



RESERVE BANK OF VANUATU



Annual Report 2011


Letter to the Minister

The Honourable Minister of Finance and Economic Management
Government Building
PMB 9058
Port Vila

Dear Minister,

Pursuant to Section 42(1) of the Reserve Bank of Vanuatu Act [CAP 125], I have the honour to transmit to you:

- (a) A report of the operations of the Reserve Bank of Vanuatu for the Year 2011; and
- (b) A copy of the Bank's Annual Statement of accounts for 2011 certified by the Auditors.


Yours faithfully,
Odo Tevi
Governor

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Contents

Board of Directors

Page 3

Management Committee

Page 4

Governor's Foreword

Page 5

Economic Overview

Page 6

Monetary Policy
Formulation

Page 9

Monetary Policy
Implementation

Page 11

Financial Institution
Supervision

Page 15

Reserve Bank Operations

Page 21

Financial Statements

Page 27

Board of Directors



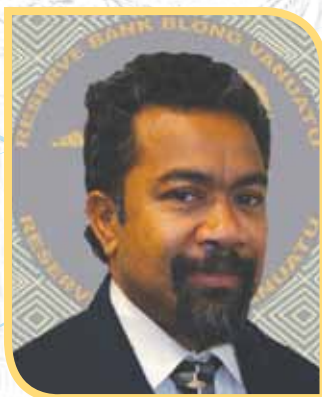
Odo Tevi
*Governor
Chairman Board
of Directors*



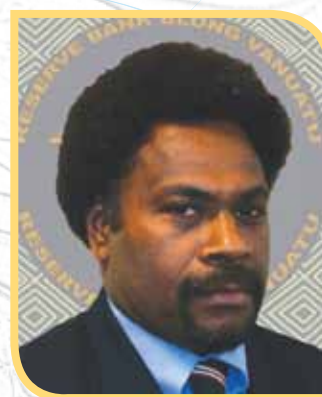
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Management Committee



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Jerry Niatu
*Director of Research
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Governors Foreword

In 2011 the Reserve Bank of Vanuatu (RBV) was once again faced with the challenge of implementing monetary policy against the backdrop of an increasingly uncertain world economy. However, aside from the challenges of managing these developments, 2011 was also a year for retrospection and celebration with the 30 years anniversary of the founding of the Reserve Bank. To mark this occasion, the Bank hosted various events, including our first Economic Symposium attended by policy makers, academics and businessmen from across the Pacific. The success of this event was not only a testament to the Bank's organisational skills and professionalism, but to its desire to build and expand on our knowledge of Vanuatu's economy.

Over the year, the prospects for the world economy worsened markedly owing to the risks originating from the sovereign debt troubles in the eurozone. This has subsequently led to a drying up of international capital markets and has the potential to significantly weigh on global economic activity in both advanced and emerging economies alike. The Vanuatu economy is not immune to such developments, with the agriculture, tourism and banking sectors most obviously likely to be affected by any movement in commodity prices or a slowdown in economic activity of our trading partners. As a result, the Bank continues to monitor external development closely.

Over the past two years the domestic economy has shown some signs of weakening which in part reflects a slowdown in property investment and the finalisation of some large donor-led infrastructure spending. However, the Macroeconomic Committee expects that 2011 will see a slight recovery in activity in comparison to 2010, albeit not to the levels seen in 2009. Nevertheless, despite the developments over the past

year, the key targets of the RBV were met: inflation stayed well within target of 0-4 percent, while foreign exchange holdings remained well above the minimum threshold of 4 months of import cover throughout of the year.

Throughout 2011 the RBV continued to develop monetary policy based on the monthly collection and analysis of economic indicators, which are communicated to the public through various monthly, quarterly and bi-annual publications. In August, owing to improving liquidity conditions, one headline tightening of monetary policy was made which saw the Statutory Reserve Deposit rate increase by one percentage point. However, the Bank's monetary stance still remains strongly accommodative to help stimulate activity and to manage external risks.

In such an uncertain environment, it is important that the RBV continues to provide confidence as one of Vanuatu's key institutions and foundations for economic development. Importantly, this requires ensuring the core functions of the Bank are conducted with the professionalism and support of all staff. At the same time, our monetary policy must continue to be built on quality evidence and research, alongside a keen oversight of the banking system. Over 2011 the Reserve Bank has continued to strive to achieve this.

Finally, I would like to thank the staff of the Reserve Bank of Vanuatu for their dedicated services to the Bank and the Board and the Minister of Finance for their continued support in this challenging period.

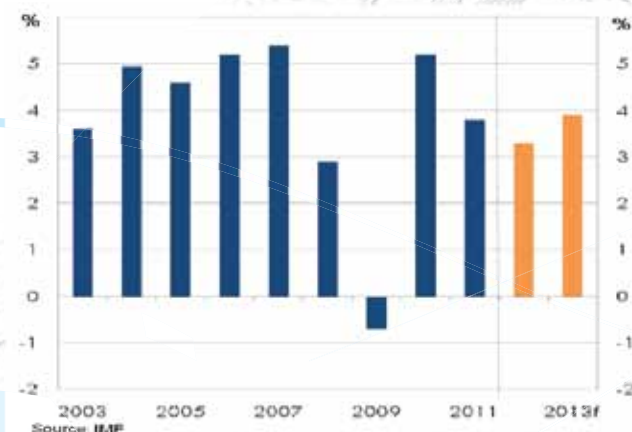

Odo Tevi
Governor

Economic Overview

International Economy

Despite a rebound in 2010, throughout the course of 2011 global economic activity increasingly showed signs of slowing. The euro area sovereign debt crisis intensified in the second half of 2011 with uncertainty over increasing sovereign bond yields holding back activity in Europe, while fiscal consolidation and continued bank deleveraging weighed on economic activity of advanced economies around the world. At the same, emerging economies in general also began to experience a slowdown from the high growth rates of 2010, resulting partly from macroeconomic policy tightening used to tame inflationary pressures.

**Figure 1: World GDP Growth 2003-2013
(Annual Data; Percentage)**



International Interest Rates

This year saw a continuation of divergence in the implementation of monetary policy between advanced and the emerging economies. In advanced economies, the US Federal Reserve maintained its very loose monetary policy stance with interest rates remaining between 0-0.25 percent throughout the year. Such levels are expected to be maintained until at least 2014. This year also saw the Federal Reserve conduct some less conventional interventions aimed at stimulating activity such as increasing the average maturity of holdings

through 'Operation Twist'. The euro area began to tighten interest rates in the second and third quarter of 2011 to deter inflationary pressures. However, by the end of the year it was clear that the uncertainty in the banking system was an overriding concern so the European Central Bank began cutting interest rates again.

Both Australian and New Zealand, faced with the deteriorating external environment and some significant natural disasters, began to loosen their respective policy stances. By the end of 2011 policy interest rates had fallen from 4.75 percent to 4.25 in Australia, while in New Zealand the policy rate had fallen from 3.00 to 2.50 percent.

In contrast emerging economies, particularly China, found themselves faced with inflationary pressures. This led to a tightening of monetary policy through increasing the official interest rate three times and reserve requirements six times over the year.

Table 1: Key interest rate indicators

	Key Interest Rates (Percent, End of Period)				
	US Fed Fund Rate	Euro Refi Rate	Australia Cash Rate	New Zealand Cash Rate	Vanuatu Rediscunt Rate
2010					
Q1	0.25	1.00	4.00	2.50	6.00
Q2	0.25	1.00	4.50	2.75	6.00
Q3	0.25	1.00	4.50	3.00	6.00
Q4	0.25	1.00	4.75	3.00	6.00
2011					
Q1	0.25	1.00	4.75	2.50	6.00
Q2	0.25	1.25	4.75	2.50	6.00
Q3	0.25	1.50	4.75	2.50	6.00
Q4	0.25	1.00	4.25	2.50	6.00

Commodity Prices

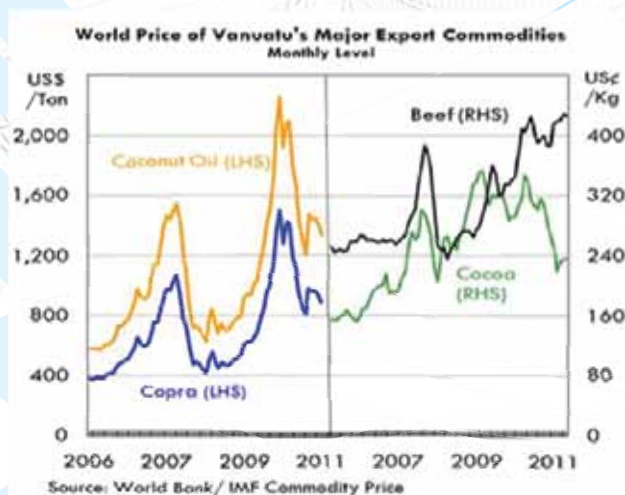
Commodity prices saw a rapid recovery during the course of 2011 mainly due to geopolitical developments in the Middle East which posed a significant risk to supply, outweighing the impact of slowing overall economic activity which likely weighed on prices.

Figure 2: Average Spot Price for Crude Oil (Monthly Data; US\$/Barrel)



The international prices of Vanuatu's major exports showed divergent prospects. Beef prices exceeded the highs observed in 2008, while moderate increases in the price of copra and coconut oil were observed over the year despite falling back during the last quarter of 2011. World cocoa prices fell substantially over the year due to over-supply.

Figure 3: Export Commodity Price 2006-2011 (Monthly Data; US\$/Ton)

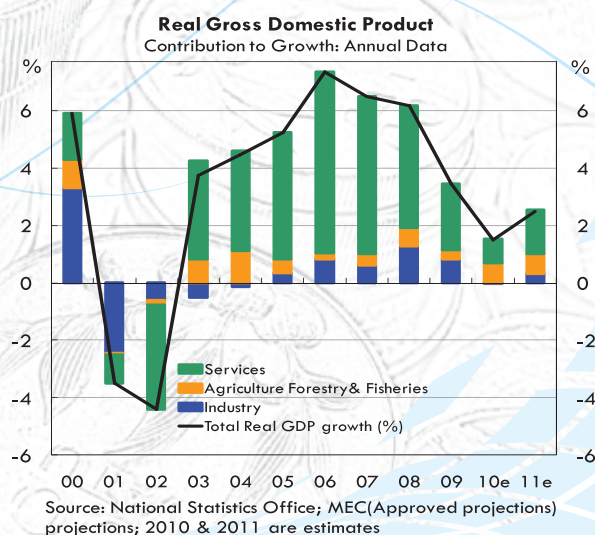


Domestic Economy

The official GDP figures for 2010 and 2011 are yet to be released by the National Statistics Office but the Macroeconomic Committee growth estimates suggest a bottoming out in 2010 with economic growth at 1.5 percent, increasing to 2.5 percent in 2011.

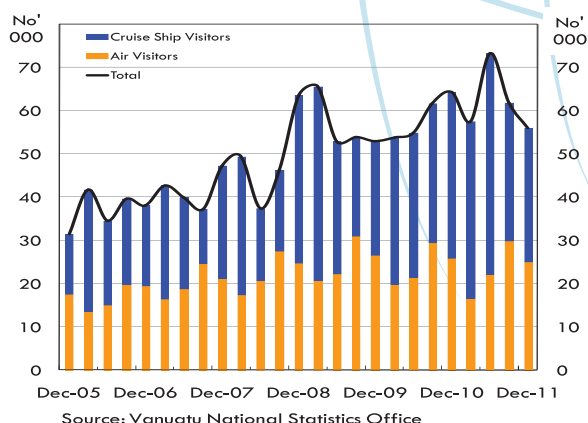
Strong growth in 2008 was due largely to the Millennium Challenge Corporation project that increased construction activities, while the real estate boom has also been a significant driver of inward investment and economic growth. The slowing of GDP growth to 1.5 percent in 2010 reflects a significant slowing in both of these sectors. However, 2011 is predicted to have performed relatively better than 2010, especially in the agriculture sector with relatively higher world commodity prices driving up domestic prices and increasing production of Vanuatu's major export commodities. The services sector is also thought to have performed relatively well, enhanced by increases in cruise ship calls and a new flight schedule introduced between New Caledonia and Vanuatu. Weighing on growth are declines in construction and the knock-on effects of the slowing world economy on inward investment.

Figure 4: Annual Growth Real Gross Domestic Product (Annual Data; Percentage Change)



Through the year total visitor arrivals by air and cruise ship declined from previous year. Air arrivals increased in early 2011 resulting from the indirect effect of Fiji flooding but declined later in the year. This was a time where all Pacific Islands were vigorously campaigning to attract tourists from similar markets.

**Figure 5: Visitor Arrivals
(Monthly Data; Thousand Visitors)**

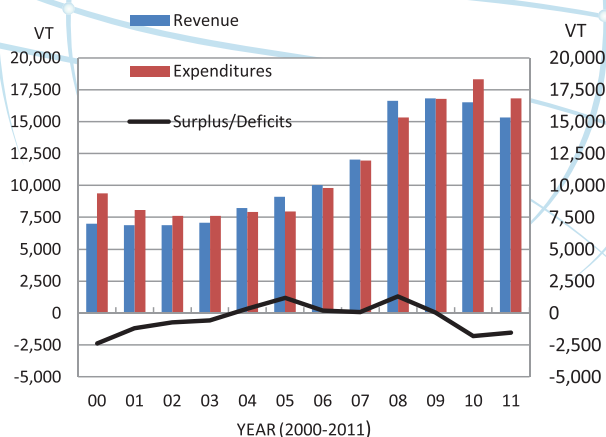


At the end of 2011, broad money supply (M2) year-on-year growth was 1.3 percent compared to a decline of 6.0 percent recorded at the end of 2010. This reflects slowing contractions in Net Foreign Assets (NFA), outweighing falls in Domestic Credit growth. Total Domestic Credit increased 11.2 percent over the 12 months, with credit to the private sector growing by 9.1 percent. This is a significant slowdown compared to 17.43 and 11.7 respectively at the end of 2010. The NFA of the commercial banks continued their declines seen since 2008, with 33.7 percent contraction over the year. The decline was partly counterbalanced by an increase in the Reserve Bank's NFA, resulting in the overall banking system NFA declining by 8.1 percent.

Over 2011, commercial bank's average weighted lending rate over the course of the year recorded a fall from 10.28 percent from 10.94 percent at the end of 2010. At the same time, interest rates on deposits increased to 2.81 compared to 1.75 by the close of 2010. This led to a significant fall in the spread between lending and deposit rates from 9.19 percent at the end of 2010 to 7.47 in December 2011.

Government budget failed to achieve targets at year end with revenue collections falling short of target by 4.9 percent and spending 23.1 percent year on year. Budget support was budgeted for but was never received, however improvement in VAT revenue collections made up some of the shortfall. On the expenditure side the government was successful in maintaining expenditure spending within target, with recurrent expenditure held below target over the year. Despite controlling the expenditure, the overall result was a deficit of VT523.6 million. These deficits were financed mainly from rollover of government domestic bonds and issue of new bonds over the year.

**Figure 6: Government Budget Balance
(Annual Data; Millions Vatu)**



Vanuatu continued to record an overall trade deficit, which narrowed over the year due to exports increasing by 3.0 percent while imports fell 1.7 percent. Over the year, the current account deficit expanded by 48.6 percent due to major reductions in net services and net current transfers accounts. On capital account, inflows decreased over the year indicating a slowdown in aid from development partners and the postponement of major aid funded projects schedule for the year. Official Reserves remained strong throughout the year, with months of import cover increasing to levels at the close of the last quarter that were well above the Reserve Bank comfortable threshold.

Annual inflation at the close of 2011 was at 1.2 percent, lower than 3.4 percent recorded in 2010 and well within the Reserve Bank target band. Much of the decline is attributed to the lagged effect of declines in world commodity prices and slowing domestic economic activity.

Monetary Policy Formulation

The Research and Statistics Department (RSD) is responsible for the collection and analysis of statistics to provide quality evidence for conducting monetary policy and advising government. Through its conduct of monetary policy, the Reserve Bank of Vanuatu (RBV) seeks to promote monetary stability by encouraging a low and stable rate of inflation and maintain sufficient international reserves to meet the country's external obligations. The year-ended inflation for 2011 of 1.2 percent remains well within the Reserve bank target band of zero to 4 percent, and international reserves exceeded its target band of 4 to 6 months of import cover, reaching 6.8 months of import cover.

In 2011 the formulation of monetary policy was made against the backdrop of worsening external conditions, while domestic activity continued to remain sluggish compared to recent years. The impact of the current slowdown of trading partners is yet to be fully understood; nevertheless domestic developments such as the finalisation of some large infrastructure projects and the end of the housing boom continue to weigh on activity. This provides a significant challenge to both analysts and policy makers alike in the RBV.

RSD continues to conduct regular reviews of international and domestic developments which are monitored, assessed and discussed at monthly meetings of the Policy Coordinating Committee (PCC) made up of technical staff in the Research and Statistics Department. The findings from such meetings are presented to the Monetary Policy Coordinating Committee (MPC), made-up of Directors and the Governor/Deputy Governor who use the information to shape a monetary policy stance. Over the year, MPC decided to maintain its loose monetary position to help foster economic activity. Expansionary fiscal policy and inflows of donor funds, meant liquidity remained high as evidenced by

strong competition for short term securities in the open market operations throughout 2011. Owing to these increases in liquidity, the RBV continued to normalise its stance and decided to tighten the Statutory Reserve Deposit (SRD) in August from 6 percent to 7 percent –similar to the tightening that occurred in 2010.

In terms of our key aims, year-ended inflation fell from 3.4 percent in 2010 to 1.2 percent in 2011 from both domestic and international factors. This is considered a comfortable level to ensure economic stability. During this period the effect of the excise tax policy had sunk in and inflation was influenced by receding commodity prices which had fallen from the peaks of 2008 and began to translate into the domestic prices. Official Reserves continued to be bolstered by donor inflows meaning that the RBV remained in a strong position to meet its external commitments and manage the exchange rate.

RSD continues to publish monthly/quarterly and biannual publications to communicate with the public developments in the four sectors of the economy. This requires RSD to regularly conduct various surveys to gather the relevant statistics for analysis. At the same time, the Department also works with international organisations to provide regular updates and assessments. Most notably, in 2011 the IMF conducted their Article IV consultation for Vanuatu. RSD played an important role not only in coordinating the visit, but also in providing the relevant statistics and explaining developments in the economy for IMF mission members to carry out their assessment.

RSD continues to strive to improve the Reserve Bank's understanding of the Vanuatu economy to better inform policy making with quality evidence. To ensure this, staff over 2011 took part in various courses

conducted by the IMF and others with the aim of building on this knowledge. Equally, as part of the process of learning and sharing information, RSD helped organise various events in celebration of 30 years as a central bank. Most notably, the Reserve Bank's first Economic Symposium which invited experts from across government, donors, business and academia to discuss the topic 'Strengthening Partnerships for Lasting Prosperity'. The event was a success and helped stimulate some important discussions surrounding Vanuatu's economic development.

Monetary Policy Implementation and Foreign Reserve Management

The Reserve Bank's Monetary Policy stance has remained broadly unchanged during 2011. The Bank's official interest rate (rediscount rate) was kept unchanged at 6.0 percent. On the other hand, the Bank continues to normalize reserve requirement by raising the reserve requirement ratio by 1.0 percentage points, from 6.0 percent to 7.0 percent, while it continues to adjust the level of system liquidity through regular open market operations.

OpenMarketOperation

Monetary Policy Implementation through regular open market operation continued to be the key instrument of monetary policy that the Bank of Vanuatu used to implement monetary policy throughout 2011. The Bank sold and redeemed Reserve Bank of Vanuatu Notes (RBV Notes) on a weekly basis to fine-tune the level of liquidity in the system. The Bank sold and redeemed RBV Notes that had maturities of 7-days, 17-days, 28-days, 63-days, and 91-days.

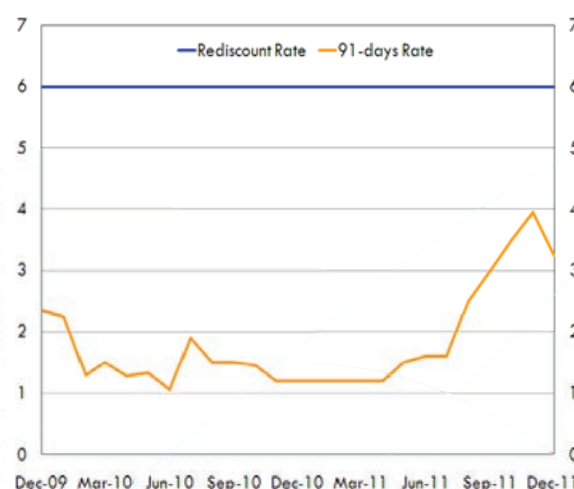
Table 2. Operations in the Market for Reserve Bank of Vanuatu Securities: 2011 (VT Million)

	2009	2010	2011
Number of OMO	47	44	40
Flotation	16070	14150	20490
Tenders	30075	30525	28165
Allotments	16025	14250	18830
Outstanding	950	1250	1630

During the year under review the Bank conducted 40 open market operations during which it allotted a total of VT18,830 million in Reserve Bank of Vanuatu Notes. This was an increase by 32.1 percent from the amount allotted in 2010. As in previous years the total amount of tenders received continued to exceed the floated amount and this reflected a continued strong demand for the RBV Notes due to the persistently high level of liquidity in the system. Moreover, the amount of RBV Notes that was floated in the domestic market during 2011 was higher than 2010 by 44.8 percent.

The yields on the various categories of the RBV Notes have remained below 2.0 percent during the first half of the year. However, during the second half of the year the yields increased with the yields on the longer maturities showing the biggest increase. The yields on the 91-days RBV Notes rose to almost 4.0 percent and then declined toward the end of the year, as illustrated in the chart below.

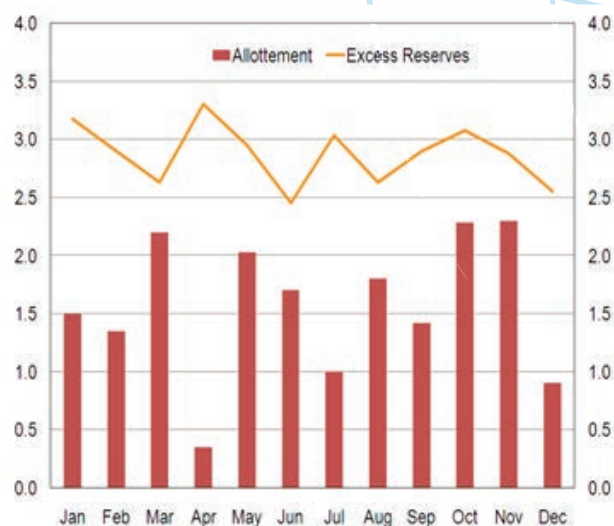
Figure 7: Policy and Market Interest Rates (Monthly Data; Percent)



The cost of monetary policy rose to VT30 million in 2011. This was a significant increase compared with the total cost of just VT19 million during 2010. The increase in the monetary policy cost was due to the combined effects of the increase in the RBV Notes yields in the second half of 2011 and an increased amount of RBV Notes being allotted during the year.

Despite the increase in the amount of RBV Notes allotted during 2011, excess reserves continued to remain high. Liquidity inflows through the Balance of Payments and new money creation on behalf of the Government, which are the two main sources of liquidity in the economy, ensured that excess reserves remained at higher levels throughout 2011.

**Figure 8 Activities in OMO during 2011
(Monthly Data; Billions of Vatu)**



Reserve Requirement

After the Reserve Bank has reduced the reserve requirement ratio from 10 percent to 8 percent in 2008 and then further reduced it to 5 percent at the beginning of 2009, the Bank has taken steps to gradually raise the reserve requirement ratio again. During August 2010 the Bank raised the reserve requirement ratio by 1.0 percentage point from 5 percent to 6 percent. In the year under review the Bank further increased the reserve requirement ratio to 7.0 percent during August 2011.

Foreign Exchange Reserve Management

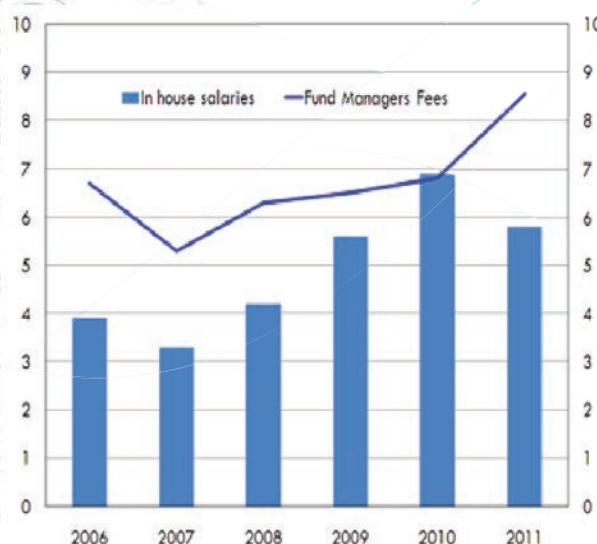
As the custodian of the country's foreign exchange reserves the Reserve Bank of Vanuatu continues to ensure that there is adequate level of foreign exchange reserves at all times to meet the country's external obligations and preserve the confidence in Vanuatu's ability to meet its external obligations. The Reserve Bank also undertakes investments of the foreign exchange reserves and in doing so it continues to ensure capital preservation and to maximize returns on the investments to finance its operation.

The total foreign exchange reserves of the Reserve Bank continued to increase in 2011, marking the ninth year in a row of yearly positive growth. This year's growth of around VT1.2 billion or 8.1 percent has boosted the Reserve Bank's total foreign assets to a

record level of VT16.3 billion. With the continued increase in the foreign reserves, the Bank continues to have sufficient foreign reserves to meet the country's external obligations.

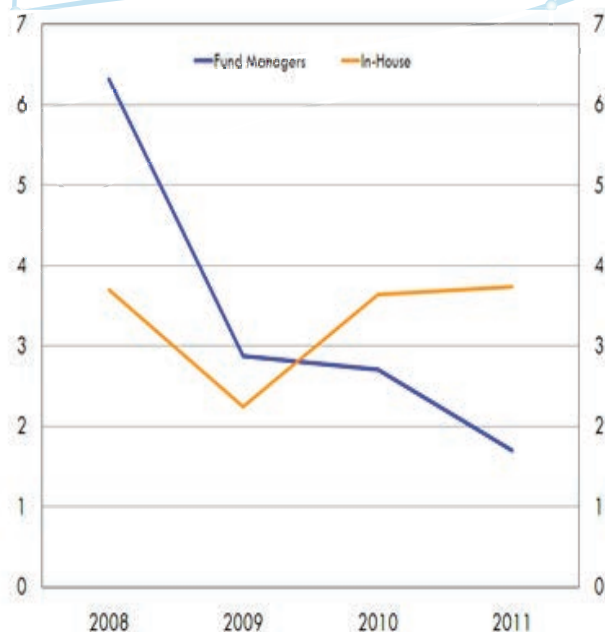
Total investible reserves have also increased along with the increase in the total foreign exchange reserves. Investible reserves increased by VT1.2 billion or 8.5 percent to VT15.7 billion. The investible reserves were managed in-house in the Reserve Bank and by external fund managers. Around 76 percent of the reserves are managed in-house in the Reserve Bank and 24 percent are managed by external fund managers. The proportion of the reserves that were managed by external fund managers were invested in highly marketable fixed income securities. On the distribution of investible reserves by asset classes, short term deposits dominated with 43 percent. Bonds came second with 33 percent, followed by short term securities which accounted for 17 percent, and the balance of 7 percent was held in cash.

**Figure 9: Cost of managing Funds through fees and salaries
(Yearly Data; Millions of Vatu)**



The total cost of foreign exchange reserves management increased further during 2011. Much of the increase was driven by in-house salaries which more than offset a decline in fund managers' fees. An additional staff was recruited to reinforce staff numbers in the reserve management area. It was the Reserve Bank's strategy to increase capacity and strengthen in-house management of the foreign exchange reserves.

**Figure 10: Rates of Return on Investments
(Yearly Data; Percent)**



During 2011 short term market interest rates in most major markets continued to remain low, as shown on table 2 below. Also, during the year, the Reserve Bank of Australia lowered its official cash rate by 50 basis points while the Reserve Bank of New Zealand lowered its official interest rate by 75 basis points. Low interest rates abroad continued to affect the rates of returns on the Bank's investments. The rate of return on funds managed by Fund Managers decreased further from 2.71 percent in 2010 to 1.7 percent in 2011. On the other hand, the rate of return on funds managed in-house has increased slightly from 3.64 percent in 2010 to 3.73 percent in 2011.

Table 3. Official Interest Rates (%)

Bank	2009	2010	2011
FED	0/0.25	0/0.25	0/0.25
BOJ	0.1	0.1	0.1
ECB	1	1	1
BOE	0.5	0.5	0.5
RBA	3.75	4.75	4.25
RBNZ	2.5	3	2.5

Exchange Rates

Vanuatu maintains a fixed exchange rate regime, and the local currency is pegged to a basket of currency. Each day the Reserve Bank, which manages the exchange rate regime on behalf of the Government, sets the exchange rate of the Vatu against the US dollar and sends the exchange rate to commercial banks which use the rate to determine the exchange rates for their customers.

Table 4. VATU Exchange Rates

FCY	31-Dec-10	30-Jun-11	30-Dec-11	Annual % Change
USD	93.15	89.39	93.56	0.44
EUR	123.75	129.05	121.29	-1.99
AUD	94.72	95.45	94.91	0.2
NZD	71.84	73.78	72.17	0.46
GBP	143.64	143.78	144.23	0.41
JPY	1.1423	1.1068	1.2049	5.48

Since the local currency is fixed to a basket of currency, movements in the Vatu exchange rates often mirrored the bilateral movements between the major currencies which are in turn caused by development in the international financial markets. At the end of 2011, the VATU depreciated slightly against most major currencies. Against the Japanese Yen, the Vatu depreciated by a noticeable 5.48 percent. On the other hand, the local currency appreciated against the Euro by 1.99 percent.

Financial Inclusion

The responsibility of the Domestic Markets Unit was further extended in May 2011 to incorporate Financial Inclusion. Financial Inclusion is about delivering sustainable financial services, at affordable cost, to the disadvantaged and low income people. As in most developing countries, the main concern here is the large proportion of the unbanked population group. Through increased access to savings, credit, insurance and other financial services, the disadvantaged population group can build financial security, manage risks against adverse shocks such as natural disaster and illness, and even invest in new business opportunities. Recent research showed that improving access to finance plays a crucial role in promoting economic growth and reducing poverty.

For Pacific Island nations, the financial inclusion initiative is specifically aimed to achieve four main goals (the Money Pacific Goals) by 2020: 1) All children to receive financial education through core curricula; 2) All adults to have access to financial education; 3) Simple and transparent consumer protection to be put in place; and 4) Twice as many Pacific islanders to have access to basic financial services. These goals were endorsed by Pacific Island Central Bank Governors and Finance Ministers in 2009.

relevant government institutions and the development partners in 2012 to develop a national strategy for financial inclusion.

In June 2011, at the request of the Reserve Bank, the Pacific Financial Inclusion Program (PFIP) worked with RBV to conduct a financial services sector assessment in Vanuatu. The aim of the study was to gather some baseline data that will assist in the development of a national strategy for financial inclusion in Vanuatu. The assessment estimated that only 19 percent of the total population of Vanuatu is currently using the available financial services in the country.

From July 2011 onward, after the Microfinance Week event in Port Vila, the Reserve Bank worked closely with the Money Pacific Project at the New Zealand Ministry of Pacific Affairs, to develop the first ever Money Pacific Calendar for 2012 for Vanuatu. The calendar is part of a shared effort to raise financial literacy in schools and communities, in town and in the rural areas, in line with the Money Pacific Goal number 2. The calendar contains practical tips on financial literacy, for each month, in English and Bislama. During the Christmas and New Year festivity seasons, eighteen thousand copies of the calendars were distributed to most secondary schools through the country, some rural communities, some business houses and the public in most islands. The distribution to the secondary schools was done with the assistance of the Department of Education.

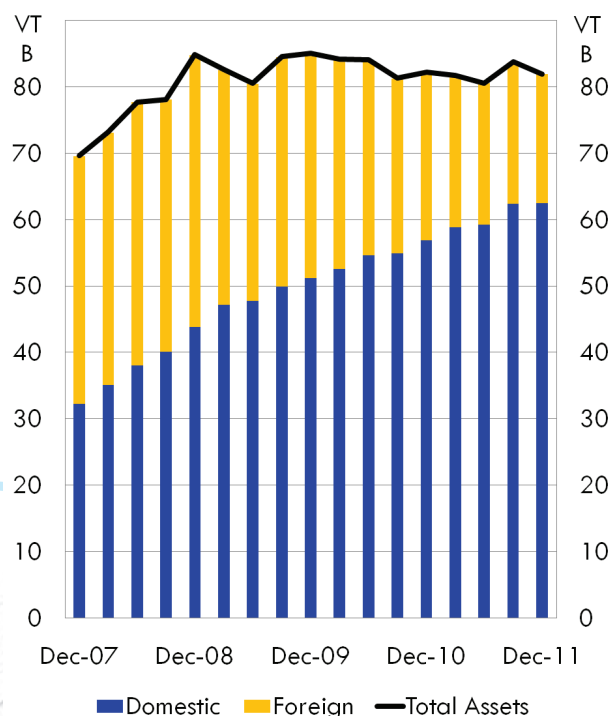
Later in the year the Reserve Bank, through a staff of the Unit, conducted a Study Visit to Fiji to discuss and learn from various personal and organizations who took part in the very initial stage of the developments of Financial Inclusion in Fiji. The study is expected to strengthen the staffs' skills in developing an approach, a work plan and the coordination of tasks to work towards the development of a viable national Financial Inclusion strategy in Vanuatu. The Bank is planning to start working in partnership with the private sector,

Financial Institution Supervision

Banking Sector Development

Domestic Banks Statement of Financial Position

Figure 11: Asset Position – Domestic Banks (Quarterly Data; Billions of Vatu)



For the twelve months to end December 2011, the domestic banking industry experienced a slight contraction in its overall financial position. Total assets dropped by 0.4 percent to VT81.9 billion (VT82.2 billion, Dec-10), driven largely from a decline in foreign assets by 23.3 percent to VT19.4 billion (VT25.3 billion, Dec-10). Domestic assets on the other hand increased 9.8 percent to VT62.5 billion (VT56.9 billion, Dec-11).

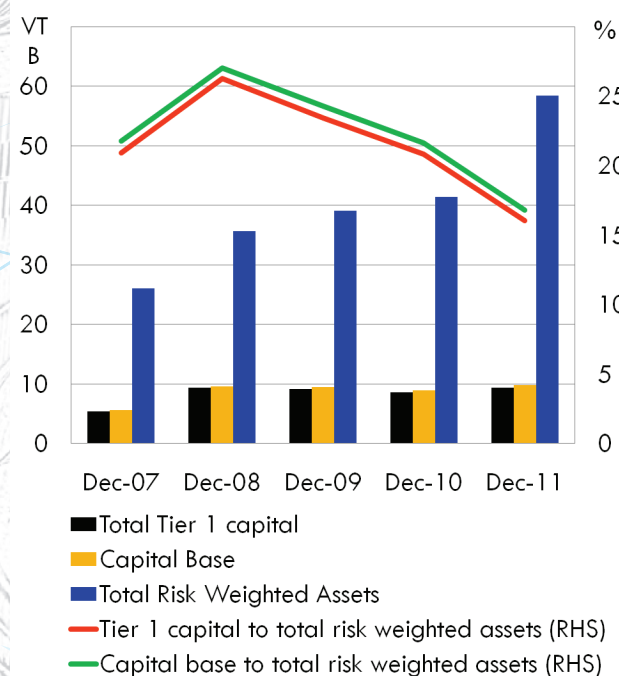
The annual reduction in foreign assets resulted from a drop in balances due from banks overseas by 26.9 percent to VT16.6 billion (VT22.7 billion, Dec-10), while growth in domestic assets is driven mainly from a 9.1 percent increase in private sector credit to VT47.9

billion (VT43.9 billion, Dec-10).

In contrast, the industry's liabilities (excluding capital) fell by 1.5 percent to VT70.7 billion (VT71.8 billion, Dec-10), sourced largely from a decrease in foreign liabilities by 14.9 percent to VT13.9 billion (VT16.4 billion, Dec-10). Alternatively, domestic liabilities increased by 2.5 percent to VT56.8 billion (VT55.4 billion, Dec-10), driven from a 0.7 percent growth in total domestic deposits to VT52.9 billion (VT52.6 billion, Dec-10). This reflected mainly growth in Vatu deposits by 4.1 percent to VT35.6 billion (VT33.2 billion, Dec-10), while foreign currency deposits decreased 10.2 percent to VT17.4 billion (VT19.4 billion, Dec-10).

Capital

Figure 12: Capital Adequacy & Tier 1 Ratio (Quarterly Data; Percent)



The aggregated capital position of the domestic banking industry continued to remain healthy over the year despite registering a fall in the overall capital adequacy ratios of the banking industry. For the year under review, the industry's capital grew by 9.6 percent to VT9.8 billion (VT8.9 billion, Dec-10) over the previous year. This increase reflected mainly growth in Tier 1 capital by 8.6 percent to VT9.4 billion (VT8.6 billion, Dec-10), due largely to a 2.6 percent increase in paid-up capital to VT3.6 billion (VT3.5 billion, Dec-10). Tier 2 capital also registered a growth of 35.6 percent to VT446.3 million (VT329.1 million, Dec-10) over the year however contributed a minor fraction of the industry's overall capital base.

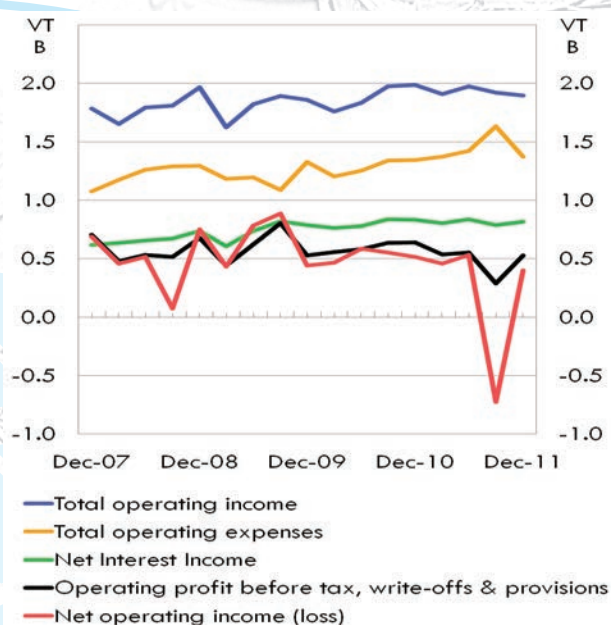
The annual review also witnessed a significant increase in banks total risks weighted assets by 41.1 percent to VT58.4 billion (VT41.4 billion, Dec-10). As a result, the industry's capital adequacy ratio fell to 16.8 percent from 21.6 percent in the previous year with tier 1 capital declining from 20.8 percent to 16.0 percent. However, this is maintained well above the Reserve Bank's regulatory requirement of 12 percent.

The financial performance of the industry dropped moderately over the year to end December 2011. The combined profit figure before tax, write-offs and provisions amounted to VT526.2 million, a reduction of 18.0 percent over the previous year (VT641.4 million, Dec-10). The decline is attributable to increases in total operating expenses recorded over the year by 1.9 percent to VT1.4 billion (VT1.3 billion, Dec-10), coupled with a reduction in total operating income of banks by 4.5 percent to VT1.9 billion (VT2.0 billion, Dec-10).

The annual increase in the industry's total operating expenses resulted from increases in interest expenses and operating expenses recorded over the year by 4.9 percent and 0.4 percent to VT491.2 million (VT468.3 million, Dec-11) and VT879.8 million (VT876.6 million, Dec-10) respectively. In contrast, the decline in total operating income mainly reflected decreases in non-interest income by 14.0 percent to VT589.0 million (VT684.9 million, Dec-10). As a result, net interest income declined 1.9 percent to VT817.0 million (VT833.0 million, Dec-10). After allowing for bad debts written-off over the year, the industry's net profit reached VT400.3 million (VT514.3 million, Dec-10).

Financial Performance

Figure 13: Earnings – Domestic Banks (Quarterly Data, Billions Vatu)



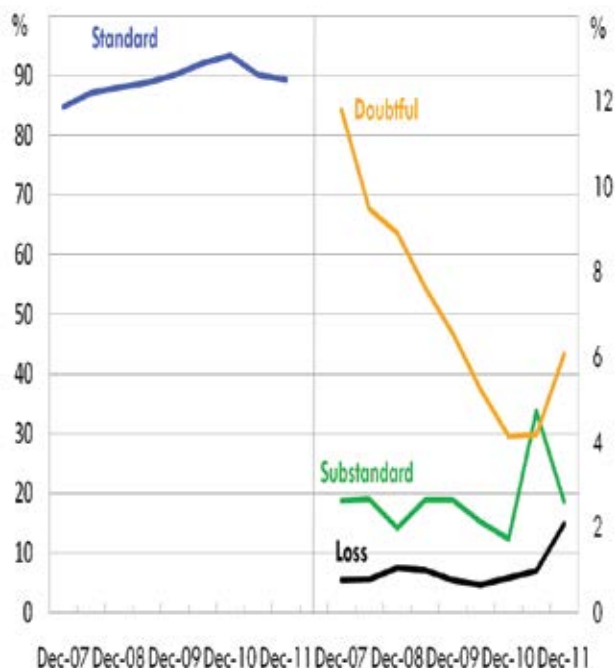
The negative performance of the industry over the year led to deterioration of all major efficiency ratios. Return on assets (ROA) and return on equity (ROE) was reduced from 0.8 percent and 6.2 percent to 0.6 percent and 4.7 percent respectively. The ratio of operating expenses to operating income also grew from 67.7 percent to 72.3 percent and ratio of interest expense to total expense rose from 34.8 percent to 35.8 percent. The ratio of non-interest expense to gross income went up to 46.4 percent from 44.1 percent while non-interest income to operating income fell to 31.1 percent from 34.5 percent from the previous year. These movements reflected the strong competition in the banking industry given our small market size.

¹ Reserve Bank categorizes capital in a two tier system where each banks are obliged to maintain at all times a minimum ratio of total capital to risk weighted assets, on both consolidated group and standalone basis, of 12 percent (of which at least one-half must be tier 1 capital).

²Total impaired assets/non-performing loans is made up of doubtful and loss loans.

Asset Quality

**Figure 14: Asset Quality – Domestic Banks
(Share of Total Loans, By Loan Category)**

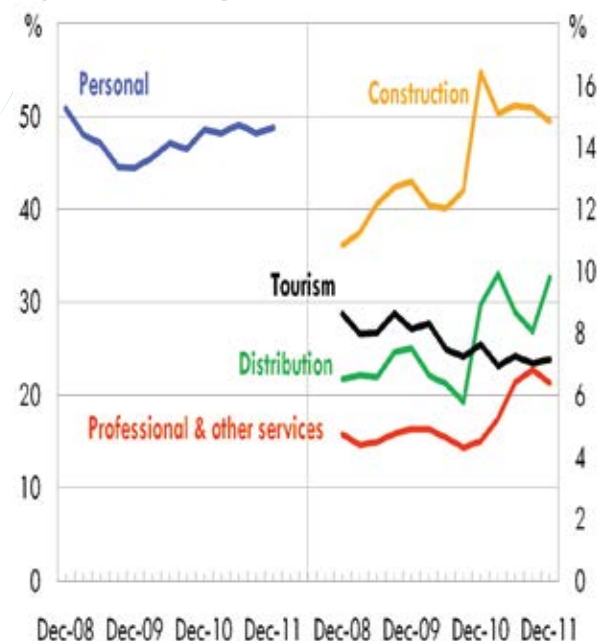


The asset quality of the domestic banking industry deteriorated significantly over the year under review. Total impaired assets² showed a marked increase of 79.8 percent to VT4.0 billion (VT2.2 billion, Dec-10), and accounted for 8.1 percent of total loans and 41.2 percent of total capital. This increase is driven from a sizeable growth in doubtful and loss loans by 60.3 percent and 179.1 percent to VT3.0 billion (VT1.9 billion, Dec-10) and VT1.0 billion (VT367.8 million, Dec-10) correspondingly.

This increase coupled with the growth in standard and substandard loans by 4.6 percent and 65.4 percent to VT44.2 billion (VT42.3 billion, Dec-10) and VT1.3 billion (VT777.7 million, Dec-10) respectively, increased the overall lending of the banking industry by 9.4 percent to VT49.5 billion (VT45.3 billion, Dec-10).

Private Sector Lending

**Figure 15: Private Sector Credit Domestic Banks
(Quarterly Data; Percent)**



Private sector credit of the domestic banking industry continued to grow over the years. For the year ended December 2011, the industry's total private sector credit reached VT48.6 billion (VT44.7 billion, Dec-10), an increase of 8.7 percent over the previous year. This increase is mainly triggered from growth in personal lending by 9.1 percent to VT23.7 billion (VT21.7 billion, Dec-10) and accounted for 48.8 percent of total private sector credit (TPSC).

Other major contributing sectors to this growth include tourism (9.8 percent of TPSC), which grew by 19.2 percent to VT4.8 billion (VT4.0 billion, Dec-10), professional and other services (6.4 percent), 54.6 percent to VT3.1 billion (VT2.0 billion, Dec-10), Distribution (7.1 percent), 1.6 percent to VT3.5 billion (VT3.4 billion, Dec-10), and manufacturing (3.8 percent), 7.4 percent to VT1.8 billion (VT1.7 billion, Dec-10).

Lending to financial institutions, entertainment and catering, mining and quarrying, government and public utilities also recorded positive growth over the previous year however accounted for less than 1.2 percent of total private sector credit.

Construction sector, transport, agriculture and fisheries sector however reported negative growth over the year.

²Total impaired assets/non-performing loans is made up of doubtful and loss loans.

Liquidity Position

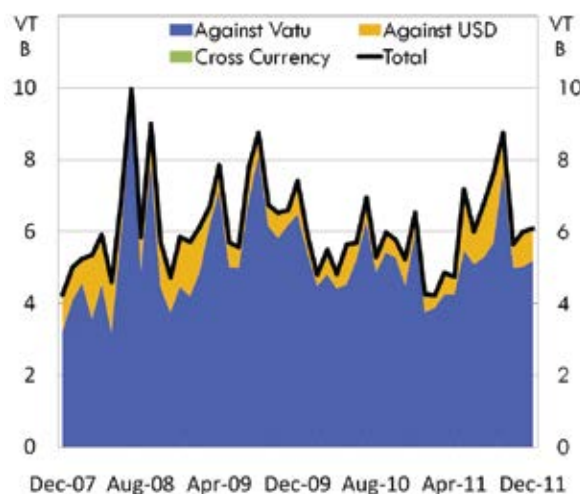
Figure 16: Liquid asset ratio Domestic Banks (Quarterly Data; Percent)



Liquidity position of the domestic banking industry remained relatively strong over the year, with total liquid assets recorded at VT7.1 billion (VT6.3 billion, Dec-10), equivalent to 13.4 percent of total domestic deposits. This showed an increase of 14.1 percent over the previous year. At this level, the industry's liquid asset ratio (LAR) stood at 17.3 percent, up from 17.5 percent in December 2010 and is maintained well above the Reserve Bank's regulatory threshold limit of 7.0 percent. The industry's LAR fluctuates occasionally reflecting mainly movements of funds in the industry's balance sheet, whether due to increased deposits placed with banks or from a loan drawdown from the banking system.

Foreign Exchange Turnover

Figure 17: Foreign Exchange Turnover Position of Domestic Banks (Quarterly Data; Billions of Vatu)



Total foreign exchange turnover of the domestic banking industry depends exclusively on the rates offered locally and abroad. In the twelve months to end December 2011, total foreign exchange dealings of the domestic banking industry fell by 7.0 percent to VT6.1 billion (VT6.5 billion, Dec-10). The annual decline reflected reduction in foreign exchange dealings against Vatu over the year by 13.1 percent to VT5.2 billion (VT5.9 billion, Dec-10). Alternatively, foreign exchange dealings against USD and other currencies increased by 49.7 percent and 153.8 percent to VT830.6 million (VT554.7 million, Dec-10) and VT75.3 million (VT29.7 million, Dec-10) respectively. The industry mainly struck deals against Vatu and USD currency and less of other currencies.

³Personal lending comprised of housing and land purchases and others.

International Banks

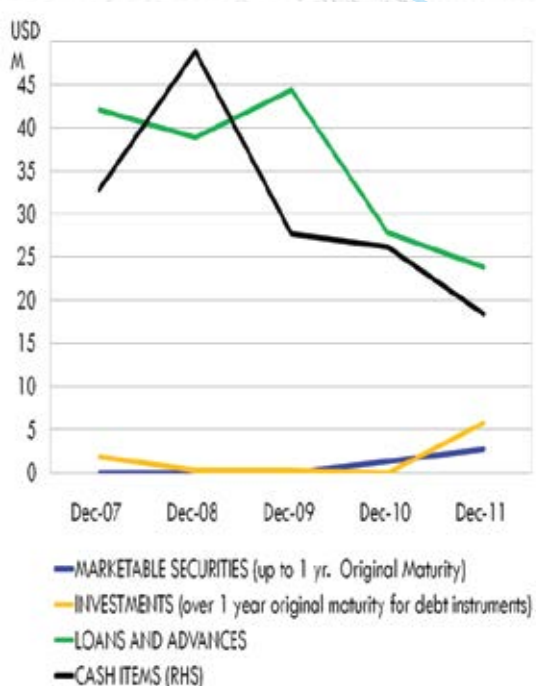
Statement of Financial Position

The international banking industry recorded an 18.2 percent decline in annual total assets to USD84.3 million (Dec-10: USD103 million) and was attributable to decreases in Cash items (29.69 percent to USD51.6 million), Loans & advances (14.5 percent to USD23.8 million) and other assets (35.8 percent to USD312 thousand). On the other hand, marketable securities and investments both recorded huge increases of 109 percent to USD2.8 million (Dec-10: USD1.3 million) and from USD7 thousand to USD5.8 million respectively. Note that all graphs are based on annualized data.

Total liabilities (less shareholders equity) also decreased by 19.1 percent to USD78.8 million (Dec-10: USD97.5 million) as a result of declines in all liabilities items. Mainly deposits fell from USD94.3 million to USD78 million and accrued liabilities by 19.3 percent to USD579 thousand (Dec-10: USD717 thousand). Other liabilities (USD123 thousand) and term debt and other borrowings (USD50 thousand) also contributed to the decline.

Note that cash items (asset) and deposits (liability) still dominated the banks' balance sheet.

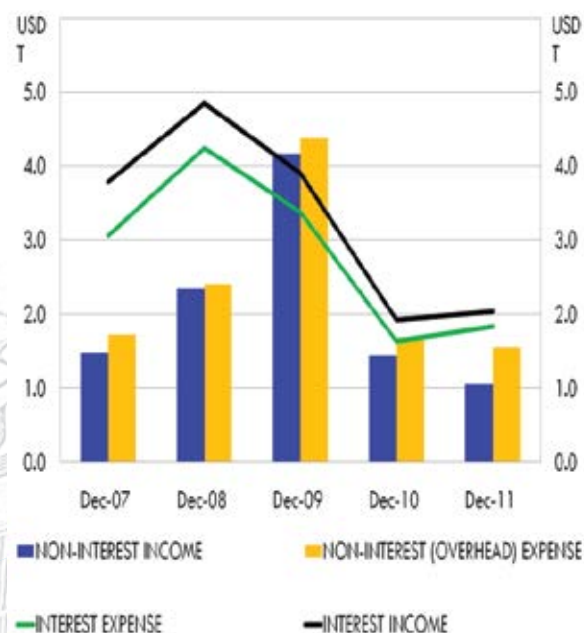
Figure 18: Offshore Banking Industry Total Assets
(Quarterly Data; Millions USD)



Statement of Financial Performance

The offshore banking industry annual performance improved significantly with a 79.5 percent increase in net earnings to USD78 thousand (Dec-10: USD39 thousand), reflecting growth in non-interest income to USD374 thousand (Dec-10: USD277 thousand) and also net gain (USD75 thousand). These increases offset the increase in both interest expense and non-interest expense during the period by 7.8 percent to USD470 thousand and by 8.4 percent to USD400 thousand respectively.

Figure 19: Offshore Banking Industry Earnings
(Quarterly Data; Thousands USD)

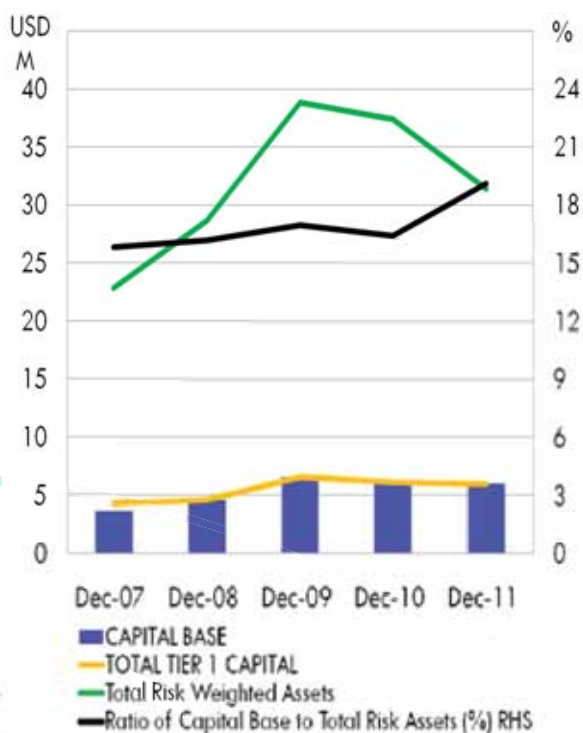


The downturn trend since 2008 as revealed in the chart above is related to the latest downfall in the worldwide financial system. International banks continue to rely mainly on interest-bearing activities as their significant part of their operations.

Capital

The combined international banks capital base annually reduced marginally by 2.4 percent to USD6 million (Dec-10: USD6.1 million) and was attributable predominantly to the reduction in Tier 1 Capital in similar proportion. Tier 1 Capital decreased due to the declines in un-appropriated earnings and additional paid-up capital in excess of net value by 6.2 percent to USD1.6 million and by 19.3 percent to USD285 thousand respectively. Contributing to this reduction is the net loss of USD78 thousand recorded this year-end.

Figure 20: Offshore Banking Industry Capital
(Quarterly Data; Millions USD; Percent)



Total risk weighted assets also declined considerably by 16.2 percent to USD31.3 million (Dec-10: USD37.4 million). Given these changes, the ratio of capital base to total risk assets increased from 16 percent to 19 percent.

Financial Institutions Supervision Department

During the year, Financial Institutions Supervision Department continued with its supervisory and regulatory roles in conducting offsite analysis as well as onsite reviews on the domestic banks, international banks, insurance companies and other financial institutions. For domestic commercial banks, the onsite reviews focus on asset quality, securities and provisioning.

In October, the Reserve Bank of Vanuatu through the department hosted its first ever Australian Prudential Regulation Authority (APRA) and AUSAID sponsored capacity building program for financial supervisors who are members of the Association for Financial Supervisors of Pacific Countries (AFSPC). The program focused on Vanuatu National Provident Fund (VNPF) and the review was on all risks that are inherent in VNPF, especially operational risk. It was a timely onsite review given the current restructuring exercise being undertaken at the Fund. Technical advice and training was provided by APRA while participants came from National Reserve Bank of Tonga, Central Bank of Solomon Islands, Central Bank of Samoa, Bank of Papua New Guinea, Reserve Bank of Fiji and Financial Services Commission Cook Islands. It was a two week exercise.

During the year in July, the department represented the Bank as a presenter during the Pacific Microfinance Week in Port Vila. The presentation focuses on the topic "We take a moment to focus on the financial service provided in our host country, Vanuatu. What is the Vanuatu financial landscape and how has it developed over the years to provide financial services to all economic groups in the country?"

The Bank also formally revoked the license of an international bank. The department continues to receive enquiries from potential wanting to establish domestic bank, international banks and insurance business.

In terms of legislation and guidelines, the Bank also revised and implemented Prudential Guideline 4 (Capital Adequacy) which includes capital charge for operational risk. This addresses part of the Basel II's international recommendations. The other Guideline being reviewed is Guideline 8 on Largest Exposures.

Reserve Bank Operations

The Bank has farewell one of its dedicated worker; In a function hosted by the Governor and Management, the bank fare well Mr. Alick Willie who is the Bank's Driver/Messenger for the last 15 years. The Governor thanked Alick for his faithful contribution to the bank and wishes him well before handing him his retirement cheque.

The bank appointed Mr. Fred Kelep to take up responsibility as Driver/Messenger and Caretaker and created a new Grounds man position which was advertised and later filled in by Mr. Thefa Nawinmal.

The Bank has developed policies for Tender, Vehicle, Key and Security which was approved by the Board. These policies will assist the Bank to better manage these important responsibilities under the respective department.

Security Section:

The Reserve Bank Security Officers has ended another successful year in providing surveillance during major and important occasions organized by the Reserve Bank of Vanuatu. The RBVSO provide and maintain a 24 hours appropriate physical security Surveillance, Currency Processing/Movement of Transactions and Storage facilities for the Bank.

Some of the major security operations in 2011 are as follows:

- The Official Finance Minister Visit to the Bank
- The Foreign Affairs Ministers Conference in the Conference room
- The transportation of the Vanuatu Passports to the Bank for secondary storage.
- Provide security during Contract Maintenance provided under SLA
- Pacific Island Financial Inclusion Working Group Meeting
- 30th Anniversary Celebrations at the Blue Waters
- Symposium Meeting at the Le lagoon Resort

There is a great need to include at least two more security officers in the team after the transfer of an officer to full time front officer.

The Maintenance

The maintenance section consisted of two main areas and that is the general building maintenance and the grounds and landscaping maintenance.

The Maintenance section has carried out some major maintenance in 2011. The first being the conversion of the old UNELCO transformer shed into the new storage facility. The tiling of Archive 2 and building of new shelves, setting up of the Archive 1 with the assistance of casual labors.

The work of upgrading landscaping for the opposite property also is a major project with the relocating of the nursery shed from No.2 property to the opposite property. With the recruitment of a new Groundsman, the team has also taken over the decoration of the offices from Rainbow gardens.

Cleaning

Cleaners performed a very important role in the bank by cleaning all offices, preparing tea for staff; organizing conference venues and general clean up. The Bank has four full time Cleaners after recruiting an additional cleaner in 2011.

The bank has continued to maintain a very successful quarterly cleaning sessions. These quarterly cleaning sessions are carried out by the Property & Assets Staff and it is in its fourth year after the opening of the building in 2008.

Such cleaning is part of the bank's planned and preventative maintenance.

Vehicles

The bank continues to maintain a fleet of four vehicles of which two are driven by Governor and Deputy Governor and the other two are use for normal bank business.

The bank has trade in the old Governors Nissan vehicle for a new Toyota Prado. The Bank has a new policy in place to govern the use and purchase of new vehicle. The new policy has in place a Vehicle Requisition Form for the control and management of the pool vehicles.

Conference Room Upgrading

The bank has continued to upgrade its conference facilities by carrying out a full maintenance and renovations works. The maintenance works includes sanding the timber ceiling and varnishing. The renovation works consisted of the following:

- * A dividing partition separating the kitchen area from the conference room
- * Installation of 2 new 24btu Air Conditioning System
- * Installation of a new extract fan in the kitchen and carpeting of the conference area.

Training

The following trainings were offered to Property and Assets section staff:

- Security Surveillance training run by Chubb Security – Security Officers were awarded certificates for their attendance.
- Protective Security attended by all Security Officers and organized by Manager Property and Assets and Chief Security Officer.
- Fire Safety Training attended Security officers and Fire Wardens organized by Property and Assets section and run by Professional Fire Services.
- Floral Arts Training attended by Thefa and Nancy Sarai. A competition was organized by USP during the Open day the duet won first prize in their presentation.

General Administration Services

The General Administration Services, in 2011, continued to facilitate traveling logistics for staff training and the Bank's official representations both locally and overseas. The office recorded an increase in staff traveling overseas, after a cutback in 2010 due to a tight operating expenditure budget. Some of the trainings undertaken in 2011 were partly sponsored; mostly by the International Monetary Fund.

Payroll continued to be maintained with the assessment & processing of loans. The revised loan policies were reviewed; and came into effect in August 2011.

The process and acquisition of products and services continued to be maintained both locally and overseas. The imported goods and services during the year were mainly furniture and uniform samples from Australia; 30 years of Central Banking shirts from Fiji; and security equipments and onsite Security Training provided by Chubb, New Zealand.

Library

The library has actively continued to promote timely and quality information with its resources.

In June 2011 the library hosted an exhibition to commemorate the Bank's 30 years of services in Vanuatu. The exhibition was mainly about news, articles and photographs collected by the bank from 1980 to 2010. Mrs. Jennifer West was also invited to exhibit some of her personal traditional money collected from Vanuatu and other the pacific islands. The library continued to maintain its services to provide adequate information to bank staff and the public. Staff accessing the library facilities such as internet search, loan and reader services continue to increase daily. Students from both primary and secondary schools, and Port Vila's two tertiary institutions, namely INTV and the Vanuatu Institute of Teachers Education (VITE) continued to maintain high number of visits to the Bank's library. The library coordinated visits on the topics of "Understanding Money, the Exchange Rate and the Role of Central Bank" to various schools in Port Vila and Outer Islands. The Awareness team of the Bank visited Year 8 students of Central School in Port Vila; Aore and Santo East Primary School, in Santo; College d'Norsup, Lakatoro Junior Secondary

School (JSS) and Rensarie Bilingual College in Malekula; Tafea College, Isangel JSS, Lenakel JSS and Kwataparam JSS in Tanna.

The library continued to maintain its relation with the Government Departments and other Central Banks and continued to serve as a depository for the World Bank Group and the International Monetary Fund.

Banking

This year a rearrangement was done separating the Settlement office from the Banking office which was in the prior year operating as a combine office.

Towards year end 2011 a new Banking officer was recruited replacing the previous officer who was transferred to the MIS office.

The office continues to maintain its high level of customer services especially to the Government, by accepting and processing deposits from the Government through its teller. Commercial Bank settlement accounts and other customer accounts continued to be monitored throughout the year.

A very essential function of the Banking office is the supervising of the clearing house. Clearing is done on a daily basis at 8.00am. Due to the increase in the volume of transaction it was agreed with the commercial banks that another clearing is to be conducted at 2.30pm on Friday's to accommodate the increase.

The table below shows the 10 year summary of transactions conducted through the clearing house from 2001 to 2011.

A slight decrease was noted in the number of effects in 2011 from the previous year and likewise in the total value of transaction. However, the number of effects and value of transaction processed through the Port Vila Clearing House still range over 350,000 cheque items and 60 billion vatu to 70 billion vatu respectively for the year ended 2011.

PORT VILA CLEARING SUMMARY for 2007

Period	No. of Effects	Value(MVT)
2001	378,016	34,995
2002	335,462	33,878
2003	263,664	28,230
2004	264,859	31,985
2005	279,162	38,562
2006	286,615	67,548
2007	370,738	60,343
2008	307,298	67,375
2009	400,757	69,356
2010	391,969	72,916
2011	377,826	69,147
Total	3,676,826	547,702

Accounts Section

The accounts office as part of the Accounts and Customer services department continues to maintain its reporting requirements in compliance with IFRS and the Reserve Bank Act

Skills upgrading continues to be part of the section's goals. During the year two members of the team were fortunate to attend for the first time the EPICOR Perspective which is an annual event held for its members to provide updates on the EPICOR financial products and provide an opportunity for customers of EPICOR Products to maximize their investment in EPICOR solutions. The event has enlightened us on a lot of issues that needs enhancement with the current EPICOR financial system that the Bank is using.

This year was also the final contract term for the Bank's external auditor, PricewaterhouseCoopers. Through its tender process for a new external auditor for the next five years, PricewaterhouseCoopers was awarded the contract yet again.

Though a lot of challenges were encountered during the course of the year, the office continues to maintain a normal operation.

Currency Office

During the year, the Bank continues to perform its function of sole issuer of the country's currency through the Currency Office.

(a) VT1/VT2 Coins

Following its public announcement to effectively stop issuing the VT1/VT2 coins on 31 March 2011, the Bank devised a rounding system which can be adopted by cash handlers in the absence of these two coins. The Bank undertook a public awareness on the possible effect of this new development in the Vatu currency among shops, financial institutions and the general public in the urban centres of Port Vila, Luganville including the municipalities of Lakatoro, Malekula and Lenakel, Tanna.

(b) Counter Transactions

The total value of counter transactions increases from previous year by 12.7 percent to a new total of VT12,636 million. During the year, the Bank continued to issue more notes and coins into public circulation than its withdrawal taking the total value of currency in circulation to a new peak level of VT 6,581 million which is an increase of 11.9 percent from previous year.

Counter Transactions			
Period (Year)	Deposits (MVT)	Issues (MVT)	Total (MVT)
2000	4,136	4,143	8,281
2001	3,980	4,098	8,078
2002	3,873	3,902	7,775
2003	3,965	4,235	8,200
2004	3,390	2,864	6,255
2005	3,442	3,773	7,215
2006	4,199	4,719	8,918
2007	4,576	5,311	9,887
2008	5,501	5,772	11,273
2009	5,425	5,636	11,061
2010	5,373	5,836	11,209
2011	5,960	6,676	12,636

Denomination wise, the VT5000 continues to maintain the lead position of being the highest value denomination in circulation by 42 percent, followed by VT1000 at 33 percent. The newly issued VT10000 takes third position followed by VT100 while the VT500 maintained the fifth position ahead of the VT200, followed by VT20, VT50, VT10, VT5, VT2 and VT1.

(c) Counterfeits

The Bank intercepted and confiscated only 3 counterfeits of the Vatu notes in its operation during the year. This may be due to the successful awareness program undertaken by the Bank to educate the general public on security features of the Vatu notes through distribution of educational materials and through the commercial banks' vigilant process of early detection during acceptance of their customers' cash deposits.

Counterfeits Summary								
Denomination	2005	2006	2007	2008	2009	2010	2011	Total
10000	-	-	-	-	-	-	-	-
5000	31	8	5	1	-	4	2	51
1000	11	6	18	4	1	-	1	41
500	1	-	-	-	-	1	-	2
200	2	-	-	-	-	-	-	2
Total	45	14	23	5	1	5	3	96

The public is continually reminded to take extra care in dealing with any suspicious looking notes.

(d) Numismatics

The Bank continued to collect commission from sales of collectors' items and also received royalties from the international sales of proof sets of coins which were struck under contracted Agreements with renowned international Mints.

Settlement Office

The Accounts and Customer Services Department (ACSD), through the Settlement Office continues to play an important role in the Payment and Settlement System of the Bank. With the SWIFT system that the Office uses, all foreign currency trades and investments, invoice payments and transfers are settled and paid when they are due.

During the year, the SWIFT system went through a major mandatory system upgrade, from SWIFTAlliance version 6.0 to SWIFTAlliance version 7.0. With version 7.0, SWIFT connectivity will be solely internet based. The upgrade was made successful through the assistance of a consultant from Decillion group, a SWIFT service partner and staff of the ICT unit. The settlement office staff commenced using the version 7.0 towards the end of October. A major achievement brought about as a result of the upgrade is a 50% reduction in the monthly connectivity charges.

The settlement office also recruited a new female settlement officer this year. She joined the office in mid December 2011 and her recruitment now completes the Settlement Office team, comprised of the Manager, a Settlement Officer and a Settlement Clerk, as per structure of the Settlement Office.

Operating independently from the Banking Office this year for the first time was a challenge for the Settlement Office. Despite these challenges, the team was able to effectively perform the functions of the office and meet its objectives and goals completing yet another successful year.

Budgeting

The Bank's 2011 budget stands at VT717 million which is an increase of 13 percent of the previous year's level of VT622 million. With the increase budget the net deficit gap has slightly widen to VT108million compared to a deficit of VT93million in the prior year.

The increase in the budget deficit is due to the projected uncertainty of the global economic outlook for the year 2011, which saw a conservative budget on the Revenue forecast. Overhead operational cost continues to increase as Bank's operations increases. Year end results show a positive outlook as opposed to the net deficit that was forecasted. Net profit for the year was VT151million, compared to a deficit of VT108million that was budgeted for though this was a

decline of 51% in profit compared to the 2010 profit of VT310million. Revenue collection has exceeded target of VT608 million to VT757million. Total expenditure on the same was below the budgeted allocation of VT717 to VT608 million.

	Budget (VTmillion)	Actual(VTMillion)
Revenue	608	757
Expenses	717	606
Net Profit/(Loss)	(108)	151

The good results reflects the prudent investment strategies efforts of the Bank during the year against the weak Global economic environment and the tight control over the budget spending that the Bank continues to operate under.

Income

The Bank recorded an operating income of VT763.5 million in the year 2011. This is a decrease of 12% over the 2010 position of VT856.1 million.

Foreign interest earnings and other interest income accounted for 82% of the total income, while 3% is from other income and 15% is from realized gains on foreign exchange movements.

Expenditure

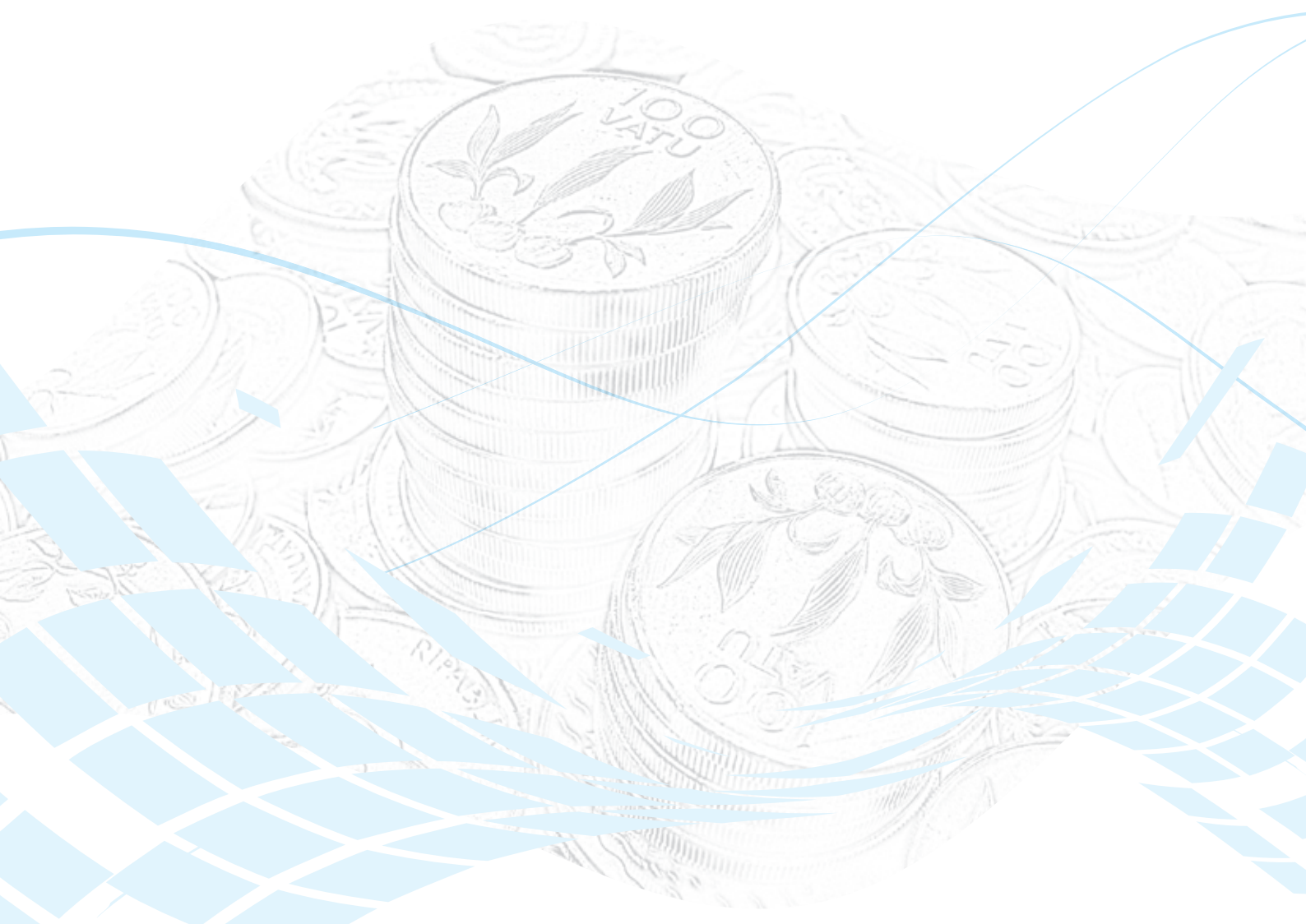
Total expenditure for this year has increased slightly by VT51.7million from 546.4million in 2010. The slight increase was due to various expenditure heads that have slightly increased compared to the same period in 2010

Operating Profit

A total of VT165.2 million in operating profits were recorded for the year ended 2011 after the deduction of the net expenditures. This is a decrease in net profits by 87% as compared to the 2010 profits. The weak global economy and increase operation contributed to the decline.

Payment to Government

Based on the above results, according to section 7(3) of the Reserve Bank Act, an amount of VT138million was transferred to the Government of Vanuatu, being 90% of the profits. 10% of which is transferred to the General reserve account of the Bank.



Statement by directors

NOTES TO AND FORMING PART
OF THE FINANCIAL STATEMENTS
statement of changes in equity
Independent Auditors Reports

FINANCIAL STATEMENTS

Statement of
FINANCIAL Position

Directors Report

Statement of Comprehensive Income

STATEMENT OF CASH FLOW

statement of distribution

Financial Contents

Directors' Report

Page 1

Statement by Directors

Page 3

Independent Auditors
Report

Page 4

Statement of
Comprehensive Income

Page 6

Statement of
Distribution

Page 7

Statement of
Financial Position

Page 8

Statement of
Changes in Equity

Page 9

Statement of Cash Flows

Page 10

Notes to and forming part
of the financial statements

Page 11

DIRECTORS' REPORT

In accordance with a resolution of the Board of Directors, the directors herewith submit the Statement of Financial Position of the Bank as at 31 December 2011 and the related Statements of Comprehensive Income, Distribution, Changes in Equity and Cash Flows for the year ended on that date and report as follows:

1. DIRECTORS

The following were directors of the Bank at any time during the financial year and up to the date of this report:

Odo Tevi – Chairman
Georges Maniuri
Jimmy Nipo
Jack Kilu
Marinette Nial Molisa

2. PRINCIPAL ACTIVITIES

The Bank's role as a central bank, as defined in the Reserve Bank of Vanuatu Act [CAP 125], is:

- (a) to regulate the issue of currency and the supply, availability and international exchange of money;
- (b) to promote monetary stability;
- (c) to promote a sound financial structure;
- (d) to foster credit and exchange conditions conducive to the orderly and balanced economic development of the country;
- (e) to regulate the banking and insurance industry.

3. TRADING RESULTS

The operating profit of the Bank for the year ended 31 December 2011 was VT165.288m (2010: VT309.716m).

4. RESERVES

An amount of VT16.529m (2010: VT162.265m) was transferred to the General Reserve for the financial year ended 31 December 2011, being 10 percent of the Net profit available for distribution for the year.

5. PAYABLE TO GOVERNMENT

In accordance with the Reserve Bank of Vanuatu Act [CAP 125] section 7(3), the balance of the amount available for distribution after allocation/transfer to the General reserve is to be distributed to the Government. Realised gains from the retain earnings reserve are also available for distribution to the Government depending on Board approval.

An amount of VT137.499m (2010:VT50m) is payable to the Government of the republic of Vanuatu.

6. BAD AND DOUBTFUL DEBTS

The directors took reasonable steps before the Bank's financial statements were made out to ascertain that all known bad debts were written off and adequate provision was made for doubtful debts.

DIRECTORS' REPORT – continued

6. BAD AND DOUBTFUL DEBTS - continued

At the date of this report, the directors are not aware of any circumstances which would render the amount written off for bad debts, or the amount of the provision for doubtful debts, inadequate to any substantial extent.

7. PROVISIONS

There were no material movements in provisions during the year apart from the normal amounts set aside for such items as doubtful debts, depreciation and employee entitlements.

8. ASSETS

The directors took reasonable steps before the Bank's financial statements were made out to ascertain that the assets of the Bank were shown in the accounting records at a value equal to or below the value that would be expected to be realised in the ordinary course of business.

At the date of this report, the directors are not aware of any circumstances which would render the values attributable to the assets in the financial statements misleading.

9. DIRECTORS BENEFIT

No director of the Bank has, since the end of the previous financial year, received or become entitled to receive a benefit by reason of a contract made by the Bank with the director or with a firm of which the director is a member, or with a company in which the director has substantial financial interest.

10. EVENTS SUBSEQUENT TO BALANCE DATE

Since the end of the financial year the directors are not aware of any matter or circumstances not otherwise dealt with in this report that has significantly affected the operations of the Bank, the results of those operations or the state of affairs of the Bank.

11. BASIS OF ACCOUNTING

The Directors believe that the basis of preparation of accounts is appropriate and the Bank will be able to continue in operation for at least 12 months from the date of this statement. Accordingly, the Directors believe that the classification and carrying amounts of the assets and liabilities as stated in the accounts to be appropriate.

12. OTHER CIRCUMSTANCES

At the date of this report, the directors are not aware of any circumstances not otherwise dealt with in this report or financial statements which render any amounts stated in the financial statements misleading.

13. NO UNUSUAL TRANSACTIONS

The results of the Bank's operations during the financial year have not in the opinion of the directors been substantially affected by any item, transaction or event of a material and unusual nature.

For and on behalf of the Board of Directors in accordance with a resolution of the Directors this 3rd day of October 2012.


.....
Governor (Chairman)


.....
Director

STATEMENT BY DIRECTORS

In the opinion of the Directors:

- (a) the accompanying statement of comprehensive income is drawn up so as to give a true and fair view of the results of the Bank for the year ended 31 December 2011;
- (b) the accompanying statement of distribution for the year ended 31 December 2011 is drawn up to reflect amounts transferred to the various reserves and distributable to the Government in line with the Reserve Bank of Vanuatu Act [CAP 125] and or as directed by the Government;
- (c) the accompanying statement of financial position is drawn up so as to give a true and fair view of the state of affairs of the Bank as at 31 December 2011;
- (d) the accompanying statement of changes in equity is drawn up so as to give a true and fair view of the movement in equity for the year ended 31 December 2011; and
- (e) the accompanying statement of cash flows is drawn up so as to give a true and fair view of the cash flows of the Bank for the year ended 31 December 2011.

For and on behalf of the Board of Directors by authority of a resolution of the Directors this day of October 2012.



.....

Governor (Chairman)



.....

Director



Independent Auditor's Report

To the Shareholder of the Reserve Bank of Vanuatu

Report on the Financial Statements

We have audited the accompanying financial statements of the Reserve Bank of Vanuatu (the 'Bank'). The financial statements comprise the statement of financial position of the Bank as at 31 December 2011 and the statements of comprehensive income, distribution, changes in equity and cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

Directors' and Management's Responsibility for the Financial Statements

Directors and Management are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and with the requirements of the Reserve Bank of Vanuatu Act [CAP 125] and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by directors and management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Independent Auditor's Report - continued

Opinion

In our opinion the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2011, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

In our opinion:

- a) proper books of account have been kept by the Bank, so far as it appears from our examination of those books, and
- b) the accompanying financial statements are in agreement with the books of account and to the best of our information and according to the explanations given to us give the information required by the Reserve Bank of Vanuatu Act [CAP 125] in the manner so required.

We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit.

Restriction on Distribution or Use

This report is made solely to the Bank's shareholder. Our audit work has been undertaken so that we might state to the Bank's shareholder those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Bank's shareholder as a body, for our audit work, for this report, or for the opinions we have formed.

Suva, Fiji
3 October 2012


PricewaterhouseCoopers
Chartered Accountants

RESERVE BANK OF VANUATU

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2011

(Expressed in 000's Vatu)

	Notes	2011	2010
Operating revenue			
Interest income	7	626,399	566,320
Net unrealised gains in foreign securities market prices		77,027	66,707
Net foreign exchange gains		36,674	207,835
Other income		23,424	15,291
		-----	-----
Total revenue		763,524	856,153
		=====	=====
Operating expenses			
Interest expense	8	41,992	45,721
Personnel expenses	9	291,297	253,737
Other operating expenses	10	264,947	246,979
		-----	-----
Total expenses		598,236	546,437
		=====	=====
Net Profit for the year		165,288	309,716
Other comprehensive income			
Change in value of available for sale financial asset		9,169	(26,662)
		-----	-----
Total comprehensive income		174,457	283,054
		=====	=====

This statement of comprehensive income is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 11 to 32.

RESERVE BANK OF VANUATU

STATEMENT OF DISTRIBUTION FOR THE YEAR ENDED 31 DECEMBER 2011

(Expressed in 000's Vatu)

	Notes	2011	2010
Net profit for the year / Amount available for distribution		165,288 =====	309,716 =====
Transfer/ distribution as follows:			
Transfer to General Reserves (Section 7(1))	4	16,529	162,265
Transfer to Retain Earnings Reserve (Section 7(2))	5	11,260	97,451
Payable to Government of Vanuatu (Section 7(3))		137,499	50,000
		----- 165,288 =====	----- 309,716 =====

The statement of distribution is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 11 to 32.

RESERVE BANK OF VANUATU

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2011

(Expressed in 000's Vatu)

Assets	Notes	2011	2010
Cash and cash equivalents	11	10,419,308	9,917,845
Investment securities	11	5,267,712	4,525,900
Government securities	12	224,695	225,720
Government bonds	13	1,293,810	1,193,650
Other receivables	14	233,935	223,879
Currency stock (notes and coins)	15(a)	352,768	406,896
Property, plant and equipment	16	1,393,398	1,437,654
Intangible assets	17	18,277	23,720
International Monetary Fund (IMF):	20		
Reserve Tranche Position		359,332	358,633
Special Drawing Rights	11	214,925	222,627
Total Assets		19,778,160	18,536,524
		=====	=====
Liabilities			
Other creditors and accruals		65,226	27,560
Demand deposits	18	10,253,679	10,237,903
Reserve Bank of Vanuatu notes		1,619,144	1,196,565
Reserve Tranche Position		359,332	358,633
Currency in circulation	15(b)	6,581,483	5,880,886
Employee provisions	19	201,999	174,638
Total Liabilities		19,080,863	17,876,185
		=====	=====
Net Assets		697,297	660,339
		=====	=====
Capital and Reserves			
Paid up capital	21	100,000	100,000
General Reserve	4	216,529	200,000
Retain Earnings Reserve	5	108,711	97,451
Fair Value Reserve	6(a)	47,260	38,091
Asset Revaluation Reserve	6(b)	224,797	224,797
Total Capital and Reserves		697,297	660,339
		=====	=====

The statement of financial position is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 11 to 32.

RESERVE BANK OF VANUATU

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2011

(Expressed in 000's Vatu)

	Notes	2011	2010
Paid up capital			
Balance as at the end of the year		100,000 =====	100,000 =====
General Reserve			
Balance as at the beginning of the year		200,000	37,735
Transfer from current year profit		16,529	162,265
Balance as at the end of the year	4	216,529 =====	200,000 =====
Retain Earnings Reserve			
Balance as at the beginning of the year		97,451	-
Transfer from current year profit		11,260	97,451
Balance as at the end of the year	5	108,711 =====	97,451 =====
Fair Value Reserve			
Balance as at the beginning of the year		38,091	64,753
Change in value of available for sale financial asset		9,169	(26,662)
Balance as at the end of the year	6(a)	47,260 =====	38,091 =====
Asset Revaluation Reserve			
Balance as at the end of the year	6(b)	224,797 =====	224,797 =====
Total Capital and Reserves		697,297 =====	660,339 =====

The statement of changes in equity is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 11 to 32.

RESERVE BANK OF VANUATU

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2011

(Expressed in 000's Vatu)

	Notes	2011	2010
Cash flows from operating activities			
Interest received		633,913	507,155
Interest paid		(38,290)	(45,254)
Other operating receipts		23,424	15,291
Other operating payments		(360,363)	(424,396)
Purchase of currency stock		-	(182,879)
Net cash provided by / (used in) operating activities	22	258,684	(130,083)
Cash flows from investing activities			
Net movement in Special drawing rights		7,702	19,143
Net treasury notes and bonds (acquired) / matured		(655,617)	436,346
Interest received on Government securities		1,025	675
Net purchase of Government bonds		(100,160)	(799,200)
Net loans to staff		(10,595)	(17,771)
Purchase of property, plant and equipment		(39,993)	(56,054)
Purchase of computer software		(191)	-
Proceeds from sale of property plant & equipment		2,472	2,200
Net cash used in investing activities		(795,357)	(414,661)
Cash flows from financing activities			
Currency issued for circulation		700,597	588,838
Net movement in commercial banks deposits		25,278	1,144,304
Payments to Government		(117,780)	(277,705)
Net movement in international institutions and agencies deposits		(29,216)	(447,986)
Proceeds from issuing Reserve Bank of Vanuatu notes		422,579	250,119
Net cash provided by financing activities		1,001,462	1,257,570
Net increase in cash and cash equivalents		464,789	712,826
Cash and cash equivalents at the beginning of the financial year		9,917,845	8,997,184
Effects of exchange rate changes on foreign currency balances	3(b)	36,674	207,835
Cash and cash equivalents at the end of the financial year	11	10,419,308	9,917,845

The statement of cash flows is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 11 to 32.

RESERVE BANK OF VANUATU

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011

(Expressed in 000's Vatu)

1. THE LEGAL FRAMEWORK

The Reserve Bank of Vanuatu ("the Bank") operates under the Reserve Bank of Vanuatu Act [CAP 125] ("RBV Act"). The Bank is an independent legal entity wholly owned by, and reporting to, the Government of the Republic of Vanuatu. The Bank is responsible for ensuring:

- Regulation of the issue, supply, availability and international exchange of the currency of Vanuatu;
- Supervision and regulation of banking business and the extension of credit;
- Advising the Government on banking and monetary matters;
- Promoting monetary stability;
- Promoting a sound financial structure;
- Fostering economic conditions conducive to the orderly and balanced economic development of Vanuatu, and
- Regulation and supervision of domestic and international (offshore) banks.

Section 6 of the RBV Act states that the net profit of the Bank for any financial year shall be determined by the application of International Financial Reporting Standards (IFRS) and current central bank best practice. Net income may include both realised and unrealised gains and losses. However for prudency only net realised gains should be available for distribution.

The financial statements were authorised for issue by the Board of Directors on October 2012.

2. BASIS OF PRESENTATION OF FINANCIAL STATEMENTS

(a) Basis of preparation

The financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards ("IFRS") and the Reserve Bank of Vanuatu Act [CAP 125] ("RBV Act").

The financial statements have been prepared under the historical cost basis as modified by financial assets measured at fair value, with changes in fair value either through profit or loss or other comprehensive income.

The accounting policies have been consistently applied and, except where there is a change in accounting policy, are consistent with those of the previous year.

The financial statements are presented in Vanuatu currency (Vatu).

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 - continued**
(Expressed in 000's Vatu)

2. BASIS OF PRESENTATION OF FINANCIAL STATEMENTS - continued

(a) Basis of preparation - continued

Standards and interpretations issued but not yet effective

The following standards and interpretations have been issued and are mandatory for the Bank's accounting periods beginning on or after 1 January 2012 or later periods and have not been early adopted. Adoption of these standards and interpretations will not have any significant impact on the Bank's financial statements.

Standard/ Interpretation	Content	Applicable for financial years beginning on/after
IAS 1 Amendment	Financial statement presentation regarding other comprehensive income	1 July 2012
IAS 19 Amendment	Employee benefits	1 January 2013
IFRS 9 Amendment	Financial instruments: Classification and measurement	1 January 2013
IFRS 13	Fair Value Measurement	1 January 2013

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies adopted in the preparation of the financial statements are set out below:

(a) Revenue recognition

Operating revenue is recognised on an accruals basis and includes interest income, sundry income and profit on foreign exchange dealing with commercial banks.

(b) Foreign currency assets and liabilities

- i) Transactions in foreign currencies are converted to Vatu at the rates of exchange prevailing on transaction dates. Year-end assets and liabilities denominated in foreign currencies are converted at the rates of exchange ruling at year end.
- ii) All realised and unrealised gains and losses on foreign currencies are recognised in the statement of comprehensive income in accordance with the provisions of section 6 of the RBV Act and are included on the computation of the annual profits or losses of the Bank.
- iii) According to Section 7(2) of the RBV Act, the Board may set up other special retain earnings reserves from time to time when required. Such reserves may also be built up by net unrealised gains, and any subsequent realised components would then be available for distribution to the Government of the Republic of Vanuatu.

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 - continued**
(Expressed in 000's Vatu)

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES - continued

(c) Coins sold as numismatic items

The Bank sells, or receives royalties on coins which are specially minted or packaged as numismatic items. These coins have not been accounted for as currency in circulation as they were not issued for monetary purposes.

(d) Financial Assets and Liabilities

Financial Assets

Fair value through profit and loss financial assets

This category has two sub categories: financial assets designated as fair value through profit and loss at inception and those that are held for trading.

The bulk of the Bank's assets and liabilities are designated as fair value through profit and loss in compliance with the Bank's approved investment guidelines. This includes offshore investment securities which includes treasury notes, bonds and bills. These financial assets are carried at fair value through profit and loss and are valued at market bid prices on balance date.

Held to Maturity financial assets

These relate to Vanuatu Government bonds which are held to maturity and are valued in accordance with note 3 (k).

Available for Sale

Available for sale financial assets are those that are designated as available for sale or that are not classified as financial assets at fair value through profit and loss, or held to maturity. Available for sale financial assets include the Bank's shareholding in the Bank for International Settlements. Unrealised gains and losses arising from changes in the fair value are recognised in fair value reserve. When available for sale financial assets are sold or impaired, the accumulated fair value adjustments are included in the statement of comprehensive income as gains and/or losses.

Financial Liabilities

Demand deposit liabilities

Demand Deposits include deposits at call. Deposit balances are shown at their amortised cost, which is equivalent to their face value. Interest is accrued over the term of deposits and is paid periodically. Details of deposits are included in Note 18.

Currency in circulation

Currency issued by the Bank represents a claim on the Bank in favour of the holder. Currency in circulation comprises notes and coins issued by the Bank and the liability for currency in circulation is recorded at face value in the Statement of Financial Position.

Reserve Bank of Vanuatu Notes

Reserve Bank of Vanuatu Notes are valued at amortised cost.

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 - continued**

(Expressed in 000's Vatu)

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES - continued

(e) Property, plant and equipment

Land and buildings are shown at fair value, based on periodic valuations by external independent valuers, less subsequent depreciation for buildings. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset, and the net amount is restated to the revalued amount of the asset. All other property, plant and equipment is stated at historical cost less accumulated depreciation, and impairment (if any).

Depreciation is charged on a straight line basis over the estimated useful lives of the assets. The rates of depreciation used are based on the following estimated useful lives (in years):

- Reserve Bank Building 40
- Plant and equipment 3-10
- Motor vehicles 4

Leasehold land is amortised over the term of the lease, which presently varies from 30 to 75 years.

Assets are depreciated from the date of acquisition. Expenditure on repairs or maintenance of property, plant and equipment incurred which does not add to future economic benefits expected from the assets is recognised as an expense when incurred.

The gain or loss on disposal of assets is calculated as the difference between the carrying amount of the asset at the time of disposal and the proceeds on disposal, and is included in the statement of comprehensive income in the year of disposal.

(f) Intangible assets

Intangible assets refer to acquired and internally developed computer software. They are carried at historical cost less accumulated amortisation and impairment (if any). Cost of the software includes direct expenses incurred to acquire and bring to use the specific software.

Other enhancement cost to the existing software is capitalised only if the benefit will produce additional future economic benefit exceeding more than one year.

Capitalised acquired software and software development costs are amortised on a straight-line basis over its estimated useful life which is 7 years. Any maintenance cost associated with the software is expensed when incurred.

(g) Currency stock (notes and coins)

Inventories of currency on hand are recognised in the statement of financial position at cost. Costs include the cost of bringing inventories to their present location and condition. When currency is issued into circulation, the value of the inventory is reduced and an expense is recorded in the statement of comprehensive income. Currency issuance is determined on a first-in-first-out (FIFO) basis.

(h) Income Tax

The Bank is exempt from income tax in accordance with Section 42 of the RBV Act.

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 - continued**
(Expressed in 000's Vatu)

3. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES - continued

(i) Employee entitlements

Employee remuneration entitlements are determined by the Governor (in consultation with the Board) in terms of Section 10 of the RBV Act. The provision for employees' entitlements to wages and salaries, annual leave and other current employee entitlements (that are expected to be paid within twelve months) are accrued at nominal amounts based on current wage and salary rates.

Liabilities for other employee entitlements, which are not expected to be paid or settled within twelve months of reporting date, are accrued in respect of all employees at the present value of future amounts expected to be paid.

Vanuatu National Provident Fund

Employer contributions to the above fund are included as an expense in the statement of comprehensive income.

(j) Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents include notes and coins held by the Bank, teller's cash, current accounts and cash held on short term deposits.

(k) Vanuatu Government bonds

Due to the present very thin secondary market for Government bonds in Vanuatu, they are accounted for as Held to Maturity by the Bank and are valued at amortised cost.

(l) Loan and Advances

Loans relate to staff loans. They are carried at recoverable amount represented by the gross value of the outstanding balance adjusted for bad and doubtful debts.

A specific provision is made based on an assessment carried out at year end. Movement in provision is charged to the statement of comprehensive income. All known bad debts are written off against the provision in the year in which they are recognised. Bad debts, in respect of which no specific provisions have been established, are charged directly to the statement of comprehensive income.

(m) Rounding

Amounts in the financial statement are rounded to the nearest thousand Vatu unless otherwise stated.

(n) Comparatives

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year.

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 - continued**
(Expressed in 000's Vatu)

4. GENERAL RESERVE AND DISTRIBUTION OF PROFITS

Section 7 of the RBV Act required the bank to create and maintain a General Reserve. The purpose of the General Reserve is to provide for events which are contingent and non-foreseeable, including covering exceptional losses on the Bank's holdings of domestic and foreign securities that cannot be absorbed by its other resources; the Reserve also provides for potential losses from fraud and other non-insured losses.

Section 7 of the RBV Act states that:

- (a) net profit be transferred to the General Reserve until the balance thereof is equal to half the authorised capital;
- (b) once the balance of the General Reserve is equal to half the authorised capital, half the net profit be transferred to the General Reserve until the balance thereof is equal to the authorised capital;
- (c) once the balance of the General Reserve is equal to the authorised capital, 10% of the net profit be transferred to the General Reserve;
- (d) after allocation of the net profit as above, the Board will set up a special retain earnings reserve which will be built up by unrealised gains and any subsequent realised components are available for distribution to the General Reserve or to Government as dividends; and
- (e) the balance of the net profit for the financial year remaining after all deductions as above be paid to the Government.

In the current year VT16.529m (2010: VT162.265m) was transferred out of net profit available for distribution to the General Reserve.

5. RETAIN EARNINGS RESERVE

In pursuant to Section 7(2) of the RBV Act, a special Retain Earnings Reserve account was set up. Unrealised gains and losses on foreign exchange are recognised in profit from ordinary activities and until such gains or losses are realised, they are not available for distribution to the Vanuatu Government and are transferred from the profits to the Retain Earnings Reserve.

6. OTHER RESERVES

- (a) **Fair Value Reserve**
In accordance with note 3(d), movements in the fair value of financial assets designated as available for sale are recorded in the Fair Value Reserve.
- (b) **Asset Revaluation Reserve**
Following the revaluation of the Bank's Land and Building in 2007, the Bank has established an appropriate Asset Revaluation Reserve.

RESERVE BANK OF VANUATU

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011 - continued

(Expressed in 000's Vatu)

7. INTEREST INCOME

	2011	2010
Overseas Investments	525,270	513,878
Domestic Investments	97,315	48,716
Staff Loans & Advances	3,814	3,726
	-----	-----
	626,399	566,320
	=====	=====

8. INTEREST EXPENSE

	2011	2010
Interest on Government accounts	989	10,526
Interest on Reserve Bank of Vanuatu notes	27,969	18,552
Other	13,034	16,643
	-----	-----
	41,992	45,721
	=====	=====

9. PERSONNEL EXPENSES

	2011	2010
Salaries and wages	163,791	161,772
Superannuation contribution (VNPF)	6,384	6,356
Staff training	26,296	10,207
Severance pay, long service leave, accrued annual leave and gratuity expense	44,258	35,696
Other	50,568	39,706
	-----	-----
	291,297	253,737
	=====	=====

RESERVE BANK OF VANUATU

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011 - continued

(Expressed in 000's Vatu)

10. OPERATING EXPENSES

	2011	2010
Auditor's remuneration	1,797	1,283
Depreciation and amortisation	85,107	83,726
Funds managers' fee	5,224	6,817
Amortisation of currency costs	54,128	49,837
Communication expenses	14,192	12,533
Bad debt expense	-	3,793
Gain on disposal of property, plant and equipment	(1,751)	(2,200)
Other expenses	106,250	91,190
	-----	-----
	264,947	246,979
	=====	=====

11. EXTERNAL ASSETS

Under Section 22 of the RBV Act, the value of the external reserves (represented by the Bank's external assets) provided for shall not be less than 50% of the total demand liabilities of the Bank. As at 31 December 2011, the value of the external reserves was 84.8% (2010: 83.7%)

(a) External assets consists of the following:

	2011	2010
Cash	9,129	7,388
Current and call accounts	978,099	1,161,742
Short term deposits	6,786,571	6,356,236
Negotiable certificate of deposit	2,645,509	2,392,479
	-----	-----
Total cash and cash equivalents	10,419,308	9,917,845
Treasury notes, bonds and bills		
- Financial assets at fair value through profit and loss	2,802,707	2,107,883
- Available for sale financial assets	2,465,005	2,418,017
	-----	-----
Total Investment Securities	5,267,712	4,525,900
Special drawings rights	214,925	222,627
	-----	-----
Total external assets	15,901,945	14,666,372
	=====	=====

(b) External assets are defined by the RBV Act as including any internationally recognised reserve asset. In these financial statements, external assets also include fully convertible foreign currency balances equivalent to VT21.928m (2010 – VT19.734m) held with local banks in Vanuatu.

RESERVE BANK OF VANUATU

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011 - continued (Expressed in 000's Vatu)

12. GOVERNMENT NON-NEGOTIABLE SECURITIES ISSUED TO THE BANK

	2011	2010
Balance at the beginning of the financial year	225,720	226,395
IMF remuneration credit	(1,025)	(675)
Balance at the end of the financial year	224,695	225,720

13. GOVERNMENT BONDS

These bonds which are valued in accordance with note 3(k) have varying maturity dates up to 2019. The maturities are set out below:

	2011	2010
Not later than 1 year	-	50,000
Between 1 and 2 years	300,000	-
Between 2 and 5 years	150,860	300,700
Later than 5 years	842,950	842,950
	1,293,810	1,193,650

14. OTHER RECEIVABLES

	2011	2010
Interest receivable	115,936	123,449
Staff loans and advances	107,026	96,432
Sundry debtors	7,622	520
Other	3,351	3,478
	233,935	223,879

RESERVE BANK OF VANUATU

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011 - continued (Expressed in 000's Vatu)

15. CURRENCY ACTIVITIES

(a) Currency Stock (notes and coins)

	2011	2010
Balance at the beginning of the financial year	406,896	273,854
Cost of new currencies	-	182,879
Less: issued into circulation	(54,128)	(49,837)
	-----	-----
Balance at the end of the financial year	352,768	406,896
	=====	=====

Currency costs are accounted for in accordance with accounting policy in note 3(g).

(b) Currency in circulation

Notes	5,876,498	5,208,001
Coins	704,985	672,885
	-----	-----
Total currency issued	6,581,483	5,880,886
	=====	=====

16. PROPERTY, PLANT AND EQUIPMENT

(a) Property, plant & equipment include:

	2011	2010
Land and Buildings – at valuation	1,348,413	1,337,497
<u>Less: Accumulated depreciation</u>	112,480	79,111
	-----	-----
	1,235,933	1,258,386
	-----	-----
Computer and Office Equipment	246,498	234,849
<u>Less: Accumulated depreciation</u>	178,660	147,479
	-----	-----
	67,838	87,370
	-----	-----
Other	134,567	125,808
<u>Less: Accumulated depreciation</u>	44,940	33,910
	-----	-----
	89,627	91,898
	-----	-----
Total – Cost/Valuation	1,729,478	1,698,154
<u>Less: Accumulated depreciation</u>	336,080	260,500
	-----	-----
	1,393,398	1,437,654
	=====	=====

RESERVE BANK OF VANUATU

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011 - continued

(Expressed in 000's Vatu)

16. PROPERTY, PLANT AND EQUIPMENT - continued

(b) Reconciliation of property, plant & equipment

	Land and Buildings	Computer and Office Equipment	Other	Total
Opening net book amount	1,258,386	87,370	91,898	1,437,654
Additions	15,156	11,968	12,869	39,993
Reversal of costs	(4,055)			(4,055)
Disposals	(176)	-	(545)	(721)
Depreciation charge	(33,378)	(31,500)	(14,595)	(79,473)
	-----	-----	-----	-----
Closing net book amount	1,235,933	67,838	89,627	1,393,398
	=====	=====	=====	=====

The amount being reversed represents costs accrued previously which are no longer payable.

17. INTANGIBLE ASSETS

The intangible asset relates to the computer software for the Bank's financial system.

	2011	2010
Cost	39,561	39,371
Accumulated amortisation	(21,284)	(15,651)
	-----	-----
Net book amount	18,277	23,720
	=====	=====
Opening net book amount	23,720	29,348
Additions	191	-
Amortisation charge	(5,634)	(5,628)
	-----	-----
Closing net book amount	18,277	23,720
	=====	=====

18. DEMAND DEPOSITS

	2011	2010
Due to commercial banks	5,308,723	5,283,453
Due to government	2,467,508	2,447,786
Due to international institutions and agencies	2,477,448	2,506,664
	-----	-----
	10,253,679	10,237,903
	=====	=====

19. EMPLOYEE PROVISIONS

	2011	2010
Opening balance	174,638	163,830
Additional provisions recognised	40,950	34,440
Utilised/ reversals	(13,589)	(23,632)
	-----	-----
	201,999	174,638
	=====	=====

RESERVE BANK OF VANUATU

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011 - continued (Expressed in 000's Vatu)

20. INTERNATIONAL MONETARY FUND

- (a) Vanuatu is a member of the International Monetary Fund (IMF) and the Bank has been designated as both the Government's fiscal agency (through which the Government deals with the IMF) and as the depository for the IMF's holding in Vatu.
- (b) Vanuatu's subscription to the IMF has been met by:
- (i) payment to the IMF out of the Bank's external assets which have been reimbursed by the Government by issue of non-interest bearing securities;
 - (ii) the funding of accounts in favour of the IMF in the books of the Bank by the Government.

21. SHARE CAPITAL

	2011	2010
Authorised capital of 400,000,000 ordinary shares	400,000 =====	400,000 =====
Issued and paid-up capital of 100,000,000 ordinary shares	100,000 =====	100,000 =====

22. RECONCILIATION OF OPERATING PROFIT TO NET CASH PROVIDED BY OPERATING ACTIVITIES

	2011	2010
Operating profit	165,288	309,716
<i>Non cash items</i>		
Depreciation and amortisation	85,107	83,724
Bad debts	-	3,792
Cost of currency issued into circulation	54,128	49,837
Reversal of costs of property, plant and equipment	4,055	-
Profit on sale of property, plant and equipment	(1,751)	(2,200)
Gain on changes in fair value	(77,027)	(66,707)
Net foreign exchange gains/ losses	(36,674)	(207,835)
<i>Net (increase)/decrease in assets</i>		
Interest receivable	7,513	(59,166)
Other receivable	(6,975)	(15,491)
Currency payments	-	(133,042)
<i>Net (decrease)/increase in liabilities</i>		
Other creditors and accruals and employee provisions	65,019	(92,711)
Net cash provided by operating activities	258,684 =====	(130,083) =====

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 - continued**
(Expressed in 000's Vatu)

23. RELATED PARTY INFORMATION

Identity of related parties

The Bank's ultimate parent entity is the Government of the Republic of Vanuatu.

The Board of Directors during the financial year ended 31 December 2011 were Odo Tevi (Chairman) Georges Maniuri, Jimmy Nipo, Jack Kilu and Marinette Nial Molisa.

During the year, key management personnel consisted of the following executives: Odo Tevi (Governor), Peter Tari (Deputy Governor), Nelson Shem (Director Corporate Services), Branan Karae (Director Accounts and Customers Services), Philip Arubilake (Director Financial Markets), Jerry Niatu, (Director Research & Statistics) and Noel Vari (Director Financial institution supervision).

Transactions with related parties

In the normal course of its operations, the Bank enters into transactions with related parties identified above.

The transactions with the Government of the Republic of Vanuatu include banking services, foreign exchange transactions, purchase of government bonds, registry transactions and distributions as noted in the statement of distribution.

The Directors are paid a sitting allowance for the services rendered. The Bank also provides non-cash benefits to the Executive Directors and executive officers in addition to their salaries such use of the Bank's motor vehicles.

Total remuneration included in 'personnel expenses' is as follows:

	2011	2010
Directors sitting allowances	405	225
Executive officers	46,846	45,087
	-----	-----
	47,251	45,312
	=====	=====

The Bank also provides loans to its staff. Total loans owing by the executive officers as at balance date equals VT24.489m (2010: VT18.063m). The loans attract interest which range from 1.5% to 6% per annum and are required to be paid in accordance with the Bank's staff loan policies approved by the Board.

24. EMPLOYEES

The number of full time permanent employees as at 31 December 2011 was 84. (2010: 76).

25. CONTINGENT LIABILITIES

The directors are not aware of any contingent liabilities at balance sheet date (2010: nil).

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 - continued**

(Expressed in 000's Vatu)

26. FINANCIAL RISK MANAGEMENT POLICIES

Exposure to operational, credit, liquidity and market risk arises in the normal course of the Bank's operations. The structure of the Bank's statement of financial position is primarily determined by the nature of its statutory functions. At the same time the Bank continually manages its exposure to risk, through a variety of risk management techniques. Risk management of the Bank is regulated by internal guidelines, and closely monitored by the Board.

Operational risk is controlled by a number of internal guidelines, and there is clear segregation of front office and back office activity which are mechanisms for managing operational risk.

Credit risk

The Bank is subject to credit risk exposure. This is the risk that a counter party will be unable to pay amounts in full when due. The Bank's maximum credit risk, excluding the value of collateral, is generally reflected in the carrying value of financial assets. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant. The Bank does not require collateral in respect of financial assets except in respect of loans to staff.

Management has a credit policy in place. Credit risk on transactions in foreign currency reserves is managed through the approval of transactions and placement of funds, the establishment of limits restricting risk and constant monitoring of positions. Counter party limits are set based on credit ratings and are subject to regular review. Currency risk and the exposure in the local currency portfolio is also monitored and managed.

Credit risk on financial assets is minimised by dealing with recognised monetary institutions with minimum acceptable credit ratings and operational limits.

At balance sheet date there were no significant concentrations of credit risk.

RESERVE BANK OF VANUATU

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011 - continued

(Expressed in 000's Vatu)

26. FINANCIAL RISK MANAGEMENT POLICIES - continued

Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting financial obligations. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest and exchange rates and maintaining of the adequate level of liquidity at all times.

The Bank holds a diversified portfolio of cash and cash equivalents plus highly graded Government securities to support payment obligations and contingent funding in a stressed environment. The Bank's comfortable level of liquidity is equated to 4 months of import cover. An acceptable cash balance is maintained at all times in different current accounts and an emergency fund of about VT200 million is maintained with one of the central banks.

The Bank's assets held for managing liquidity risks comprise of high quality instruments, including commercial papers, particularly Negotiable Certificates of Deposits and Bank Bills, and debt issued by foreign Governments which are easily converted to cash.

The following tables show assets and liabilities at year end grouped by contractual maturity.

2011 Maturity Analysis

	0 - 3 months	3 - 6 months	6 - 12 months	Over 1 year	No specific maturity	Total
ASSETS						
Cash and cash equivalents	9,163,540	1,255,768	-	-	-	10,419,308
Treasury notes, bonds & bills	-	-	-	5,267,712	-	5,267,712
Government securities	-	-	-	224,695	-	224,695
Government bonds	-	-	-	1,293,810	-	1,293,810
Other receivables	126,909	-	-	107,026	-	233,935
Currency stock (notes and coins)	-	-	-	352,768	-	352,768
Property, plant and equipment	-	-	-	1,393,398	-	1,393,398
Intangible assets	-	-	-	18,277	-	18,277
Special Drawing Rights	-	-	-	-	214,925	214,925
Total	9,290,449	1,255,768	-	8,657,686	214,925	19,418,828
LIABILITIES						
Other creditors and accruals	53,957	11,269	-	-	-	65,226
Demand deposits	5,647,246	736	2,263,774	2,341,923	-	10,253,679
Reserve Bank of Vanuatu Notes	1,619,144	-	-	-	-	1,619,144
Currency in circulation	6,581,483	-	-	-	-	6,581,483
Employee provisions	-	-	-	201,999	-	201,999
Total	13,901,830	12,005	2,263,774	2,543,922	-	18,721,531
Net Liquidity Gap	(4,611,381)	1,243,763	(2,263,774)	6,113,764	214,925	697,297

RESERVE BANK OF VANUATU

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011 - continued (Expressed in 000's Vatu)

26. FINANCIAL RISK MANAGEMENT POLICIES - continued

Liquidity risk - continued

2010 Maturity Analysis

	0 - 3 months	3 - 6 months	6 - 12 months	Over 1 year	No specific maturity	Total
ASSETS						
Cash and cash equivalents	9,707,985	163,131	46,729	-	-	9,917,845
Treasury notes, bonds & bills	-	-	93,301	4,432,599	-	4,525,900
Government securities	-	-	-	225,720	-	225,720
Government bonds	50,000	-	-	1,143,650	-	1,193,650
Other receivables	127,446	-	13,352	83,081	-	223,879
Currency stock (notes and coins)	-	-	-	406,896	-	406,896
Property, plant and equipment	-	-	-	1,437,654	-	1,437,654
Intangible assets	-	-	-	23,720	-	23,720
Special Drawing Rights	-	-	-	-	222,627	222,627
Total	9,885,431	163,131	153,382	7,753,320	222,627	18,177,891
LIABILITIES						
Other creditors and accruals	24,972	2,588	-	-	-	27,560
Demand deposits	5,863,286	7,069	2,030,180	2,337,368	-	10,237,903
Reserve Bank of Vanuatu Notes	1,196,565	-	-	-	-	1,196,565
Currency in circulation	5,880,886	-	-	-	-	5,880,886
Employee provisions	9,470	-	-	165,167	-	174,638
Total	12,975,179	9,657	2,030,180	2,502,536	-	17,517,552
Net Liquidity Gap	(3,089,748)	(153,474)	(1,876,798)	5,250,784	222,627	660,339

RESERVE BANK OF VANUATU

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011 - continued (Expressed in 000's Vatu)

26. FINANCIAL RISK MANAGEMENT POLICIES - continued

Market Risk

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. In respect of the Bank, market risk comprises interest rate risk and foreign currency risk.

(i) Interest rate risk

Interest rate risk refers to the risk that interest rates will move adversely. The Bank limits interest rate risk by modified duration targets. The benchmark modified duration for the total portfolio is capped at eighteen months. The duration of the portfolio is re-balanced regularly to maintain the target duration.

The interest rates of financial assets and liabilities at the balance sheet date are as follows:

Financial assets:

Cash and current accounts	-	floating interest rates.
Short term deposits	-	fixed interest rates, maturing in 180 days or less.
Treasury notes, bonds and bills	-	fixed interest rates, maturing in 9 years or less.
Vanuatu government bonds	-	fixed interest rates, maturing as detailed in note 13.
Staff loans	-	fixed interest rates, maturing in 20 years or less.

Financial liabilities:

Domestic Institutions	-	fixed interest rates, payable in 30 days or less.
Statutory bodies/banks	-	fixed interest rates, maturing in 30 days or less.
Government of Vanuatu	-	fixed interest rates, payable in 30 days or less.
Reserve Bank of Vanuatu Notes	-	fixed interest rates, payable in 30 days or less.

All other financial assets or financial liabilities are non-interest bearing.

RESERVE BANK OF VANUATU

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011 - continued

(Expressed in 000's Vatu)

26. FINANCIAL RISK MANAGEMENT POLICIES - continued

Market Risk - continued

(i) Interest rate risk - continued

Assets and liabilities will mature or re-price within the following periods:

Risk	2011 Interest rate	Less than 1 month VT'000'	1 – 3 months VT'000'	3 -12 months VT'000'	Over 1 year VT'000'	Non interest bearing VT'000'	As at 31.12.11 VT'000'
ASSETS							
Cash and cash equivalents		5,191,721	3,962,689	1,255,769	-	9,129	10,419,308
Treasury notes, bonds and bills		2,465,005	-	-	2,802,707	-	5,267,712
Government securities		-	-	-	224,695	-	224,695
Government bonds		-	-	-	1,293,810	-	1,293,810
Other receivables		-	-	-	233,935	-	233,935
Currency stock (notes and coins)		-	-	-	-	352,768	352,768
Property, plant and equipment		-	-	-	-	1,393,398	1,393,398
Intangible assets		-	-	-	-	18,277	18,277
Special Drawings Rights		-	214,925	-	-	-	214,925
Total Assets		7,656,726	4,177,614	1,255,769	4,555,147	1,773,572	19,418,828
LIABILITIES							
Other creditors and accruals		-	-	-	-	65,226	65,226
Demand deposits		-	149,096	-	2,180,913	7,923,670	10,253,679
Reserve Bank of Vanuatu notes		1,619,144	-	-	-	-	1,619,144
Currency in circulation		-	-	-	-	6,581,483	6,581,483
Employee provisions		-	-	-	-	201,999	201,999
Total Liabilities		1,619,144	149,096	-	2,180,913	14,772,378	18,721,531
EQUITY							
Issued Capital		-	-	-	-	100,000	100,000
General Reserve		-	-	-	-	216,529	216,529
Retain Earnings Reserve		-	-	-	-	108,711	108,711
Fair Value Reserve		-	-	-	-	47,260	47,260
Asset Revaluation Reserve		-	-	-	-	224,797	224,797
Total Equity		-	-	-	-	697,297	697,297
Total Equity and Liabilities		1,619,144	149,096	-	2,180,913	15,469,675	19,418,828

RESERVE BANK OF VANUATU

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011 – continued

(Expressed in 000's Vatu)

26. FINANCIAL RISK MANAGEMENT POLICIES – continued

Market Risk - continued

(i) Interest rate risk - continued

Assets and liabilities will mature or re-price within the following periods:

2010 Interest rate Risk

	Less than 1 month VT'000'	1 – 3 months VT'000'	3 -12 months VT'000'	Over 1 year VT'000'	Non interest bearing VT'000'	As at 31.12.10 VT'000'
ASSETS						
Cash and cash equivalents	5,729,332	3,971,265	209,860	-	7,388	9,917,845
Treasury notes, bonds and bills	2,418,017	-	93,301	2,014,582	-	4,525,900
Government securities	-	-	-	225,720	-	225,720
Government bonds	-	-	-	1,193,650	-	1,193,650
Other receivables	-	-	123,449	96,433	3,997	223,879
Currency stock (notes and coins)	-	-	-	-	406,896	406,896
Property, plant and equipment	-	-	-	-	1,437,654	1,437,654
Intangible assets	-	-	-	-	23,720	23,720
Special Drawings Rights	-	222,627	-	-	-	222,627
Total Assets	8,147,349	4,193,892	426,610	3,530,385	1,879,655	18,177,891
LIABILITIES						
Other creditors and accruals	-	-	-	-	27,560	27,560
Demand deposits	-	321,992	-	2,075,794	7,840,117	10,237,903
Reserve Bank of Vanuatu notes	1,196,565	-	-	-	-	1,196,565
Currency in circulation	-	-	-	-	5,880,886	5,880,886
Employee provisions	-	-	-	-	174,638	174,638
Total liabilities	1,196,565	321,992	-	2,075,794	13,923,201	17,517,552
EQUITY						
Issued Capital	-	-	-	-	100,000	100,000
General Reserve	-	-	-	-	200,000	200,000
Retain Earnings Reserve	-	-	-	-	97,451	97,451
Fair Value Reserve	-	-	-	-	38,091	38,091
Asset Revaluation Reserve	-	-	-	-	224,797	224,797
Total Equity	-	-	-	-	660,339	660,339
Total Equity and Liabilities	1,196,565	321,992	-	2,075,794	14,583,540	18,177,891

RESERVE BANK OF VANUATU

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011 - continued (Expressed in 000's Vatu)

26. FINANCIAL RISK MANAGEMENT POLICIES - continued

Market Risk - continued

(ii) Foreign Currency risk

Foreign currency risk is the risk the value of financial instruments will fluctuate due to changes in foreign exchange rates.

The Bank attracts foreign currency risk on holdings of financial assets (principally external assets) and liabilities that are denominated in a currency other than Vatu. The investment guidelines of the Bank set out the approved foreign currencies which it may invest in.

The Bank does not hedge its exposure to exchange fluctuations in these currencies.

In accordance with the RBV Act, the task of maintaining the safety and liquidity of foreign reserve assets, as well as the returns from reserves asset management, are achieved through diversification of investment by entering into transactions in international capital and money markets. Analysis of risks is the process of managing the foreign currency reserves by comparing estimated risk levels with set limits.

The following tables show the currency concentration of the Bank's assets and liabilities as at 31 December 2011 and 2010 in Vatu equivalents.

2011 Foreign Currency Risk

	USD	EUR	AUD	GBP	Other	Total
ASSETS						
Cash and cash equivalents	219,586	644,809	7,012,548	295,486	2,248,670	10,421,099
Treasury notes, bonds & notes	3,611,924	181,686	1,368,382	105,718	-	5,267,710
Other receivables	14,209	1,930	50,112	1,450	13,228	80,928
Special Drawing Rights	-	-	-	-	214,925	214,925
Total Assets	3,845,719	828,425	8,431,042	402,654	2,476,823	15,984,662
LIABILITIES						
Demand deposits	1,899	-	-	-	2,466,704	2,468,603
Total Liabilities	1,899	-	-	-	2,466,704	2,468,603
NET POSITION	3,843,820	828,425	8,431,042	402,654	10,119	13,516,059

RESERVE BANK OF VANUATU

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011 - continued (Expressed in 000's Vatu)

26. FINANCIAL RISK MANAGEMENT POLICIES – continued

Market Risk - continued

(ii) Foreign Currency - continued

2010 Foreign Currency Risk

	USD	EUR	AUD	GBP	Other	Total
ASSETS						
Cash and cash equivalents	321,405	497,372	6,503,094	292,172	2,285,358	9,899,401
Treasury notes, bonds & notes	3,521,784	144,074	755,517	104,525	-	4,525,900
Other receivables	16,335	2,122	-	2,081	71,799	92,337
Special Drawing Rights	-	-	-	-	222,627	222,627
Total Assets	3,859,524	643,568	7,258,611	398,778	2,579,784	14,740,265
LIABILITIES						
Demand deposits	38,273	-	-	-	2,465,149	2,503,422
Total Liabilities	38,273	-	-	-	2,465,149	2,503,422
NET POSITION	3,821,251	643,568	7,258,611	398,778	114,635	12,236,843

(iii) Sensitivity to Foreign Currency Risk

The sensitivity of the Bank's financial assets and liabilities to assumed across-the-board 5% strengthening/weakening of the Vatu against other foreign currencies is shown below:

	2011	2010
USD	(+/-) 192,191	(+/-) 201,118
EUR	(+/-) 41,421	(+/-) 33,870
YEN	(+/-) 67	(+/-) 67
GBP	(+/-) 20,133	(+/-) 20,995
AUD	(+/-) 421,552	(+/-) 385,460
NZD	(+/-) 112,343	(+/-) 114,868
CAD	(+/-) 748	(+/-) 5,688
SDR	(+/-) 109	(+/-) (118,022)

A weakening of the Vatu against the respective currencies would have the opposite effect of an equal amount.

**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011 - continued**

(Expressed in 000's Vatu)

27. FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

The fair value of an instrument is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms length transaction.

Quoted market values represent fair value when a financial instrument is traded in an organised and liquid market that is able to absorb a significant transaction without moving the price against the trader.

Financial Assets and Liabilities

The valuation of the Bank's financial assets and liabilities are discussed below:

Cash and cash equivalents

The reported value of cash and cash equivalents is considered to be its fair value due to the short term nature of the financial assets.

Treasury notes, bonds and bills

Bonds are valued at mark to market.

Government bonds

The reported value of government bonds is considered to be its fair value.

Demand Deposits

The carrying value of deposits are considered to approximate their fair value as they are payable on demand.

Reserve Bank of Vanuatu Notes

The carrying value of the Reserve Bank of Vanuatu Notes are considered to approximate their fair value as they are redeemable in accordance with the Bank's policy.

Currency in Circulation

The carrying value of Currency in Circulation is considered to be its fair value as reported in the accounts.

Other Financial Assets and Liabilities

The reported values of other financial assets and liabilities are considered to be their fair value.

28. EVENTS OCCURRING AFTER BALANCE DATE

No events have occurred since balance sheet date which would require either disclosure or adjustments in the financial statements.

