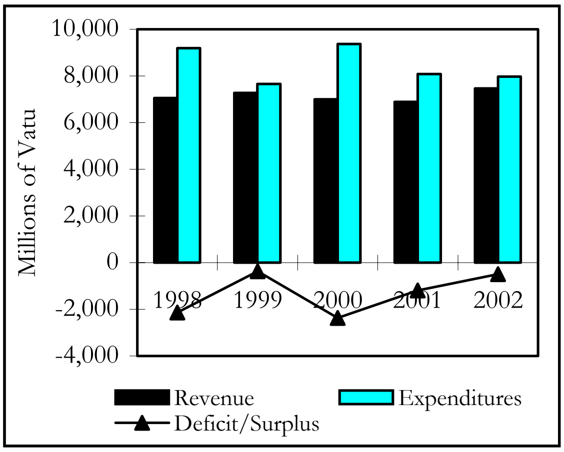
2.2. FISCAL OPERATION

In preparing the 2002 budget, the Vanuatu Government had opted for a balance budget of VT9,272.8 million. The budget basically consisted recurrent expenditures (75 percent), development expenditures (12 percent) and amortization of public debts (13 percent).

The projected revenue for the year consisted of tax revenue (69 percent) and non-tax revenue & grants (12 percent), while financing made up the balancing 19 percent.

At the end of fiscal year 2002, the Vanuatu Government operated a budget deficit of VT495.2 million, compared to a higher deficit of VT1,254 million in 2001. The improvement in the deficit was mainly attributed to a decrease of 54.4 percent in development expenditures as no major development projects were undertaken during the year.

Chart 8. Govt Expenditures and Revenue.



The total stock of public debt at the close of the period was approximated at VT13,003.1 million. Domestic debt, mostly in vatu, increased by VT546.2 million to VT3,107.4 million, while external debt stock declined by VT221.2 million to VT9,895.7. Meanwhile, the Vanuatu Government continues to make payments on existing domestic and external debts in terms of principal and interest both in vatu and foreign currency.

2.2a. Revenue

As percent of the budget, the actual recurrent revenue collected for the year fell short of the full program to record 89.4 percent. The shortfall occurred mainly due to a general decline in revenue collection from taxes.

Of the domestic recurrent revenue, tax collection for the year constituted 86.7 percent, as compared to 92.6 percent recorded in the previous year. Total tax collection for the year consisted of international taxes, 39.8 percent, Value-Added Tax (VAT), 39.4 percent, whereas other taxes made up 20.7 percent of the balance. Against 2001, international tax made up 40.1 percent, VAT, 41.3 percent, and other taxes accounted 18.7 percent.

Revenue collected from non-tax sources, which constituted the remaining 12.8 percent of total recurrent receipts, declined by 11.4 percent from the corresponding period of 2001. However, a substantial increase of 114.5 percent in non-tax revenue was collected for the budget year. This increase was mainly attributed to increases in entrepreneurial and property income of 106.8 percent and administrative fees and charges of 126 percent from the budgeted figure.

Total grants received for the year amounted to VT603.9 million, an increase of 37.2 percent from the level attained in 2001.

2.2b. Expenditures

Total recurrent expenditures to date totaled 98.8 percent of the budgeted figure of VT7,166.8 million. By economic classification, salary and wages, which accounted for 54.7 percent of total recurrent expenditures, increased by 2.9 percent from the corresponding period of 2001.

The large decrease in development expenditures was due mainly to the Vanuatu Government not undertaking any major projects during the quarter as compared to the corresponding quarters of 2001 and 2000. In 2000, VT1,794.1 million was spent from development expenditures compared to VT527.5 million in 2001 and VT59.1 million in 2002.

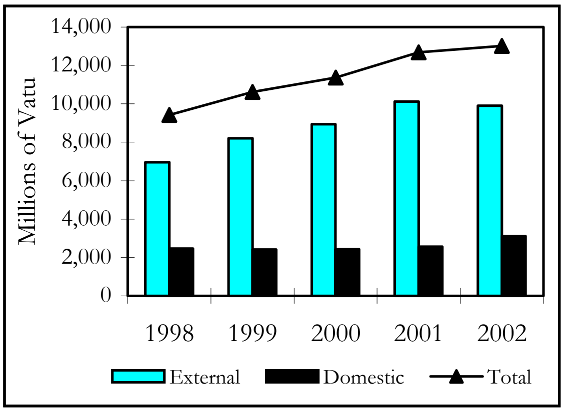
2.2c. Financing

Government fiscal operation for 2002 was partially financed by borrowing domestically. Two of the main instruments commonly utilized by the central government to finance its deficits are rollovers and recourse to overdraft facility with the RBV. There was no new external borrowing in 2002. Thus, most financing was sourced domestically. Of a total of VT1,026.1 million bonds that matured in 2002, a total of VT500.2 million was rolled over into 1 and 7 years bond, while VT325.9 million was retired or amortized; an additional VT488 million was borrowed.

2.2d. Outstanding Government Debt

In December 2002, the total outstanding public debt stood at approximately VT13.0 billion, of which 23.9 percent is in the form of domestic debt portfolios. The debt stock was approximately 39.4 percent of GDP.

Chart 9. Public Debt



Domestic debt, in terms of bond holding and domestic loans, totaled VT3,107.4 million. This represents an increase of VT546.2 million from 2001. Of the bond holding, corporate bodies shared 44.6 percent, the RBV, 29.0 percent, commercial banks with 26.3 percent and others making up an insignificant 0.1 percent.

Total external debt of the country stood at approximately VT9,959 million, a decrease of 1.7 percent from the level at the end of 2001. Consisting 76.1 percent of total debt, the external debt liability of the Vanuatu Government is broken up into bilateral and multilateral loans arrangement.

The Vanuatu government paid out VT1,030.1 million on amortization of public debts in 2002 compared to VT1,274 million in 2001. A total of VT262.1 million was paid out as interest payments on both domestic and external loans, as compared to VT244.1 million in 2001.

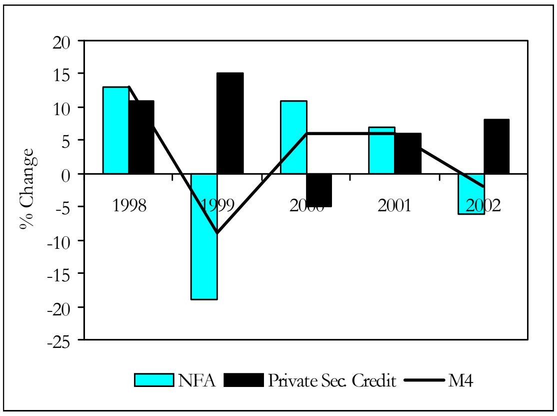
Table 1. 2003 Budget

Revenue (Million Vatu)	
Tax Revenue	6469.5
Non- tax Revenue	721.2
Recurrent Revenue	7190.7
Grant aid	550.0
Total Revenue & Grants	**7758.2**
Gross Borrowing	1834.2
Sale of Financial assets	77.0
Total Receipts	**9669.4**
Expenditures (Million Vatu)	
Goods and Services	5809.1
Interest Payments	308.2
Subsidies & Transfers	1074.2
Acquisition of Assets	39.6
Recurrent Budget	**7231.1**
Development Budget	375.0
Expenditure & Net Lending	**7606.1**
Amortization	2022.4
Change in Balance	40.9
Total Payments	**9669.4**

2.3. MONETARY DEVELOPMENT

After increasing by 5.6 percent during 2001, total money supply (M4) contracted by 1.7 percent to attain VT35,009.1 million at the end of 2002. This development stemmed from a decline in net foreign assets (NFA), despite a growth in domestic credit.

Chart 10. Monetary Aggregates



As depicted in Chart 10, NFA is the major determinant in M4 as reflected in both trends, while a reverse occurred for private sector credit. In 1998, both NFA and M4 increased due the disbursement of the CRP loan, and the upsurge in liquidity from the VNPF crises, which increases M4. In 1999, due to establishment of the oil mill in Santo the major rival for VCMB which is RBV's main source of foreign exchange and the removal of guidelines for foreign exchange. Both aggregates increased over 2000-2001 as largely explained by developments in the NFA position of commercial banks. The developments in 2002 are explained in latter parts of this report. The annual fluctuations in private sector credit over the past four years partly reflected the state of the economy.

2.31. Determinants of Money

2.31a. Net Foreign Assets

The decline in total NFA to VT24,457.9 million at the end 2002 was contributed by declines in the holdings of NFA by both the monetary authorities and the commercial banks (See Chart 10).

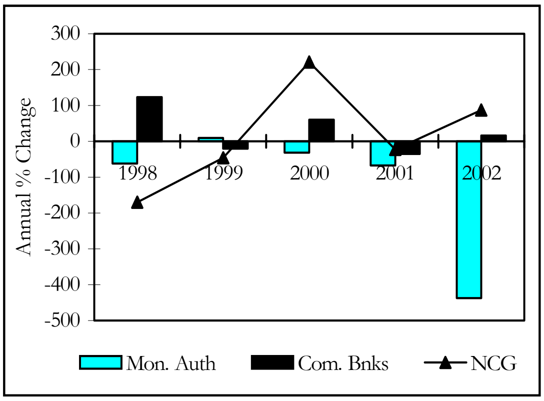
The NFA position of the monetary authorities have declined for the second year in a row, with this year's decline accelerating to 12.5 percent from 1.8 percent in 2001. The NFA holdings of the monetary authorities fell to VT4,703 million, reflecting significant foreign exchange outflows, particularly to commercial banks, which are net buyers of foreign exchange from the Reserve Bank. At the end of the year, the level of reserves was equivalent to 4.62 months of import compared to 5.72 months of imports in 2001.

Likewise, the commercial banks' NFA position dropped by 4.3 percent to VT20,042 million in 2002. This was due to a substantial rise of 107.9 percent in commercial banks' balances (liabilities) to non-residents, which more than offset the 14.0 percent increase in banks' claims (assets) on non-residents. This development was also explained by the significant decline in residents deposits denominated in foreign currencies.

2.31b. Domestic Credit

Domestic credit reached VT14,561.9 million during the year, registering an increase of 11.9 percent from 2001. Net credits to the government, claims on non-financial public enterprises (NFPE), and claims on private sector, all contributed to the increase.

Chart 11. Net Claims on Government

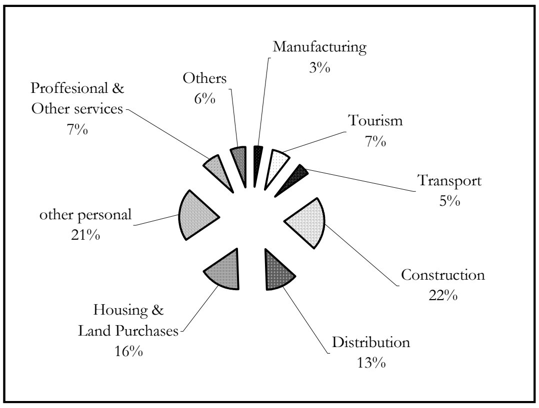


The government's net lending position vis-à-vis the banking system deteriorated from last year as net claims on government increased by 87.2 percent during 2002. This increase was entirely influenced by a 16.1 percent increase in the government's net lending from the commercial banks, which outweighed the considerable decline by 437.4 percent in the government's net lending from the monetary authorities. This huge decline in the government's net lending from the monetary authorities in 2002 was mostly explained by the settlement of their overdraft with the Reserve Bank at the end of the year.

As depicted in Chart 11, the government's net position vis-à-vis the entire banking system has displayed a disheartening position. as the net position with the commercial banks outweighed improvement in the net position with the monetary authorities. In 2001, government's net lending position improved again as its net position with both the commercial banks and the monetary authorities improved. The government's net position vis-à-vis the banking system improved between 1998 and 1999 due basically to the CRP monies, which increased its deposits viz-viz the banking system.

Claims on NFPE, particularly to the Vanuatu Commodities Marketing Board (VCMB) increased by 3.9 from 2001. This increase contrasted the huge 103.3 percent increase in 2001, during which the VCMB increased the domestic price for copra to VT25,000 per tonne, which in turn triggered its overdraft from the RBV. The increment during 2002 continued to reflect the persistent maintenance of the price subsidy for copra.

Chart 12. Sectoral Distribution of Loans



Private sector credit registered a growth of 7.9 percent from the previous year to reach VT13,437.0 million in 2002. This corresponded with the general decline in commercial banks lending rates at the end of the year. Sectors which experienced increases in loans and advances during the year included tourism (8.4%), public utilities (70.9%), construction (18.0%), and personal (including housing & land purchases) 13.9 percent.

2.31c. Sectoral Distribution of Credit

On a sectoral basis as shown in Chart 12, construction received the largest share of 21.0 percent of total banks credit in 2002, as against 19 percent in 2001; this expansion could be explained by the decline in lending interest rate charged on manufacturing/industries sector. Other personal loan sector followed with a share of 20.5 percent in 2002, compared to 15.5 percent in 2001. This was also related to a decline in minimum rate charged on personal loans during the year. Housing and land purchases accounted for 16 percent and distribution, 12.5 percent.

2.31d. Components of Money Supply

The contraction in the level of money supply in 2002 was associated with a decline in quasi-money[1] despite a huge rise in narrow money[2].

The fall in quasi-money registered 15.0 percent as compared to a growth in 2001. The decline was associated with a negative growth of 23.8 percent recorded for time and savings deposits denominated in foreign currency, which outweighed the 14.2 percent increase in time and savings deposits in vatu.

Following the decline in the previous year, narrow money grew by a considerable 44.7 percent in 2002. This was driven by a substantial increase of 59.5 percent in demand deposits, particularly its foreign currency component. The level of currency outside the banking system in 2002 was lower by 1.3 percent than the level in 2001.

2.32. Interest Rates[3]

The annual interest rates of commercial banks displayed various movements in the upper and lower interest rates at the end of 2002 as compared to the previous year. Savings deposit noted a reduction by 2.00 basis points in minimum interest rate to reach 0.5-2.00 percent. In terms of fixed deposits, movements were shown for the one-month maturity where the upper interest was raised by 1.25 basis points, while the lower interest was reduced by 0.25 basis points to 1.00-5.00 percent. The 2-3 months category portrayed a 1.50 basis points rise in the upper limit, whereas the lower limit fell by 0.25 basis points to range between 1.00-5.00 percent. The 4-6 months category declined by 1.00 basis points in its upper interest to range between 1.50-4.50 percent. Moreover, maturities between 7- 12 months' interest range moved from 1.50-6.50 percent in 2001 to 1.75-4.75 percent in 2002. The interest range on maturities above 12 months moved from 1.75-7.00 percent in 2001 to 1.75-6.25 percent in 2002.

With the aforementioned developments, the weighted average interest rates for fixed deposits in 2002 reached 4.13 percent, up from 3.55 percent in the previous year. On the other hand, the weighted average rate of interest for total bank deposits fell by a slight 0.1 basis points to 2.07 percent at the end of the period.

On the lending arena, the interest rates range for both commercial and agricultural loans moved from 9.75 –18.00 percent in 2001 to 10.00-16.00 percent in 2002, respectively. Interest rates charged for lending to manufacturing/industries sectors depicted declines of 2.00 basis points in its upper limit, with a fall of 0.5 basis points in its lower limit, to 10.00-16.00 percent. A decline of 2.00 basis points in minimum rate was noted for the interest on personal lending to a range between 9.75-25.00 percent. Interest charged on housing loans portrayed declines of 3.75 basis points and 0.10 basis points in their upper and lower interest, respectively, to range between 5.90-12.50 percent at the end of the year.

These interest rate movements were the causal factor for the decline in the weighted average rate of interest for bank loans by 1.85 percentage points from 2001 to 11.58 percent in 2002. The inter-bank lending was maintained at 5.50 percent.

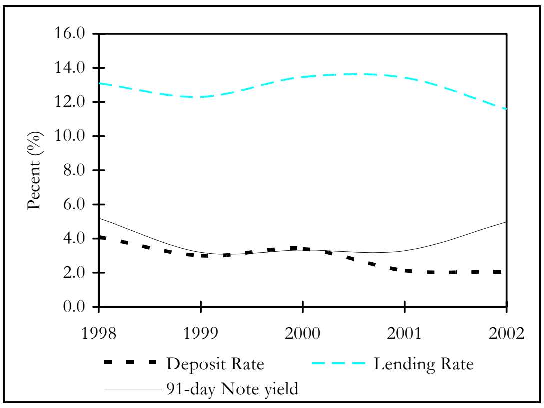
1 Quasi money is represented by time and savings deposits in both local and foreign currency.
2 Narrow money comprises currency outside banks and demand deposits of residents
3 After the merging of two banks in August 2002, data on interest rates represent only 2 out of 3 banks.

2.32a. Interest Rate Spread

The aforesaid movement in the weighted average rate of interests for total bank deposits and total bank loans have resulted in the interest rate spread to narrow by 1.79 basis points to 9.51 percent at the end of 2002.

The weighted average yield rate on the 91-day and the 28-day RBV notes issued by the Reserve Bank at the end of 2002 was at 4.98 percent and 4.15 percent, respectively.

Chart 13. Interest Rates



According to Chart 13, the 91-day note yield was gradually edging up by the end of the year as the distribution of liquidity in the banking system turned uneven. Weighted average and lending rates also depicted a sliding trend as in 1999. Interest paid on RBV notes also followed the development in commercial banks liquidity.

2.33. RBV Notes

The Reserve Bank Notes outstanding at the end of 2002 reached VT330 million. This represented an annual decline of VT116.3 million. During 2002, the Bank issued Notes totalling VT2,345 million, as compared to VT2,725 million in 2001. Also, in 2002 the Bank introduced the 119-days and 182-days notes in the market in addition to the 28-days and 91-days notes.

2.34. Deposits with Commercial Banks

Resident's deposits (demand, savings and fixed--excluding government deposits) with the commercial bank amounted to VT33,092.3 million at the end of 2002, a decline by VT525 million from 2001. Of this total, deposits denominated in foreign currency accounted for 66.8 percent of the total deposits, while the remaining 33.2 percent deposits were in vatu. Fixed deposits accounted for 62.9 percent of total deposits, demand deposits 29.1 percent, and savings deposits 7.9 percent.

In terms of different categories, deposits of private business amounted to VT15,693.3 million, representing 48.5 percent of the total deposits and a fall by 4.5 percent from the previous year. Deposits of individuals followed with VT14,750.4 million or 44.3 percent of total loans. Deposits of non-financial public enterprises increased by 36.5 percent to VT1,714.8 million in 2002. Deposits under others category depicted an annual increase of 78.5 percent to VT860 million.

Government deposits with the commercial banks at the end of 2002, was also lower by 16.5 percent or by VT48.3 million from a year earlier.

2.35. Reserve Money

Reserve money[4] registered an annual growth of 0.9 percent during the year. This was driven by annual increases recorded for currency outside banks (1.6%) and statutory reserve deposits (25.7%). Excess reserves, on the other hand, contracted by 25.3 percent. The reduction in excess reserves at the end of 2002 was a combined effect of outflows through the balance of payments, and liquidity destruction by the government. The growth in SRD was due to a rise in the average deposits of residents in vatu and half of demand deposits in foreign currency held

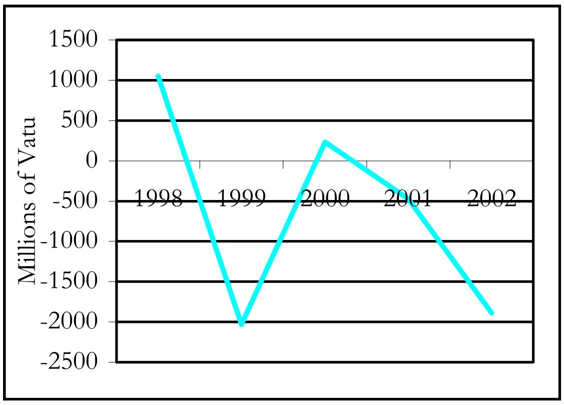
4 Reserve money consists of currency in circulation, statutory reserve (SRD) and excess reserves.

with the commercial banks during the months of October and November 2002.

2.4. BALANCE OF PAYMENTS

As depicted in the chart below, the overall balance of payments position further deteriorated in 2002 from the low deficit of 2001.

Chart 14. Balance of Payments



The current account recorded an enormous shortfall, which was partly financed by the capital and financial account. These adverse developments resulted in a VT4,259 million net reserves (excluding the IMF position) by end-December 2002. This figure was sufficient to finance 4.7 months of imports, compared to 5.7 months recorded in 2001.

The imbalance in the country's current account in 2001 and 2002 was caused by the country's worsening trade deficit, which eventually offset the surpluses in the services and current transfers. The continuous trade deficit has a usual negative direction in Vanuatu's current account as imports estimated to be five times its exports.

2.41. Trade Balance

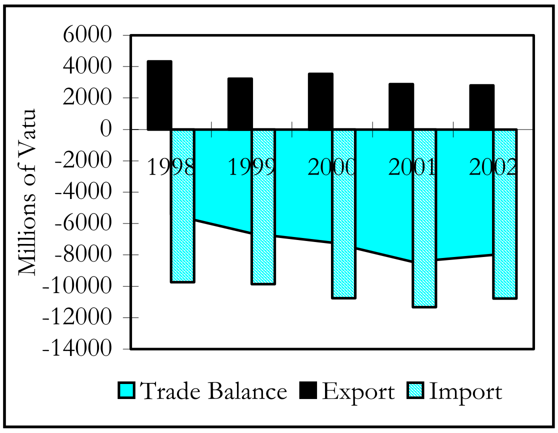
The merchandise trade balance narrowed by 5.7 percent this period, as against the previous year. Despite this improvement, the trade balance remained in deficit, caused by diminishing exports and increasing imports.

Exports during the year experienced 3.6 percent drop, while imports marked a decline of 5.2 percent. In view of these developments, a slump in imports determined the movement of the trade balance, subsequently pinpointing the fall of mineral fuels and machinery imports by 29.0 percent and 8.7 percent, respectively, as the major factors.

2.41a. Exports

Total provisional exports registered a decline of VT101 million last year from VT2,894 million to VT2,793 million this year. Commodities accounting for this decline were copra, beef, kava and timber by 84.6 percent, 23.8 percent, 15.6 percent and 68.7 percent, respectively.

Chart 15. Trade Balance



Copra exports crashed to a low of VT174 million, compared to VT323 million recorded in 2001. This development resulted from the arrangement made between Coconut Oils Products Vanuatu (COPV) and Vanuatu Commodities Marketing Board (VCMB) for VCMB to supply COPV copra to be crushed locally, prior to any export of surplus.

Beef exports during the year continued to depict a decline since 2000 to record VT239 million. In 2001, exports registered VT193 million. However, the outlook for 2003 looks promising since Australia is opening up it's market for organic beef and New

Zealand is negotiating with the Vanuatu Abattoirs Limited for the same product.

Cocoa increased by 55.5 percent from that exported in 2001. This rise was largely due to cocoa exports managed by private individuals and companies that mainly targeted the organic cocoa market in Australia and other potential markets.

2.41b. Imports

Total provisional import (c.i.f.) dropped by 5.2 percent in 2002, of which imports for domestic consumption declined by 2.8 percent. The developments in imports could be explained by the imports of each individual item that constituted the total imports. There had been declines in imports of the major constitutes such as the mineral fuels, which fell by 29.0 percent and machinery and equipment, also declining by 8.7 percent. There have been increases in beverages and tobacco (20.6 percent), animal fats (5.7 percent) and chemicals (7.1 percent). However, these positive developments were not adequately large to offset the decline.

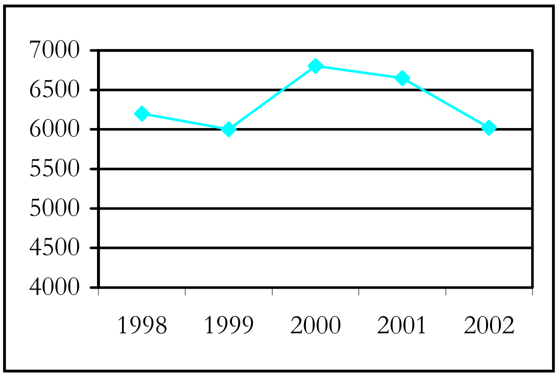
2.41c. Direction of Trade

Imports into the country indicated Australia as the main exporter of goods to Vanuatu, accounting for 39.3 percent of total imports followed by New Zealand (39.3%), Fiji (8.3%), France (5.3%) and New Caledonia (4.0%).

On the export front, Australia again retained its dominance accounting for 29.2 percent of Vanuatu's exports followed by the European Union (10.8%), Japan (10.7%), New Caledonia (9.0%) and Bangladesh (4.9%).

Tourism earnings, which accounted for almost one half of the total services receipts, slightly dropped in 2002 in reflection of a decline in tourist arrivals by both cruise-ships and air. Australian visitors dominated around 65.0 percent of Vanuatu's total visitors, although arrival from Australia dropped dramatically late last year, probably reflecting impacts of the Bali bombing.

Chart 16. Tourism Earnings (inward travel)



Net income also recorded a marginal decrease; however, receipts and payments expanded to reflect growing investment in banks and other sectors. Current transfers account recorded almost the same level as in 2001.

Foreign direct investment though reduced with more investment activities by the commercial banks both contributed to the turnaround surplus of the financial account. Portfolio investment again recorded an increase in assets to reflect an increase in securities purchased abroad by Vanuatu enterprises.

The reserves are forecasted to be better in 2003 with the official transfers standing as main source of inflow reflecting anticipated government budget funds.

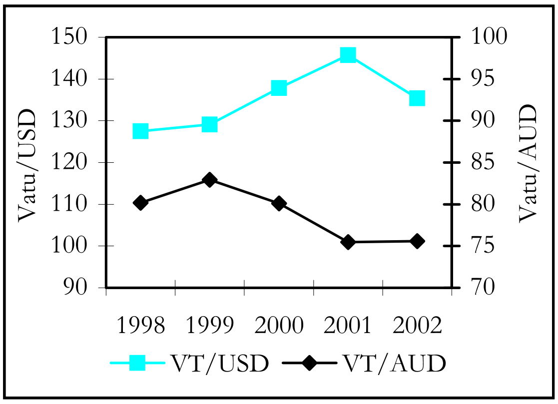
2.42. EXCHANGE RATE

The exchange rate of the vatu is pegged to a weighted basket of currencies of a few major trading partners. Therefore, movements of the major currencies against the vatu are influenced by their cross rates against the US dollar.

The annual average nominal exchange rates of the vatu against the US dollar and Aussie dollar as depicted in the graph below shows Vatu appreciating against the US dollar

(4.7%), Sterling Pound (0.5%) and the Japanese Yen (7.9%), while it depreciated against the Aussie dollar (0.3%), New Zealand dollar (4.9%) and the Euro dollar (0.1%).

Chart 17. Exchange Rates movement of Vatu against USD and AUD



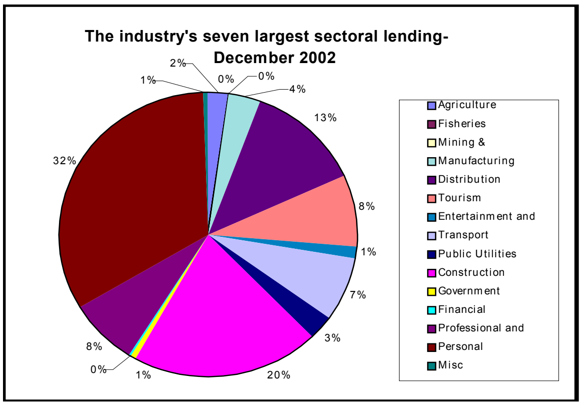
The closing rates for the year-end compared to last year witnessed the Vatu appreciating against the US dollar (10.2%), while depreciating against the Sterling Pound (0.4%), Aussie dollar (0.3%), Japanese Yen (0.5%), New Zealand dollar (12.8%) and the Euro dollar (7.2%). The highest Vatu nominal rates against the US dollar stood at 133.17 in December while recording the lowest of 147.24 in January.

2.5. DOMESTIC BANK INDUSTRY PERFORMANCE

The Year 2002 saw consolidation within the domestic banking system, with ANZ bank (Vanuatu) Limited completing its acquisition of the operations of Banque Hawaii Limited. With the acquisition, ANZ contributed about 60.5 percent in the industry's balance sheet, 45.6 percent in the industry's total lending assets and 92.7 percent in the industry's capital base.

For the industry as a whole, total assets increased by 17.3 percent to VT50 billion during the December 2002 quarter; a yearly increase of 16.2 percent. Quarterly growth in assets was driven by growth in both the domestic assets by 29.9 percent to VT24 billion and foreign assets by 7.9 percent to VT26 billion.

While the industry's total lending assets remained around VT12.5 billion during the December quarter of 2002, the chart below indicated that there was an evenly distribution of lending funds to the seven largest sectoral lending, namely Personal, Construction, Distribution, Tourism, Professional, Transport and Manufacturing sectors. Both Personal and Construction sectors remained accounted for over 50 percent of the total industry lending assets.



The level of impaired assets improved by 2.5 percent to VT508 million during the December quarter of 2002; an yearly improvement of 18.4 percent. While there was an increase in the Loss loans during the December quarter, the improvement of impaired assets was attributed to the fall in doubtful loans by 22 percent to VT261 million. Overall, standard assets accounted for 89 percent of total loans, while substandard and impaired assets accounted for 7 percent and 4 percent of total lending assets, respectively.

The industry reported a slight drop in its total capital by 2.1 percent to VT 2.9 billion during the December quarter, despite recording a yearly increase of 12.7 percent. The quarterly drop was attributed to a fall in the industry's disclosed reserves and retained earnings by 2.8 percent to VT2 billion. Despite the drop in both the industry's capital base and risk weighted assets (by 3% to VT7.7 billion), the industry remained well capitalized with all participants reporting capital ratios in excess of the required minimum. In aggregate, the industry's total capital ratio was 38 percent well over the 8 percent minimum requirement.

3. OPERATIONS

3.1. RESERVE BANK ASSETS AND PROFITS

This year 2002 has not been a good year for the Reserve Bank, in terms of profit making, although making profits is not the Bank's main objective. The net profit of the Bank in 2002 amounted to VT57.4 million, the lowest ever since its inception in 1980. This was in contrast to VT149.8 million made in 2001. Several factors contributed to this poor performance. Firstly, the official foreign reserves fell sharply by 12.9 percent in 2002. This decline plus falling interest rates abroad were reflected in the huge fall in the interest earned on investments abroad. Interests earned on investments on domestic government bonds and secured lending have increased by 3.8 percent and 11.4 percent, respectively. Secondly, the Bank's expenditures increased by a substantial 28.1 percent in 2002, reflecting: (a) loses on sale on bonds due to closing of individual account to transfer portfolio to the investment pool; (b) VT4.8 million increase in interest paid on RBV notes due to the issue of longer term (119 days, 182 days) at higher interest rates; and (c) expenditures relating to the production of new vatu coins.

3.2. BANKING

3.2a. Currency Operations

The total stock of currency notes and coins issued by the Reserve Bank and outstanding at the end of 2002 amounted to VT2,273.7 million, representing an increase of 1.7 percent from 2001. Out of this total, VT357.3 million were held by commercial banks as vault cash and the remaining balance of VT1,916.1 million were held by the public or currency outside banks. In 2002, currency held by the public fell by 1.3 percent from an increase of 5.8 percent in the previous year. On the hand, vault cash or currency held by commercial banks rose for the second successive year with growth accelerating to 20.1 percent in 2002 from 7.7 percent in 2001. Commercial banks usually hold vault cash to cater for daily withdrawals by depositors as well meeting day-to-day operational expenses.

The Reserve Bank of Vanuatu is the sole issuer of currency in Vanuatu, a right given to it by the Reserve Bank of Vanuatu Act. The Bank issued both vatu banknotes and vatu coins in different denominations. Of the total currency (including outstanding FNH notes and coins) outstanding in 2002, vatu banknotes amounted to VT1,872 million and coins totalled VT401 million. Vatu banknotes and coins in circulation have increased by 1.2 percent and 3.4 percent, respectively, in 2002.

The Bank issued banknotes in denominations of VT100, VT200, VT500, VT1,000 and VT5,000. The 1,000-vatu note continues to claim the lion's share of total notes in circulation even though its percentage share fell to 48.5 percent from 49.2 percent in 2001. The 5000-vatu note came second, increasing its total share to 41.6 percent from 40.6 percent in the preceding year. The VT500 and VT200 claimed third place and fourth place, respectively. The Bank has stopped printing the VT100 bill since 1999 and has replaced it with the VT100 coin. The vatu coins issued by the Reserve Bank consisted of denominations of VT1, VT2, VT5, VT10, VT20, VT50 and VT100. In terms of percentage share of the total coins in circulations, the VT100 coin continues to enjoy dominance with 56.4 percent, followed by the VT20 (16.1%), VT10 (10.9%), VT50 (9.0%), VT5 (4.4%), VT2 (2.1%) and VT1 (1.4%).

As the sole issuer of currency, the Bank through its currency office, always make sure it meets the public's demand for currency. This is done through the commercial banks that buy currency from the RBV. Also, apart from designing and making arrangements for the production of currency, the Bank also make sure the currency that are in circulation are in good condition. It does this by checking the currency returned to the RBV and determine whether the currency are fit for reissue of not. Banknotes that are soiled or worn out and coins that are mutilated are destroyed.

In 2002, a total of 2,688,855 notes were examined, 451,270 notes less than those examined last year. Of the total notes examined in 2002, 27 percent were rejected as being unfit for re-issue, while the remaining 73 percent were fit for re-issue.

3.2b. Counter Operations

As a bank, the Reserve Bank of Vanuatu maintains deposit accounts for the government, commercial banks and the VCMB. The important relationship between the Bank and the government and commercial banks are outlined in the Reserve Bank of Vanuatu Act.

Table2. Counter Transactions (MVT)

	Withdrawals	Deposits	Totals
1998	5120	4974	10094
1999	4145	4136	8281
2000	3983	4125	8108
2001	4098	3980	8078
2002	3902	3873	7775

Source: Reserve Bank of Vanuatu

The government and commercial banks use their accounts with the Reserve Bank to make deposit as well as withdrawals. In 2002, the total number of transactions over the counter declined further by 3.8 percent. This was reflected in fewer withdrawals and deposits compared to 2001. Withdrawals over the counter declined by 7.8 percent and deposits fell further by 2.7 percent

The total number of cheques and payment orders passed through the clearinghouse in 2002 fell to 335,462 from 378,016 in 2001. In line with the decline in the number of effects, the total value of cheques cleared in the clearinghouse also declined (see table 3)

Table 3. Operation of Clearing House

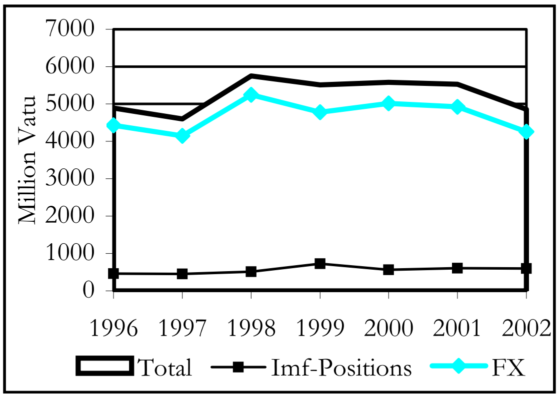
Year	No. of Effect	Value (MVT)
1998	352,683	32,030
1999	370,352	34,224
2000	398,286	32,622
2001	378,016	34,995
2002	335,462	33,878

Source: Reserve Bank of Vanuatu

3.2c. External Reserves Management

The Reserve Bank is vested with powers as the sole manager of Vanuatu external reserves. In exercising this responsibility, the Bank seeks to ensure that the reserves are managed prudently within the parameters of safety, liquidity and profit maximization.

Chart 19. Official Foreign Reserves



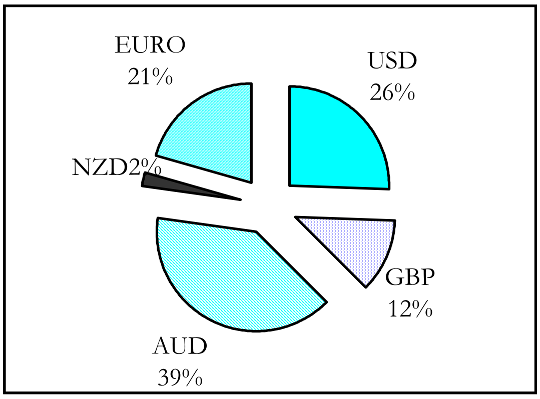
The total reserves of the Reserve Bank of Vanuatu, including the IMF positions, recorded VT4,854 million by end 2002. This represented a 12.2 percent drop from end 2001, reflecting more financing to the balance of payments transactions during the year.

For the year as whole, net sales of foreign exchange from all sources was recorded. Out of the various sources of purchases, 57 percent came through the Government official transfers, 42 percent from the

Vanuatu Commodities Marketing Board (VCMB) plus Coconut Oil Productions Vanuatu Ltd (COPV) export proceeds and the remaining 1 percent from commercial banks. On the sales side, banks grabbed 90 percent mainly to finance their customers' current transactions and the other 10 percent was sold to government.

The Reserve Bank of Vanuatu holds a portfolio of foreign currency assets in which 43 percent are held in bonds and other securities. It is one of the views of the RBV to invest in very secure instruments and in 2002, bond holdings expanded significantly. The geographical distribution of foreign reserves varies throughout the year and usually in line with the interest rates movement in the international markets.

Chart 20. Composition of Foreign Reserves



Income earned in 2002 dropped by 11.0 percent, as compared to earnings in 2001. This decline was reflected in the fall in the official foreign reserves.

Out of the total foreign exchange as at end 2002, Australian dollar accounted for 39.0 percent, US dollar 26.0 percent, Euro 21.0 percent and sterling 12.0 percent. The New Zealand and Canadian dollars accounted for the remaining 2.0 percent.

3.3. RESEARCH DEPARTMENT

The Research Department continuously monitors the economic and financial developments in Vanuatu as well as internationally, enabling the Bank to carry out its functions effectively. It does this through the collection, consolidation and analyzing economic and financial data.

Within the Department, there are four sections comprising the external sector, monetary sector, real sector, and fiscal sector. The Bank is the compiling agency for monetary and balance of payments statistics in Vanuatu, a role assumed by the Research Department. For data on the fiscal operation of the government and data on the real economy, the Bank relied on data compiled by the Department of Finance, Statistics Office and other sources including VCMB.

Throughout 2002, the Reserve Bank continued to utilize its various monthly, quarterly and annual reports to disseminate information on economic and financial matters to the public. The Bank regularly provides statistics to the National Statistics Office (NSO), the International Monetary Fund (IMF), Asian Development Bank (ADB) and other domestic and international organizations.

The Department is also responsible for the formulation of monetary policy. In 2002, the Department continued to prepare and presented the Reserve Money Program to the Monetary Policy Committee that meets on a regular basis. It continued to represent the Bank on various committees including the Macroeconomic Committee (MEC) and Cash Flow Committee.

3.31. Major Developments in 2002

3.31a. Coordinated Portfolio Investment Survey

One of the most significant developments that took place, within the Research Department, in the year 2002 was the introduction of the survey called *Coordinated Portfolio Investment Survey* (CPIS). The CPIS is being undertaken by the IMF as an important tool to capture the world's total portfolio investment assets and geographical distribution of the holdings, thereby contributing to a better understanding of capital flows. The Survey was part of an international survey and has included the participation of 70 economies.

Given the current globalisation trend and the liberalization of the international financial system, it tends to allow for more freedom of capital movement across country boarders. The fact that large capital flows freely across boarder has created great concern and has also posed difficulty in measuring the magnitude. This situation has called for the increasing importance of Portfolio Investment Survey, with the sole intention of keeping tract on the size of these capital movements.

The CPIS that is carried out on an annual basis began for Vanuatu in 2002 with the assistant of IMF consultants. The survey involves the gathering of statistical data relating to Portfolio Investment (such as Equity, short and long term securities and the country of non resident issuer) for both domestic and offshore institutions, for the year 2001. The CPIS coverage includes major domestic financial institutions comprising of Commercial Banks, Trust Companies, Accounting and Legal Firms, Government, Statutory Bodies including the Reserve Bank of Vanuatu and the Vanuatu National Provident Fund (VNPF). The movement of Portfolio Investment assets is important in countries with Offshore Finance Center, of which, Vanuatu is part. Such information will be of great benefit to Vanuatu's Offshore Finance Center Institutions as it provides the country's international investment position as compared to other countries in the world.

Sources of information and data came from the Vanuatu Financial Services Commission (VFSC), RBV's Banking Supervision Department and the External Sector enterprise survey. Compiled data, which was schedule to be completed by May 2002, successfully met the target. The report was finally presented at the Hong Kong CPIS workshop in June 2002. Vanuatu was the only country that represented the Pacific, and apart from the other Asian countries that participated, Vanuatu was one of the few countries that were praised for being complied with the new BPM5 format and an excellent balance of payments structure. The final results after comments from the CPIS participants were taken into account and the final report was submitted to the IMF towards the end of December 2002. The IMF has compiled all the Country reports and will be published around April 2003.

3.31b. Exchange Arrangements

The Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER) is furnished to the IMF every year. This is one of the requirements of the Fund as to prepare in accordance with Article XIV, section 3 of the Articles of agreement. The regulatory framework for current and capital has been receiving much attention recently and the Reserve Bank facilitates the updated descriptions to the Fund.

Vanuatu has no restriction in any exchange arrangements, however there existed various documentation and tariffs requirements in certain parts of transactions especially in merchandise trade. In 2002, there was no major change in the Vanuatu arrangement except for the restructuring of import taxes and licenses. There has been some temporary ban to some animal products for health reasons and currently ongoing.

3.4. BANKING SUPERVISION DEPARTMENT

Since the establishment of the Bank Supervision Department in 1996, the department has continued to increase its primary role of supervising Vanuatu's domestic commercial banks as an effort to comply with the continuous fast changing international requirements. Year 2002 was no exception, however, it was arguably the most challenging year for the Banking Supervision Department.

3.41. Major Events

In early 2002, Vanuatu's banking system experienced the impact of the Patriot Act. Generally, this Act has resulted in US banks closing the correspondent accounts of Vanuatu banks.

Because of the adverse impact of the Act, there were a number of remedy measures put in place to limit the impact. Amongst them, the RBV wrote to the US government agencies outlining supervisory practices in Vanuatu. On March 2002, the RBV issued a directive to all domestic commercial banks on terrorist financing, which was subsequently issued as a regulation on April 2002

Year 2002 also saw the IMF undertook an assessment of the extent to which regulatory and supervisory practices in Vanuatu for financial sector complied with internationally accepted standards and measures of good practice. The assessment included not only the offshore market but also the domestic banking sector. The assessment of the regulation and supervision of the domestic banking sector indicated a high level of compliance with the Basel Core Principle for Banking Supervision. In its principle-by-principle examination of the present law and present practices, the domestic supervision regime was assessed as being materially non-compliant with only two of the Core Principles, both of which have since been addressed. The RBV was pleased with the outcome of the review, especially in view of the fact that the Bank Supervisory role is relatively new. Moreover, it undercover the importance that the RBV places on this function.

Following the enactment of the International Banking Act, the RBV assumed responsibility for the supervision of the offshore banking sector from the Vanuatu Financial Services Commission (VFSC). While this will impose some additional burden on the Reserve Bank and its supervisory staff, it should be noted that the expected standards of supervision are precisely the same for both domestic and offshore banks.

In December 2002, RBV issued a directive to the Board of European Bank to remove Tom Bayer and Robert Bohn Jnr. from any executive positions following their indictment in America over their alleged involvement in an international lottery scam.

During the last quarter of 2002, the banking industry welcomed the introduction of ATM by another bank. This brings the total of banks with ATM facilities to two.

3.42. Prudential Guidelines

During the year, the RBV issued new prudential guidelines to commercial banks.

Prudential guideline 6 (Restrictions of shareholdings) was issued in April 2002. The aim of this guideline is to clarify aspects of the Financial Institutions Act in relation to restrictions on banks' shareholdings to ensure that they are not exposed to excessive risk as a result of their equity associations.

Prudential guideline 7 (Dealings with Subsidiaries and Associates). Issued in April 2002, the aim of this guideline is to clarify aspects of the Financial Institutions Act in relation to a bank's dealings with its subsidiaries and associates.

Prudential guideline 8 (Restrictions on Exposures Greater than 25%). Issued in April 2002, the aim of this guideline is to clarify aspects of the Financial Institutions Act in relation to restrictions on exposures greater than 25 per cent of capital (Section 38 of the Act) and to ensure that banks implement prudent measures and limits to monitor and control the risk of credit concentrations in respect of large exposures to individual counterparties or groups of related counterparties on a consolidated basis.

Prudential Guideline 9 (Customer Due Diligence) was issued in July 2002. The objective of this guideline is to ensure that banks have in place know-your-customer (KYC) policies. This guideline is based on principles outlined by the Basel Committee on Banking Supervision in its paper, "*Customer due diligence for banks*" issued in October 2001. Consistent with ensuring that banks operating in Vanuatu implement sound risk management practices, this guideline requires all domestic banks to incorporate the principals and recommendations outlined in this Guideline into their risk management policies.

Prudential guideline 10 (Management of Financial Institutions: Fit & Proper Requirements) was issued in September 2002. This Guideline aims to ensure that a financial institution, licensed under the Financial Institutions Act No. 2 of 1999, is well managed and that persons occupying key positions within the institution must have the degree of probity and competence commensurate with their responsibilities. These key positions include directors and senior managers. Under this guideline and amendments to the Financial Institutions Act, the RBV may direct that a bank remove an officer if they are considered to be no longer fit and proper.

3.43. Onsite Visits

Reflecting global concerns about money laundering and terrorist financing, the Reserve Bank expanded the scope of its on-site examination program, which includes assessment of banks' credit risk management systems, to include Anti-Money Laundering (AML). The aim of the visit was not to review files with the view of identifying instances of money laundering. Rather, the aim was to review policies against the requirements of Prudential Guideline No.9 (PG 9) and Financial Transaction Reporting Act (FTRA) No.33 of 2000. Undertaking these visits, representative of the Financial Intelligence Unit are invited to participate.

3.44. New Legislations

The department was also involved in the development of a number of pieces of legislation during the year.

3.44a. International Banking Act:

The aim of the Act, which became effective on 1 January 2003, is to ensure the effective supervision of the offshore sector. The Act, which had been developed over a number of years in consultation with members of the industry, will significantly strengthen the supervisory framework for the international banks.

The key provisions of the Act are:

- all licensees, licensed under the Banking Act (CAP 63) will be required to reapply for a license under the International Banking Act;

- there will be a minimum capital requirement of USD 0.5 million.

- all licensed banks will be required to maintain a physical presence in Vanuatu. This means that there needs to be meaningful mind and management in Vanuatu together with records. This requirement will enable the effective supervision of these banks and see the end of so-called "shell" banks, which were the focus of the USA Patriot Act.

3.44b. Financial Institutions Act (Amendment):

The purpose of the amendments was to strengthen and clarify the ability of the RBV to issue prudential guidelines, provide RBV greater control over banks' external auditors and introduce an enhanced 'fit & proper' regime.

3.45. Department Representation

While the RBV, through the department, played a major role in a number of developments in the financial sectors, it also represented the RBV in a number of committees.

3.45a. IMF Working Group:

The department has been representing RBV in this committee. The committee was established by the Government to assess the recommendations made the IMF in its assessment of Vanuatu's regulatory and supervisory practices. They are to report directly to the Minister of Finance, their assessment on recommendations made by the IMF.

3.45b. Association of Financial Supervisors of Pacific Countries:

A regional group named Association of Financial Supervisors of Pacific Countries (AFSPC) was recently created at the initiative of eight Heads of Supervision in the Pacific region and endorsed by the Governors of Central Banks and Ministers of Finance. This association was established to facilitate the sharing and coordination of matters relating to supervision and regulation of financial institutions within the region. Peter Tari (Deputy Governor in charge of Bank Supervision Department) was elected as Deputy Chairman of AFSPC.

3.5. LEGAL DEVELOPMENTS

The Legal Office of the Reserve Bank of Vanuatu is directly under the Governor's Office. It is responsible for giving legal advises to the Bank in general, in relation to issues arising under the Reserve Bank Act, Cap 125 and the Financial Institutions Act No 2 of 1999 including other relevant legislations. The legal office has been working closely with all the departments within the Bank, particularly the Banking Supervision Department.

The Bank, through the Legal Office, was involved in liaising with the State Law Office. Firstly, in participating in the preliminary meetings leading up to the enactment of the Acts and amendment Acts. Secondly, the Bank's Legal Officer did an attachment with the Litigation and Financial Intelligent Unit (FIU) within the State Law Office twice a week in the second half of the year to get familiarized in the area of litigation.

The most significant development was the enactment of the International Banking Act No. 4 of 2002 by Parliament. As a result of this enactment, the Reserve Bank was given the mandate to regulate and supervise international (offshore) banks. This gives an additional statutory duty on top of the Bank's existing supervisory role over domestic banks under the *Financial Institution Act No. 2 of 1999*. To date the Bank has issued license to the current offshore banks.

A couple of other amendments were also made to related Acts in response to the passing of the International Banking Act, as follows;

1. Section 3 of the *Reserve Bank Act*, which provides for the principle objectives of the Bank, was amended pursuant to the *Reserve Bank (Amendment) Act*, to include the regulation and supervision of domestic and international (offshore) banks.

2. The *Financial Institutions (Amendment) Act No. 21 of 2002* provided for the amendments to sections 2(3), 13, 15(3)(b), 21(2), 22(1), 23, 33(2), 35(1), 38(1), 42, 55 of and the Schedule to the *Financial Institution Act No.2 of 1999*. Basically, the amendments provide for the requirements to be followed by the Bank in carrying out its functions relating to domestic banks.

The Banking Act [Cap.63] was repealed by the Banking (Repeal) Act No.18.of 2002 as a result of the passing of the Financial Institution Act No.2 of 1999 and the International Banking Act, No.4 of 2002.

3.6. INFORMATION TECHNOLOGY UNIT

The Information Technology (IT) Unit was formerly known as the Data Processing Section under the Operations Department. In May of 2002, it was made a separate unit due to the growth and other dynamic changes to the nature of the work of the unit in maintaining the Bank's Local Area Network, Information Systems, changes in working methods, changes in technology, decision making methods and etc.

3.61. Significant IT Operations in 2002

The Bank has embarked on several major projects in the last quarter of the year to improve and enhance its information systems and other computing facilities but on the whole its network.

3.61a. Windows 2000 Network Platform

The most important project being the adoption of the Windows 2000 network platform that enables the integration of most other systems run and supported by the Bank. Windows 2000 will replace Netware as the new network platform for the Bank by the end of the first quarter of 2003.

3.61b. SWIFT

Another important system of the Bank is the SWIFT system. SWIFT stands for The Society for Worldwide Inter-Bank Financial Telecommunications. The Bank acquired the SWIFT system in late 1999 and has been using the system since then for most of its financial payments and settlements instructions. SWIFT has gone through some major changes and the one in front now is the network upgrade from the X.25 protocol to the purely Internet Protocol network. The Internet Protocol network will enable more services by SWIFT, for example, the interactive exchange of messages or files and applications to communicate in real time by using the technologies of the Internet. The Bank has a deadline of August 2004 to migrate to the Internet Protocol network and is working towards that goal. The SWIFT system is an important system for the daily work of the Foreign Exchange Office and Accounts Section of the Bank.

3.61c. Client/Server Relational Database Management System

IT unit is currently analyzing the possibility of a secured open database connectivity system to enable a corporate database method for the Bank. A client/server database system will be selected after careful examination of the most appropriate system. This project is important for centralized storage and maintenance of the Bank's common data for use by it's various departments.

3.61d. Local Intranet and RBV Internet Website

The Bank has also embarked on a project to develop its own Internet website. This project is nearing completion and will open to the public before mid 2003. It is believed that most of the Bank's public data will become more readily available over the Internet. Currently the Bank runs an internal Intranet where most of its common data are published and accessed. Some common information is shared effectively via this method.

3.61e. Training

Training IT personnel is an important area in the Bank and most training acquired by the staff has actually been put to good use. Training acquired by IT staff most times corresponds to a set project or to improve or enhance an existing system. Some of the training acquired to date is in the areas of

SWIFT, Windows 2000, Netware, SQL Server and Microsoft Exchange. All these have a meaning to the projects set in place as well as improving and developing IT staff to better handle their tasks each day.

The Bank continuously looks for ways to improve its information systems, upgrade its network set-up or merely bring out information to the public in a most effective way. This is an ongoing process in order to keep up to date with the dynamic and fast change in technology. Other changing economical, social as well as legislative needs also call for new or improved ways of doing things in the Bank for better analysis and reporting. IT Unit is therefore basically there to provide this network support for the entire Bank.

3.7. RELATIONS WITH INTERNATIONAL ORGANISATIONS

The Bank continued to benefit from Vanuatu's membership in the IMF, through IMF's Technical Assistance Progam. In 2002, the Bank was fortunate to have the service of Mr. Andrew Milford, Advisor to the Banking Supervision Department who was on an IMF secondment with the Reserve Bank. Also, the former General Advisor to the Bank, Mr. Ferdie van de Walle, who was also funded by the IMF, visited the Bank from time to time during the year.

Mr Philip Turnbul, who replaced Mr Roger Purdue in 2001 as the Multi-Sectoral Statistician at the Pacific Financial Technical Assistance Center (PFTAC), based in Suva, Fiji visited the Reserve Bank twice in 2002. Also, the IMF Article IV consultation also visited Vanuatu in their 24-month cycle surveillance study in August 2001 followed by a Staff Report.

3.8 PUBLICATIONS

The Bank continued to disseminate to the public economic and financial data as well as commentary on economic and financial developments in Vanuatu and overseas through its Quarterly Economic Review (QER) and monthly Financial and Economic News summary (FEN).

The Bank has been publishing the Quarterly Economic Review since June 1986. It contains a comprehensive set of analytical data and commentary on domestic financial and economic trends.

The monthly publication contains monetary data and a description of recent monetary developments. It also gives an overview of domestic, regional and international financial and economic news.

4. INTERNAL MANAGEMENT

4.1. ADMINISTRATION

In May 2002, the Data Processing Section (DPS) was separated from the Operations Department with its name changed to "Information Technology Unit" owing to the need to streamline the operation of the Operations Department and to upgrade other departments that needs to be upgraded to improve efficiency.

At the end of May and beginning June, two staff were transferred from the Operations Department to the Administrations Department to assist in the efficient running of the department. Payroll processing was also transferred to the Administration Department in June 2002.

4.1a. Appointment of Deputy Governor

Mr Peter Tari, Director of the Banking Supervision Department, was appointed Deputy Governor effective May 2002. He oversees the affaires of the Banking Supervision Department, Administration Department and the Information Technology Unit.

The Deputy Governor also assumes the functions and powers of the Governor, in the Governors' absence.

4.1b. The Board of Directors

The Reserve Bank Act under section 8(3) requires four Board Members. Two of the current four members took up the office as Board of Directors in June this year, after their appointment was made effective by the current Minister of Finance after the post was left vacant for almost a year after the former Board member's term expired in the first quarter of 2001.

The Board of Directors of the Reserve Bank of Vanuatu was composed of Mr Andrew Kausiama, Governor and Chairman of the Board, together with Mr Geordie Mackenzie-Reur, Mrs Aniva Tarilongi and Odo Tevi who represented the Ministry of Finance and Economic Manangement (MFEM). This was the first time in the Bank's history that a female was appointed a member of the Board of Directors. The Bank's legal officer, Mrs. Sonia T. Marahare attends as Secretary to the Board.

Under section 11 of the *Reserve Bank Act (Cap 125),* the Board is required to sit at least four times a year. In 2002, the Board held four ordinary sittings and two extra ordinaries.

4.1c. Management

The Management Committee comprises the Governor (as Chairperson), Deputy Governor, and the Directors of each of the three Departments within the Bank. The committee meets on a regular basis, discusses, and makes decisions on issues relating to the development and internal management of the Bank.

4.2. OFFICIAL REPRESENTATION OVERSEAS

In March, Governor Andrew Kausiama attended a conference on Financial Sector Regulation and Supervision in Pacific Island Countries jointly conducted by the IMF Singapore Training Institute and Pacific Financial Technical Assistance Center, held in Singapore. In July, Governor Kausiama attended the Central Bank Governors' Symposium in England and then went on to Basel in Switzerland to attend the 72nd Annual General Meeting of the Bank of International Settlements (BIS) which was held from 6 to 8 July 2002. Also, in September, the Governor attended the Commonwealth Finance Ministers meeting being hosted by the government of UK, followed by the IMF-World Bank Board of Governors 2002 annual general meeting in Washington D.C. He also attended South Pacific Central Bank Governor's meeting in Wellington, New Zealand in December 2002.

Deputy Governor, Peter Tari also represented the Bank in overseas meeting in 2002. In June, the Deputy Governor, together with the Legal Officer, attended the APG annual meeting on money laundering in Brisbane, Australia. The Deputy Governor also attended a course on International Accounting and Auditing for the Bank in Hong Kong during October. In November, the Deputy Governor attended a regional workshop on Regulation and Supervision of Banks/Financial Institutions conducted by the Pacific Financial Technical Assistance Center, followed by a Heads of Supervision meeting in Suva Fiji.

Heva Alilee, Director of Operations represented the Bank on the 4th Annual Asian meeting for Central Banks being hosted by the Citigroup Asset Management in November 2002.

Mr. Simeon Athy, Director of the Research Department, attended a meeting on General Data Dissemination System (GDDS) in Suva Fiji, in November. This meeting was hosted by the Pacific Financial Technical Assistance Center

4.3. TRAINING AND DEVELOPMENT: Seminars, Courses and Meetings

The Bank continues to attach great importance in training and development to improve staff skills in various banking and other related areas. A staff training policy has been developed and will soon be submitted to the Governor of the Reserve Bank for consideration.

In 2002, a number of staff participated in training both locally and abroad. Staff training in 2002 includes part-time training and short specific courses.

Local training opportunities offered by the University of the South Pacific (USP) Center in Port Vila have been beneficial to staff development. In 2002, a number of staff were offered opportunities to take extension courses in areas of Financial Management, Economic Statistics, Macroeconomics, Management and English at USP. Other short-term courses attended by staff were in the area of Information Technology (IT). Also, a member of staff attended a course on Professional Secretary/Receptionist offered by Next Vanuatu, while another participated in a workshop on Legislative Drafting Process at the State Law Office.

Oversea trainings were mainly short and specific courses offered by a number of organizations including the IMF, Singapore Training Institute, and the Bank of France. Courses attended include Central Bank Accountancy, Anti Money Laundering Techniques for Banking Supervisors, Balance of Payments, Monetary Operations, Human Resource Management, CS DRMS 7.2 Debt Data backup and Database Management System. Apart from training, some staff attended conferences and meetings. Two staff of the Research Department attended a meeting on Coordinated Portfolio Investment Survey in Hong Kong. In terms of conferences, the Manager of the Currency Office attended a conference on currency in Honolulu, Hawaii in October.

4.4. STAFF COMPLIMENT

At the end of 2002, the total number of staff of the Reserve Bank of Vanuatu increased to 53, of whom 52 were Ni-Vanuatu and 1 expatriate under the IMF TA program who served as an Advisor to the Banking Supervision Department. Another expatriate who has served as a general advisor to the Bank under the IMF TA program visited the Bank from time to time in 2002. During each of his visits to the Bank he stayed for one month. There was one recruitment made during the year.

4.5. OTHER ACTIVITIES

As in previous years, the Bank continued to offer holiday jobs to students during the Christmas holidays. These students were offered work experiences in each of the four departments within the Bank.

During 2002, the RBV soccer club participated in several soccer competitions and friendly matches, both indoor and outdoor. In the second half of the year, the RBV soccer club entered a team in the oldies futsal league and won a trophy.

4.6. ACKNOWLEDGEMENT

The Board and the Governor of the Reserve Bank of Vanuatu wishes to express their appreciation for the continuous dedication of staff during the year. This appreciation is also extended to the International Monetary Fund (IMF) for the staff provided to the Bank under its technical assistant (TA) program.