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 2012; and

(b) A copy of the Bank's Annual Statement of accounts for 2012 certified by the Auditors.

Yours faithfully,
Odo Tevi
Governor

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Anatole Hymak
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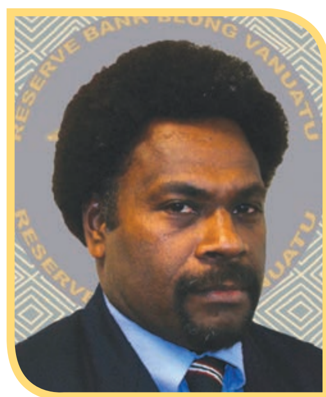

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Governors Foreword

The year 2012 has been another challenging year for the Bank as the trends of the global economy growth continued to remain slow and largely unchanged from the previous year. Fragile financial markets and fiscal consolidation in major economies continued to drag on the global economic growth, while the risks of excessive fiscal consolidation in the US and uncertainty over the long term viability of the euro-zone area prevented the restoring of confidence to the longer-term outlook. Over the coming months economic activity is expected to be sluggish in advanced economies but remain relatively strong in developing economies. However, this outcome is heavily depended on the policy makers' ability in finding lasting solutions to the pressing problems in the U.S. and Europe - if these risks are not carefully managed, the outlook for the world economy and Vanuatu's key trading partners could worsen very quickly.

On the domestic front, Vanuatu's economy has seen some modest improvements in 2012. Copra production and export level dropped in first half of the year due to the fall in international copra and oil prices but picked up again towards the second half of the year. This is against the activities in the tourism sector which remained relatively strong and the key driver behind the economic growth recorded in 2012. The services, agriculture, forestry, fisheries and livestock sectors also contributed to the slight upturn in economic activity in 2012.

The Bank's key monetary policy targets were met over the year. Official reserves level remained well above the four months of import cover level. And this level is forecasted to remind high within the coming months with the projected increase in donor funding inflows that is expected to bolster the Bank's foreign assets. On the inflation front, the rate of inflation over the last twelve months remained well within the 0- 4 percent target range and is forecasted to remain within this range in the first half of 2013.However, the Bank remains mindful of the upward risk pressures on inflation that may arise from upcoming donor driven economic activity, combined with the possibility that the persistent upward movement in commercial banks' excess reserves will translate into faster lending growth. The Bank will continue to closely monitor the developments in this area.

The rediscount rate and all prudential requirements have remained unchanged during the year. The Bank maintained an accommodative monetary policy stance over the year given the sluggish rate of domestic economic activity and risks posed from external developments. However, relevant indicators are being monitored closely to inform decisions markers over the timing of any further tightening of the monetary policy stance to manage the risks of inflationary pressures.

Amidst the gloomy economic conditions, the Bank ended another successful year achieving its work plans targets. A net profit of VT108.1 million was achieved, though lower by 39% compared to the 2011 net profit of VT165.2million. This financial performance reflected largely the weak global investment climate during the year and the tight expenditure control by Management. Of the profit made, VT10.8million was transferred to the Bank's General Reserves Account and VT97.3million paid to the Government in dividend.

On currency matters, the Bank with the Board approval tendered the printing of the next three denominations (VT 200, VT500, VT1000, VT2000) of the new family of Vatu polymer notes series on Guardian® Polymer Substrate. This followed on from the first and highest denomination (VT10000) of the series that was issued in 2010. The tender was awarded to Oberthur Fiduciarea, a French company in Europe at the total cost of about Vt300 million. The Bank consulted widely with its stakeholders on this project during the year.

In 2012 the Bank also conducted the central banking awareness programs through schools and rural communities, coordinated by the Research and Statistics Department and the Corporate Services Department. The awareness were conducted in two parts; the first part focused on the School awareness and the second part covered the Master Vatu Currency Reform awareness. The main topics covered were:

-Task and Function of the Reserve Bank of Vanuatu
-The Role of Money or Understanding Money in our Society. Years 9/10
-Exchange rate and Gross Domestic Product (GDP). (Years 11-13)
-Master Vatu Currency Reform.
-Career Talk.

I would like to take this opportunity to thank the Board of Directors for their support and guidance during the year and my deep appreciation to the Reserve Bank Management Team and all staff for their good work, commitment and cooperation in 2012.

Odo Tevi
Governor and Chairman of the Board

Economic Overview

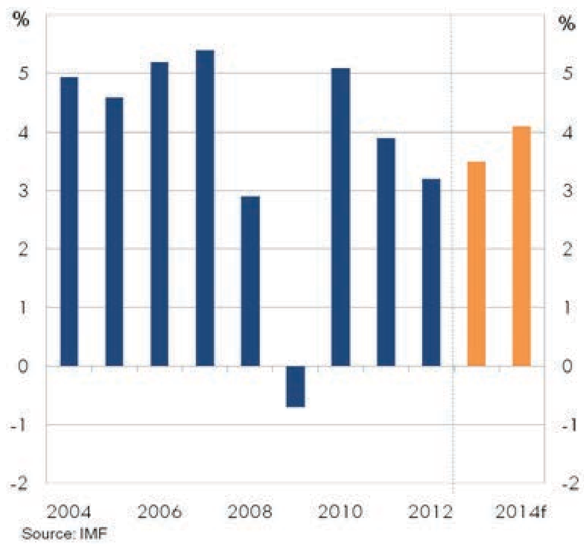
International Economy

Over the year, global economic growth weakened dramatically from 3.9 percent in 2011 to 3.2 percent in 2012. The first and second quarters of the year started with low growth but the third and fourth quarter accelerated moderately to 3.0 percent, led by the emerging economies as broadly expected while the United States recovery surprised on the upside. However, there was dismal growth in the euro zone as a consequence of diverse strains and fragilities in the euro zone periphery weighed heavily on global economic growth.

In the US, the Federal Reserve announced a new third round of quantitative easing earlier in the year to stimulate the economy prior to the presidential election. A step taken following the uncertainties surrounding the 600 billion-dollar fiscal cliff that threatens the US economy into recession. However, in the third quarter the US economy performed better due to temporary factors -including the inventory accumulation, and in the fourth quarter unemployment and housing sector improved moderately. The euro zone consisted of diverse growth performances. This saw some economies falling into a double-dip recession especially those in severe sovereign debt distress compounded by weak aggregate demand from fiscal austerity, high public debt and financial sector fragilities. Also the failed rounds of negotiations and summits in the euro zone to restore normalcy in the single currency weighed heavily on global economic growth with signs of stronger spill-over to other economies. Bond spreads in the peripheral economies declined markedly while prices of many risky assets, such as equities, increased globally with increased capital flows into other economies especially the emerging market economies.

Growth in the emerging economies also slowed down from 6.3 per cent in 2011 to 5.1 percent in 2012 as a result of the adverse trade spill-overs from weaknesses in the US and the euro zone economies. Internal factors also contributed to the slowdown as well as weakening in investor sentiment -especially for China and India, as policy instruments were issued to engineer the soft landing of their economies after performing strongly since 2008.

Figure 1: World GDP Growth 2004 -2014 (Percentage change; annual data)



Key Interest Rates

The European Central Bank (ECB) held their accommodative policy stance during the last quarter of the year to help ease the pressures in the financial system. The ECB expects economic weakness in year 2012 to extend into year 2013, while risks related to the region's sovereign debt difficulties remain a central concern.

In US, the Federal Reserve Bank assessment shows that economic activity and employment have expanded at a moderate pace in the last quarter of the year, however the high unemployment rate remained a concern. Household spending continued to advance, and the housing sector has shown further signs of improvement, but growth in business fixed investment has slowed. Reflecting this, the Federal Reserve has decided to keep the target range for the federal funds rate at 0 to 1/4 percent and anticipates that this low range will be appropriate at least as long as the unemployment rate remains above 6.5 percent.

Within the region, the Reserve Bank of Australia forecast suggested that the Australian economic growth has expanded close to trend over the past year, driven by very large increases in capital spending in the resources sector. Other sectors in the Australian economy, however, have experienced weaker conditions. It is expected that the peak in resource investment will occur in 2013 providing a challenge for policy makers, as they search for other sources of demand. Interest rates were cut from 3.25 per cent at the end of the September quarter to 3.0 percent at year end. For the New Zealand economy, the Reserve Bank of New Zealand assessment suggests that repairs and construction in Canterbury will continue to improve demand conditions, while the housing market is strengthening, owing to falls in mortgages lending rates. With these developments, RBNZ left the third quarter headline policy rate unchanged in the last quarter of the year.

Table1: Key Interest rate indicator

Period	US Fed Funds Rate	Euro Refi Rate	Australian	New Zealand	Vanuatu Rediscount Rate
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
2012 Q1	**0.25**	**1.00**	**4.25**	**2.50**	**6.00**
Q2	0.25	0.75	3.50	2.50	6.00
Q3	0.25	0.75	3.25	2.50	6.00
Q4	0.25	0.75	3.00	2.50	6.00

Sources: the Federal Reserve, European Central Bank, Reserve Bank of Australia, Reserve Bank of New Zealand and Reserve Bank of Vanuatu.

World **Trade**

International trade and the role of exchange rate continued to follow closely the pace of the ongoing uneven global economic growth, with the euro area still experiencing high unemployment rate while US and the emerging economies' are showing signs of improvement in the unemployment rate. The euro area register a trade surplus of 7 percent over the last twelve months in exports compared to 2 percent in imports with improvement registered in trade deficits for Greece, Portugal, Germany and Italy. China's foreign trade surplus expanded by 6.2 percent year-on-year with exports increasing to 7.9 percent year-on-year, compared to imports of 4.3 percent. China's share in global trade increased to 11.1 percent for the same period compared to 10.4 percent in 2011. On the other hand, the US trade deficit narrowed compare to 2011; indicating that the US economy has strengthened in 2012 compare to the four years since the 2008 global financial crisis.

Commodity Prices

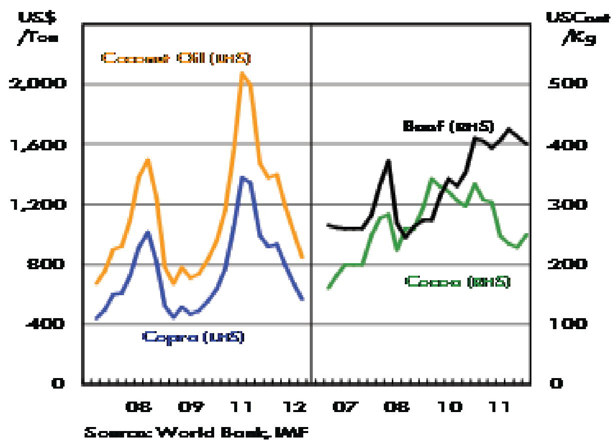
The average world oil price in the fourth quarter of the year was US$101.91 per barrel, compared to US$101.91 in the third quarter. The average oil price at the end of year 2011 was US$103.19 per barrel.

The global oil prices continue to be held up by geopolitical developments in the Middle East and improved prospects for the US and China's economy, while the general slowing down of the global economic activity remains an anchor on price movement.

Figure 2: Average Spot Price for Crude Oil (US $/Barrel

With respect to developments in other commodity markets, the prices of Vanuatu's major exports products declined markedly over the year. Cocoa average world price fell in the last quarter of the year to US$245.1 cents per kg, down from US$249.4 per kg at the end of the third quarter in the year. Coconut oil price likewise dropped to a 7-month low at US$8433.7 per ton at year end and copra price fell to US$564.7 per ton in the last quarter from US$671.7 per ton in the third quarter. Beef world market price on the other hand recorded an increase in average price to US$ 419.1 per kg in the last quarter compared to third quarter and a 3 percent increase over the year.

Figure 3: Export Commodity Price 2008-2012

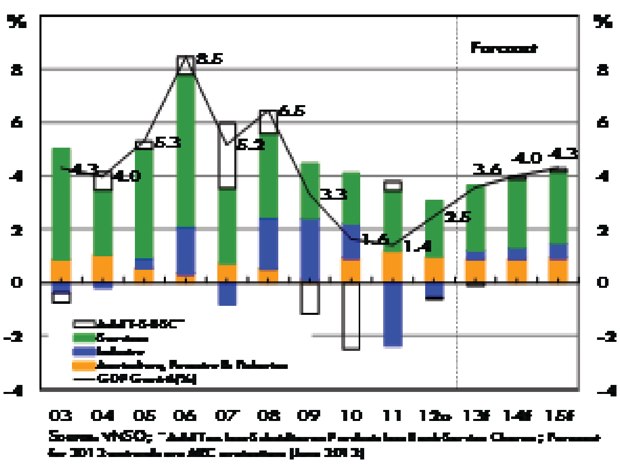


Domestic Economy

The Macroeconomic Committee (MEC) at its last meeting in December 2012 made minor revision to its GDP growth forecast for 2012 to 2015. Year 2012 real GDP growth forecast was revised down from 2.9 percent to 2.5 percent, construction sector down to an estimated 22.2 percent, a decline from the previous 3.2 percent forecast. And the industrial sector growth was revised down by 6.1 percent. This is compared to the agricultural and services sectors which are forecasted to grow by 4.6 percent and 3.3 percent respectively. These revisions were brought about by an expected improved performance from the agricultural sector despite the lower commodity prices, and an anticipated pick-up in copra and coconut oil production. The outlook for growth in the year is still expected to be supported largely by increased tourism arrivals and services activities, and various ongoing private sector-led construction projects (the value of projects remains small compared to the previous year's level thus, explaining the contraction in economic activity). 2013 real GDP growth is projected at 3.6 percent, down from the previous forecast at 4.3 percent, with the increased likelihood that major donor-projects originally planned to take place during the year will be spread out into 2014. These projects are expected to drive growth in the three years period up to 2015 and with the prospect of the tourism improving further, the domestic economy is predicted to grow by 4.0 percent in 2014 and 4.3 percent in 2015.

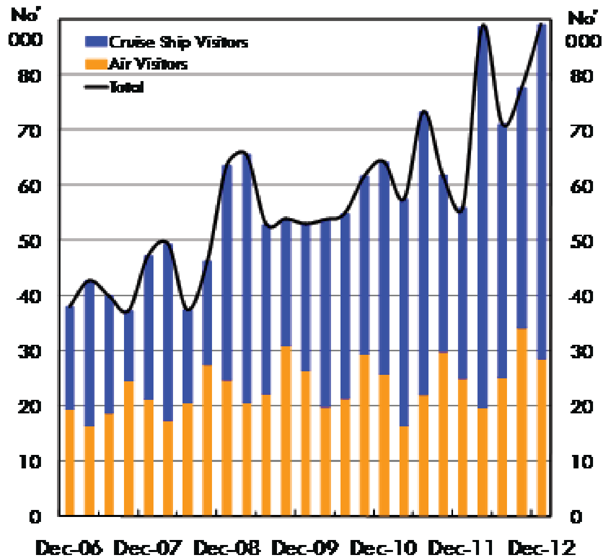
Key partial indicators of domestic consumption continue to suggest that domestic demand has slowed in the last quarter of 2012. The annual growth in imports declined while private sector lending growth stagnated.

Figure 4: Real Gross Domestic Product



Inflation further weakened in the 4th quarter of the year with various expenditure groups recording declines. The year-on-year inflation rate dropped by 0.3 percentage points to 0.8 percent while, quarter-on-quarter inflation was 0.1 percent. Inflation continued to remain within the RBV inflation target range of 0-4 percent, with projected inflation in upcoming quarters expected to remain within these bounds in line with th current slowdown in international commodity prices.

Figure 5: Visitor Arrivals



Source: Vanuatu National Statistics Office

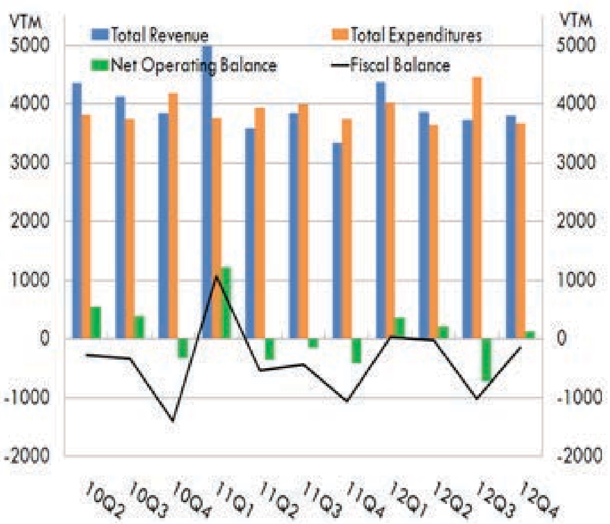
Total non-resident visitor arrivals (cruise-ship plus air visitors) rose 15 percent to 89,225 visitors in the December quarter and a further 58 percent over a year ago (from 56,148 visitors in December quarter 2011). Cruise-ship visitor arrivals rose in the last quarter and over the year while air visitor arrivals recorded a decline in the last quarter of the year but both areas performed better against the 2011 December quarter outcome. Up to December, Vanuatu received 108,158 visitors by air (compared to 93,960 in 2011) and 218,667 visitors by cruise (compared to 154,938 in 2011), a 15 percent and 41 percent increase over the year, respectively.

Broad Money supply (M2) contracted by 4.1 percent during the December quarter owing to decreases of 10.7 percent and 74.4 percent in net foreign assets (NFA) and net claims on the government, respectively. Furthermore, the decline was mirrored in all its components, of which M1 fell by 5.6 percent and Quasi-money 3.1 percent. The annual growth of M2 also showed a decline of 0.6 percent. Total NFA of the banking system further declined by 10.7 percent and 6.3 percent during the 4th quarter and over the year to December 2012, respectively. The decline over the 4thquarter was attributed to a 30.7 percent fall in the monetary authorities NFA, while commercial banks NFA fell by 1.7 percent. The banking system continued to witness outflows of foreign exchange over the last two quarters seeing a return to the trend seen since the end of 2008. This is reflected in the decline in both the monetary authorities and commercial banks foreign assets. Domestic credit grew by 1.4 percent in the 4thquarter of the year and 5.8 percent over the same period in 2011. The growth was driven by increases in credit to the private sector and municipalities which outweighed the decline in the net claims on the government and claims on non-financial enterprises.

Private sector creditgrew by 2.5 percent in the fourth quarter compared to a negative 0.2 per cent growth recorded at the end of the third quarter. The increase in the fourth quarter led to the annual growth rate in December 2012 rising to 6.9 percent, as compared to 6.6 percent in September 2012. Despite the quarter-on-quarter increase the annual growth in private sector credit has witnessed a slower pace than normal since the second half of 2012. The annual trend reflects weak domestic demand.

Commercial banks' liquidity continued to remain high throughout the year as excess reserves continued to remain above its target level. The high level of excess reserves has transmitted into lower short-term yields on RBV notes and drop in deposit and lending rates by commercial banks. In line with this conditions, Reserve Bank maintained its indicator interest rate below 1.0 percent throughout the year 2012.

Figure 6: Government Budget Balance



Source: Department of Finance and Treasury

Government budget faced another deficit with recurrent expenditure exceeding revenue by VT305.90 million. This shortfall extended to VT554.28 million when net acquisition of fixed capital assets is accounted for. Similarly, the overall budget deficit comes to VT1,427.18 million when development grants and recurrent budget are considered.

Development grants were budgeted at VT6.8 billion but only VT2,174.13 million was received while spending VT1,908.55 million in addition to acquiring fix capital assets to the sum of VT1,138.48 million leaves a deficit of VT872.90 million. External Budget support was budgeted for but did not materialise due in part to political instability so the shortfall was financed from domestic borrowing.

Vanuatu's current account deficit declined 22 percent in December from September quarter with improvement in the primary income and imports, while the secondary income surplus also registered an increase. The capital account showed a quarterly increase in December while the current account balance also improved by 19 percent year-on- year.

Over the period, development in the exchange rate follows closely the sentiments to hold foreign currency and the demand for holding or investing in foreign currency with respect to economic growth performance of each country. The Australian dollar continues its appreciation against the Vatu, being the most important export and import destination for Vanuatu. The US dollar being the main trading currency continues to weaken against the Vatu while putting downward pressure on inflation rate.

Monetary Policy Formulation

Monetary policy formulation begins with the regular reviews of international and domestic economic developments by the Policy Coordinating Committee (PCC). The findings are presented to the Monetary Policy Coordinating Committee (MPC) who determine the monetary policy stance. The PCC is made up of technical staff within the Research and Statistics Department, while the MPC members consists of the Governor (Chairman), Deputy Governor and the senior managers of the Research Department, Financial Markets Department, Financial Institution Supervision Department and the Accounts and Customer Services Department. Over the year, the Bank assessed that the weight of risks centred on the need to provide leverage to domestic economic activity after the 2010 slump which continued unabated into 2011 with further weaknesses signs shown throughout 2012. On the international front, euro zone peripheral economies were in a double dip recession with a knock-on-effect felt in the advance and emerging economies. This led to weak global economic growth, with central banks maintaining very loose monetary policy stances throughout the year.

Inflation throughout the year remained at the lower end of the band as a result of the strength of the trading partners' currency against the weak US dollar. The months of import cover remained well above the four months of import cover target. Despite this, there was excess liquidity in the banking system with private sector loans performing weakly. This led the Bank to continue to maintain a broadly accommodative monetary policy stance throughout the year. The Bank increased the SRD requirement in the latter half of 2012, from 6 percent to 7 percent but maintained the rediscount rate at 6 percent throughout 2012.

Fiscal policy over the year was broadly expansionary, contributing to a high level of liquidity in the banking system. The government budget support, from its development partners did not materialised, forcing the government to borrow domestically to cover the funding shortage gap.

Monetary Policy Implementation, Reserve Management & Financial Inclusion

The Financial Markets Department (FMD) carries out the Reserve Bank's functions of Monetary Policy Implementation, Foreign Exchange Reserve Management, Exchange Rate Management, Investment Risk Management, Financial Inclusion and other related functions.

Monetary Policy Implementation

The Bank maintained an accommodative monetary policy stance throughout 2012. To support its monetary policy stance, the Bank has issued less Reserve Bank of Vanuatu Notes (RBV Notes) in its domestic market operations during 2012 while keeping the official interest rate (rediscount rate) at 6.0 percent and the reserve requirement ratio unchanged at 7.0 percent.

Open Market Operation

Open Market Operations (OMO) remains a key instrument of monetary policy that the Reserve Bank utilizes to implement monetary policy in Vanuatu. The Bank continued to conduct weekly OMO throughout 2012, selling and redeeming RBV Notes with maturities of 7-days, 14-days, 28-days, and 91-days.

Table 2. Operations in the Market for Reserve Bank of Vanuatu Securities: 2012 (VT Million)

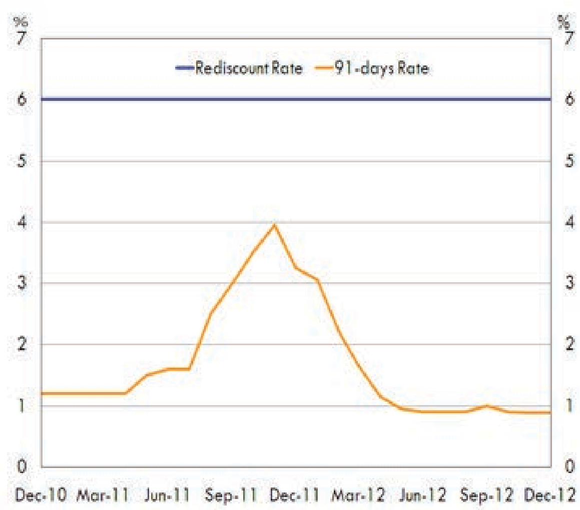
	2010	2011	2012
Number of OMO	44	40	49
Flotation	14150	20490	12679
Tenders	30525	28165	28401
Allotments	14250	18830	12455
Outstanding	1250	1630	1018

During the year, the Bank conducted 49 open market operations. However, the amount of RBV Notes being issued in the market has been reduced significantly. In 2012, the Bank issued around VT7.8 billion less RBV Notes as compared with the total Notes issued during 2011.

On the other hand, the total amount of tenders received was higher than in 2011 due to strong demand for RBV notes.

As the Bank reduced the amount of RBV notes issue, a strong competition for RBV Notes caused the yields on the various Notes to decrease to their lowest levels. The interest rates of the various RBV Notes maturities, including the 91-days RBV notes, have decreased and remained below 1.0 percent for most of 2012, as illustrated in chart 7 below.

Fig 7: Policy and Market Interest Rates
(In Percent, End of Month Position)



The drop in the RBV Notes and the notes interest rates during the year saw , the total cost of monetary policy declined significantly during the year to VT15 million compared to VT30 million in 2011.

Excess reserves have increased by around VT615.0 million or 24.0 percent during 2012. Matured RBV Notes contributed around 26.0 percent of the total increase in the excess.

Reserve Requirement

The Reserve Bank left the Reserve Requirement ratio or Statutory Reserve Deposit (SRD) unchanged during 2012. Commercial banks were required to maintain 7.0 percent reserve requirement with the Reserve Bank.

Market Operations with **Government Bonds**

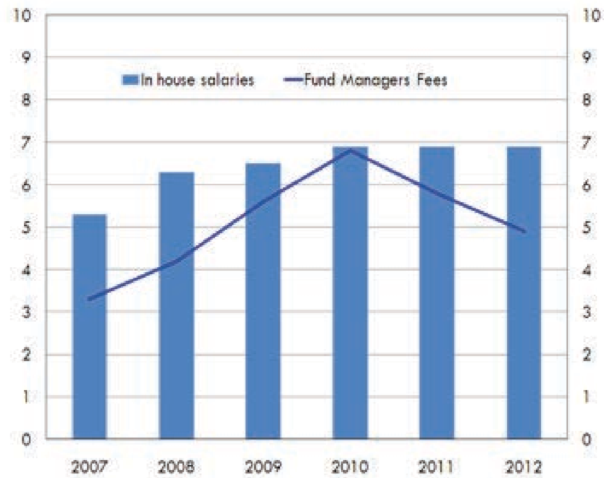
As the Fiscal Agent for the Government, the Bank has been issuing Government Bonds in the domestic market on behalf of the Government. Over the year , a total of VT1,801 million Government bonds were issued. Of this amount, VT1, 101 million were re-issue of matured bonds and VT700 million were new issued bonds. A lot of interests were generated from the public based on the non-competitive bids that was received for the Government Bonds as a result of the public awareness program that were carried out by the Financial Markets Department.

Foreign Exchange Reserve **Management**

Foreign exchange reserve management is one of the key functions of the Reserve Bank of Vanuatu. The Reserve Bank of Vanuatu Act (CAP. 125) mandated the Bank to manage the official foreign reserves. When managing the official foreign reserves the Bank aims to ensure there are sufficient foreign reserves to meet the country's external obligations as well as capital preservation and sufficient returns on the investments.

The Bank recorded a net increase in it's foreign reserves in 2012 at VT342.5 million. The increase, is significantly lower to the previous year's level at VT1273.2 million. Demand for foreign exchange from the market increased with total sales of foreign exchange recording a 28.9 percent increase over the last twelve months. Even as the total foreign exchange purchases exceeded sales, the amount purchased in 2012 was lower than in 2011 by 9.2 percent. The official foreign reserves are sufficient to cover around 6.8 months of Vanuatu's imports at the end of 2012.

Figure 8: Cost of managing Funds through fees and salaries (Yearly Data; Millions of Vatu)

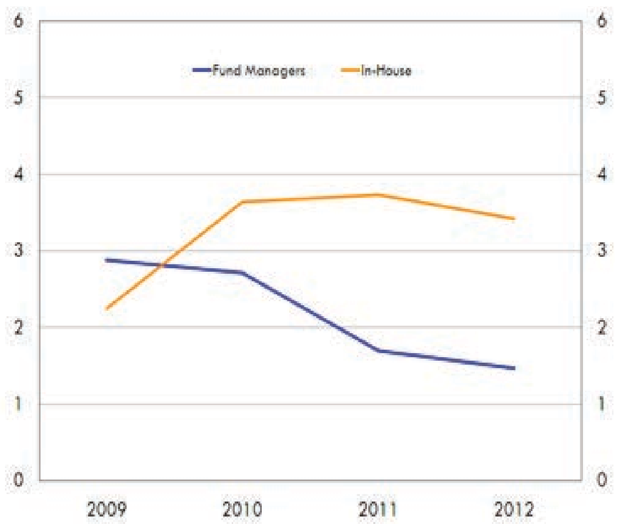


The foreign reserves are managed both in-house and by external fund managers. During 2012, the composition of funds managed in-house and funds managed by external fund managers was unchanged from the previous year. Around 76 percent of investible reserves were managed in-house and 24 percent were managed by external fund managers.

Table 3. Official Interest Rates (%)			
Bank	**2010**	**2011**	**2012**
FED	0/0.25	0/0.25	0/0.25
BOJ	0.1	0.1	0.1
ECB	1	1	0.75
BOE	0.5	0.5	0.5
RBA	4.75	4.25	3.00
RBNZ	3	2.5	2.5

The Bank faced a number of challenges during the year. Firstly, many of the Bank's investment counterparties credit ratings were downgraded below the Bank's benchmark limiting the option for the Bank to invest in counterparties that offer better interest rates. Secondly, the difficulty of managing the positions under the continued global low interest rates environment. During 2012 the Reserve Bank of Australia and European Central Bank reduced their official interest rates further.

Figure 9: Rates of Return on Investments (Yearly Data; Percent)



Low interest rates globally and limited investment opportunities have had an impact on the rates of return on investments. During 2012, the rates of return on funds managed in-house decreased from 3.73 percent in 2011 to 3.42 percent in 2012. Likewise the rates of return on funds managed by external managers declined from 1.7 percent in 2011 to 1.47 percent in 2012. Despite these developments, the Bank was able to surpass its revenue target for the year 2012.

Buying and Selling of Foreign Exchange

The Bank buys and sells foreign exchange in the market. As in the last couple of years, the Bank continues to buy more foreign exchange than it sold in 2012. The main sources of foreign exchange in 2012 are from donor funds and the Government. On the other hand, commercial banks in Vanuatu are the main buyers of foreign exchange from the Reserve Bank, accounting for around 66.0 percent of the total foreign exchange sold during the year.

Buy and Sellback Facility

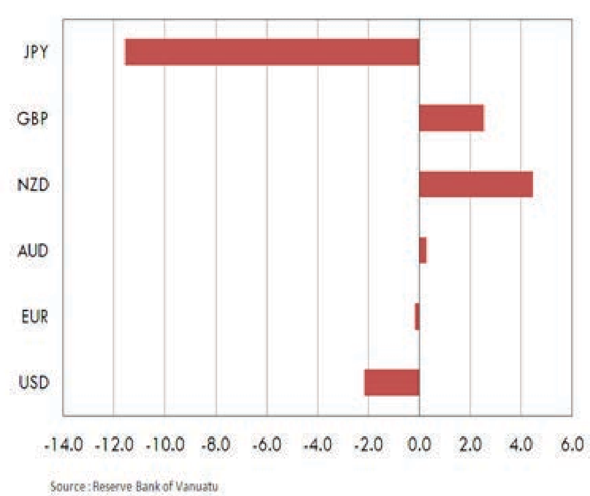
To encourage commercial banks to sell foreign exchange to the Reserve Bank, the Bank introduced a new 'buy and sellback arrangement' August 2012. Under the new arrangement, commercial banks are encouraged to sell foreign exchange to the Bank and make arrangements to buy back the foreign exchange at later dates. Since the launch of the new facility only one bank has used the facility. The Bank bought a total of USD8.3 million under this facility during 2012.

Exchange Rates

The Reserve Bank continues to maintain a fixed exchange rate regime whereby the local currency is pegged to an undisclosed basket of foreign currencies. The Bank reviews the currency weights in the basket annually. In 2012, the review of the weights was done in October.

Throughout 2012, the Reserve Bank sets the official exchange rate daily and communicates the rate to commercial banks at 9.00am. Commercial banks use the Reserve Bank's exchange rate to set their rates to their customers. at which.

Fig 10. VATU per FC Exchange Rates-2012 (Year on Year Change in Percent)



Movements in the exchange rates of the local currency against the major currencies in 2012 continued to mirror bilateral movements between the major trading currencies. During 2012, the New Zealand dollar and the British pound were the best performing currencies against the Vatu. They have appreciated by 4.5 percent and 2.5 percent, respectively. Though it also appreciated against the local currency, the Australian dollar's performance was rather muted by a string of interest rate cuts by the Reserve Bank of Australia. On the other hand the Japanese Yen was the worst performing currency against the Vatu, depreciating by 11.6 percent against the local currency. The Vatu appreciated against the US dollar by 2.2 percent.

Financial Inclusion

As part of its effort to promote financial inclusion in Vanuatu, the Bank successfully organized a first ever National Financial Inclusion Workshop during August 2012. The work shop was organized in collaboration with the Pacific Financial Inclusion Program (PFIF), the Alliance for Financial Inclusion (AFI) and Australian Aid (AUSaid). With the theme 'Developing a National Strategy for Financial Inclusion in Vanuatu', the workshop gathered together relevant stakeholders to discuss financial inclusion issues and agree on ways to advance financial inclusion further in Vanuatu. The workshop, participants identified and agreed on these action items:

1. Establish a National Financial Inclusion Task Force;

2. Conduct survey on financial access and demand for financial services;

3. Financial Literacy and Consumer Protection.

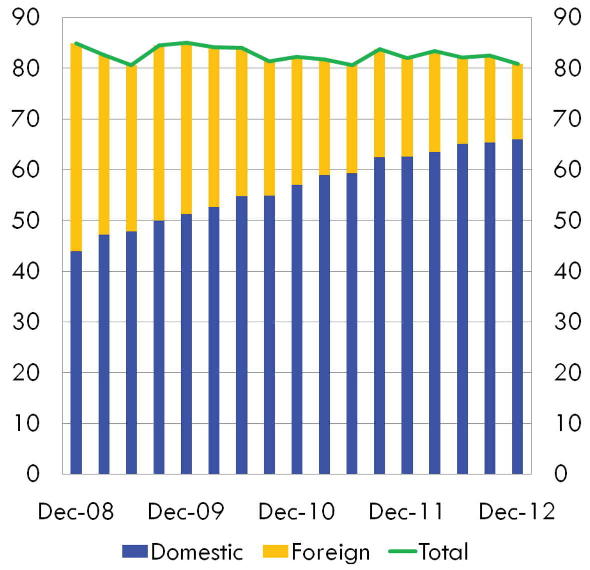
During September, the Reserve Bank participated in the Alliance for Financial Inclusion (AFI) Global Policy Forum in South Africa, and made a commitment to the Maya Declaration to spearhead financial inclusion in Vanuatu.

Financial Institution Supervision

BANKING SECTOR DEVELOPMENTS

Domestic Banks Financial Position

Figure 11: Asset Position Domestic Banks (Levels; billions of Vatu)

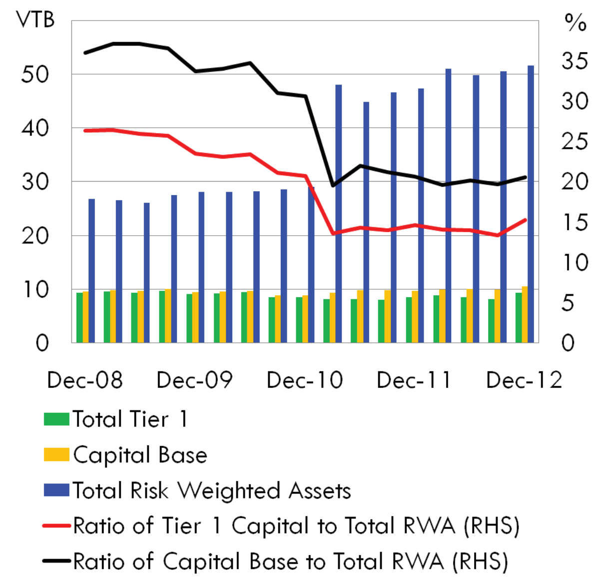


The financial position of the domestic banking industry over the year ended December 2012 dropped by 1.4 percent to VT80.8 billion, compared to VT81.9 billion reported in December 2011. The annual decline was mainly attributable to decreases in foreign assets by 27.3 million, triggered largely from reduction in balances due from overseas banks by 26.0 percent to VT13.0 billion. Domestic assets however increased by 7.2 percent to VT65.9 billion, reflecting mainly growth in claims on private sector by 6.9 percent to VT51.2 billion over the year. Refer to Figure 11.

In contrast, banks liabilities (less capital) also fell by 2.9 percent to VT68.6 billion (VT70.7 billion, Dec-11). This resulted mostly from reductions in foreign liabilities by 22.1 percent to VT10.9 billion, driven mainly from decreases in balances to non-residents by 5.4 percent to VT1.5 billion. Banks domestic liabilities on the other hand, increased by 1.8 percent to VT57.8 billion, sourced mainly from growth in unclassified liabilities by 34.9 percent to VT5.1 billion over the previous year.

Capital

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



For the twelve months under review, the domestic banking industry remained soundly capitalized, registering its Capital Adequacy Ratio (CAR) at 20.5 percent, with Tier 1 capital at 18.3 percent. At this level, the industry recorded its capital at VT10.6 billion , an increase of 8.5 percent over the year (VT9.8 billion, Dec-11).

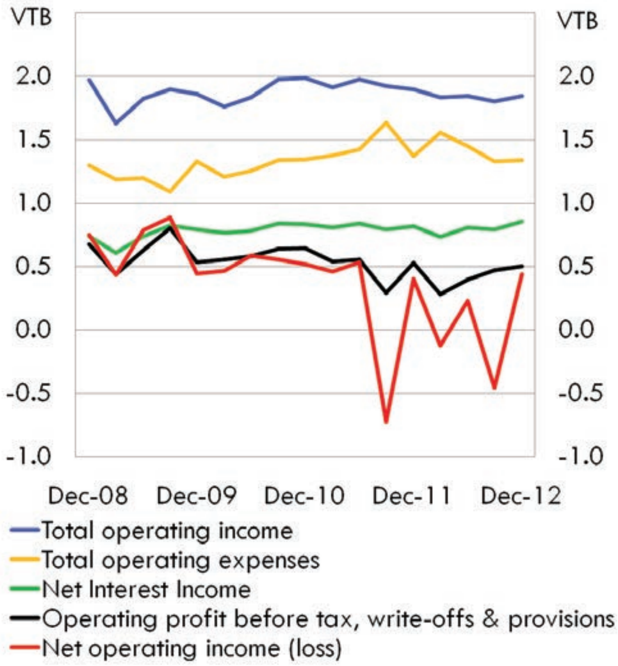
This increase is driven from growth in Tier 1 capital by 10.5 percent to VT9.4 billion (VT8.5 billion, Dec-11), stemmed from increases in paid-up capital and disclosed reserves and retained earnings by 12.0 percent and 6.3 percent to VT4.0 billion and VT5.4 billion correspondingly. In contrast, the industry's Tier 2 capital fell by 5.6 percent to VT1.2 billion (VT1.2 billion, Dec-11), resulting mainly from declines in unaudited profits by 13.9 percent to VT694.0 million. Refer to Figure 12.

Over the year, banks total risk weighted assets grew by 9.0 percent to VT51.5 billion (VT47.3 billion, largely triggered from increases in risk weighted on and off balance sheet assets by 9.0 percent to VT46.1 billion. Also contributing to this increase, is risk on operational assets which grew by 9.8 percent to VT5.5 billion over the year.

[1]*This excludes branches of foreign banks*

Financial Performance

Figure 13: Earnings – Domestic Banks (Quarterly Data)



The banking industry reported another positive performance at the end of December 2012. Operating profit before tax write-offs & provisions reached VT502.1 million, despite declining from VT526.2 million reported in December 2011. The decline reflected largely decreases in total operating income by 3.0 percent to VT1.8 billion, which more than offset the decline in total operating expense by 2.4 percent to VT1.3 billion. Consequently, net interest income increased by 4.7 percent to VT855.3 million.

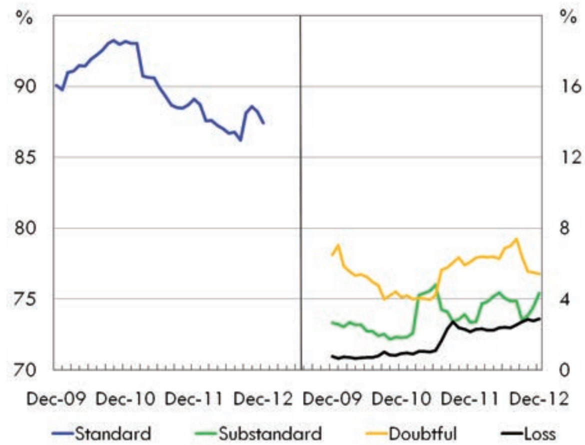
The annual decrease in total operating income is sourced mostly from reduction in interest income by 6.0 percent to VT1.2 billion, while reduction in total operating expenses is due to cuts in interest expense by 23.8 percent to VT374.4 million.

After factoring provisions and bad debts written-off of VT37.9 million and VT24.8 million respectively over the year, the banking industry reported a net profit of VT439.3 million, up from VT400.3 million registered in the previous year. Refer to Figure 13.

Nonetheless, the Return of Assets (ROA) and Return on Equity (ROE) dropped marginally to 0.6 percent (0.64 percent, Dec-11) and 4.3 percent (4.7 percent, Dec-11) respectively over the year.

Asset Quality

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



Asset quality of the banking industry continued to deteriorate over the year. In December 2012, Non-Performing Loans (NPLs) stood at VT4.2 billion, an increase of 4.8 percent over the previous year (VT4.0 billion, Dec-11). This represented 8.1 percent of total lending assets and 39.8 percent of total capital. The annual growth in NPLs reflected mainly increases in loss loans by 39.2 percent to VT1.4 billion. In contrast, doubtful loans fell by 7.1 percent to VT2.8 billion.

Also over the year, the industry reported considerable growth in substandard loans by 73.0 percent to VT2.2 billion, but accounted for 4.3 percent of total loans.

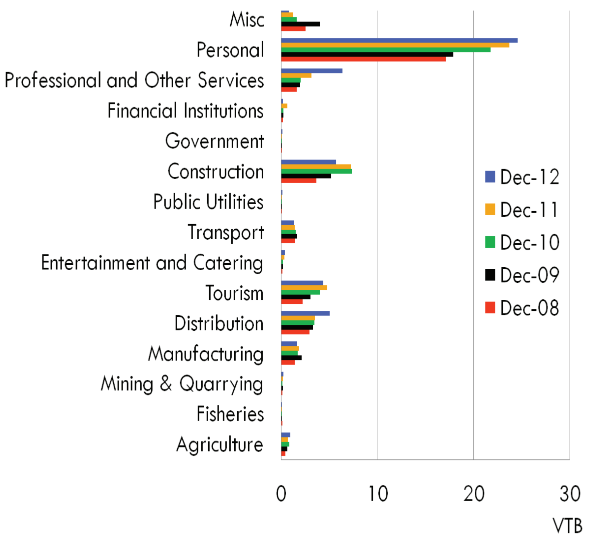
The industry however maintained high quality standard loans representing 87.6 percent of total lending assets. This increased by 2.5 percent over the previous year. At the end of December 2012, banks total lending assets reached VT51.7 billion, an increase of 4.5 percent over the previous year (VT49.5 billion). Refer to Figure 14.

On the provisioning side, both specific and general provisions increased by 19.0 percent and 37.6 percent to VT2.1 billion (VT1.8 billion, Dec-11) and VT833.9 million (VT606.2 million, Dec-11) correspondingly. In addition, security held by banks grew by 11.8 percent to VT35.2 billion (VT31.5 billion, Dec-11).

[2]Non-performing loans is made up of doubtful and loss loans

Private Sector **Lending**

Figure 15: Private Sector Credit Domestic Banks (Total Loans; By Industry; Quarterly Data)



Total private sector credit (PSC) of the banking industry grew by 6.1 percent to VT51.6 billion (VT48.6 billion, Dec-11) over the year. This reflected mainly growth in personal, professional and other services, and distribution sector by 3.7 percent, 103.2 percent, and 45.1 percent to VT24.6 billion, VT6.3 billion, and VT5.0 billion respectively. Refer to Figure 15.

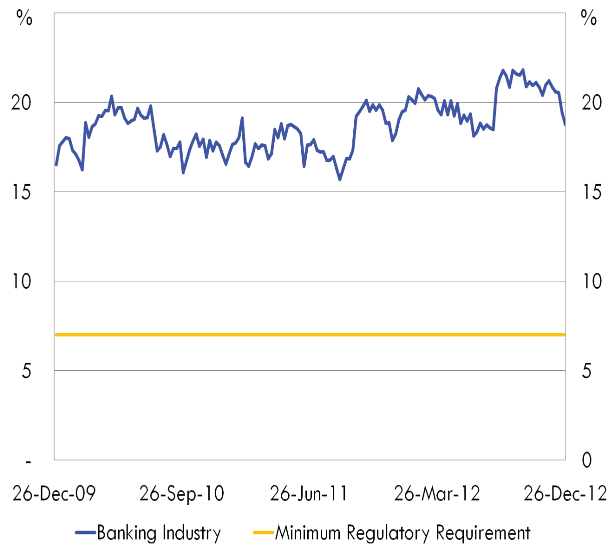
This growth is also attributed to increases in lending to agriculture sector by 41.2 percent to VT931.1 million, entertainment & catering, by 9.1 percent to VT352.2 million, mining and quarrying, by 33.0 percent to VT194.4 million, Government, by 98.7 million to VT107.5 million, and public utilities, by 70.1 percent to VT85.2 million.

Lending to the construction sector, tourism, manufacturing, transport, financial institutions, fisheries, and miscellaneous, however declined over the year.

The industry's five largest lending sectors are mainly to personal, professional and other services, construction, distribution, and tourism sector representing 47.7 percent, 12.3 percent, 11.0 percent, 9.8 percent, and 8.4 percent of total PSC correspondingly.

Liquidity Position

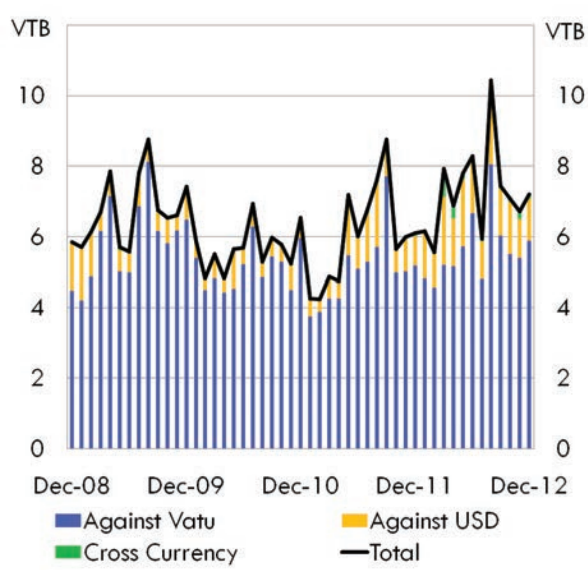
Figure 16: Liquid Asset Ratio - Domestic Banks (Quarterly Data)



The banking industry's liquidity position remained adequately sound despite fluctuating over the year. For the year ended , banks combined liquid asset ratio (LAR) was reported at 18.8 percent, up marginally from 18.2 percent in December 2011. This is equivalent to VT7.0 billion (VT7.1 billion, Dec-11) of total liquid assets, and accounted for 13.3 percent of banks overall domestic deposits (VT52.7 billion). The industry's liquidity position is consistently maintained well above the minimum threshold regulatory limit of 7 percent. Refer to Figure 16.

Foreign Exchange **Turnover**

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



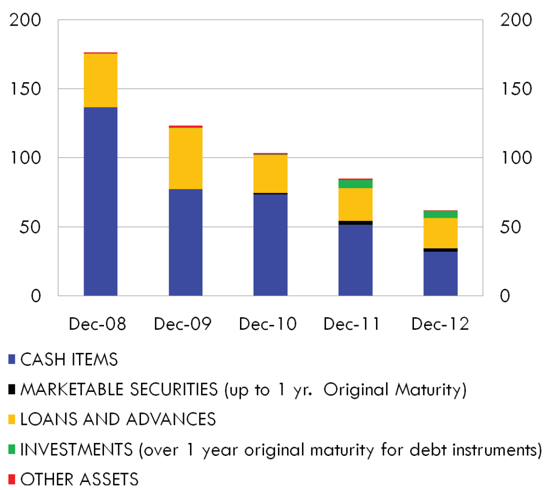
The industry's foreign exchange position increased by 6.5 percent to VT7.2 billion over the year (VT6.8 billion, Dec-11), driven by both foreign exchange dealings against Vatu and USD currency, by 3.2 percent and 20.8 percent to VT5.9 billion and VT1.2 billion respectively. Banks foreign exchange turnover against other currencies also grew by 71.6 percent to VT129.3 million over the year. Refer to figure 17.

Conversions to Vatu are mostly from USD currency, while conversions to USD are mainly from AUD currency.

International Banks

Statement of Financial Position

Figure 18: Offshore Banking Industry Total Assets (Millions of USD, Annual Data)

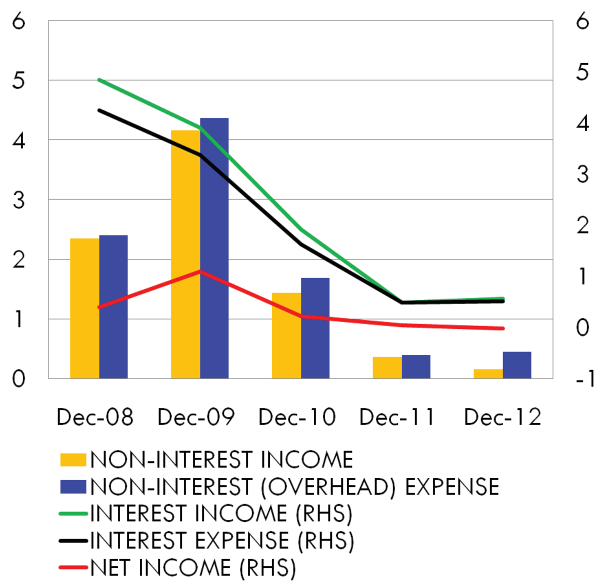


The international banking industry's financial position recorded a 26.5 percent decline to USD61.9 million compared to the previous year (Dec-11: USD84.3 million). This is mainly attributed to falls in cash items of 38.4 percent to USD31.8 million, loans and advances by 8.3 percent to USD21.9 million and investments (maturity over a year) by 12.8 percent to USD5.1 million. Marketable securities also declined but by a trivial amount. Cash items remained the core component of banks balance sheet, representing 51.3 percent of total assets. Refer to Figure 18.

Total liabilities (excluding capital) similarly decreased by 28.5 percent to USD56.3 million (Dec-11: USD78.8 million), due mostly to reduction in deposits by 28.8 percent to USD55.6 million (Dec-11: USD78 million). On the other hand, \accrued liabilities increased by 13.8 percent to USD659,000 thousand and loss reserves climbed to USD10,000 (Dec-11: USD4,000).

Statement of Financial Performance

Figure 19: Offshore Banking Industry Earnings (Millions of USD; Annual Data)



The offshore banking industry's annual performance deteriorated significantly recording a loss of USD14,000 (Dec-11: USD47 thousand). This reflected mainly a high decrease in non-interest income of 55.1 percent to USD168,000 (Dec-11: USD374,000), coupled with increase in interest expense and non-interest/overhead expense by 6.7 percent and 14.3 percent to USD524,000 and USD457,000 respectively. Refer to Figure 19.

The recent collapse in the worldwide financial system continues to affect the industry.

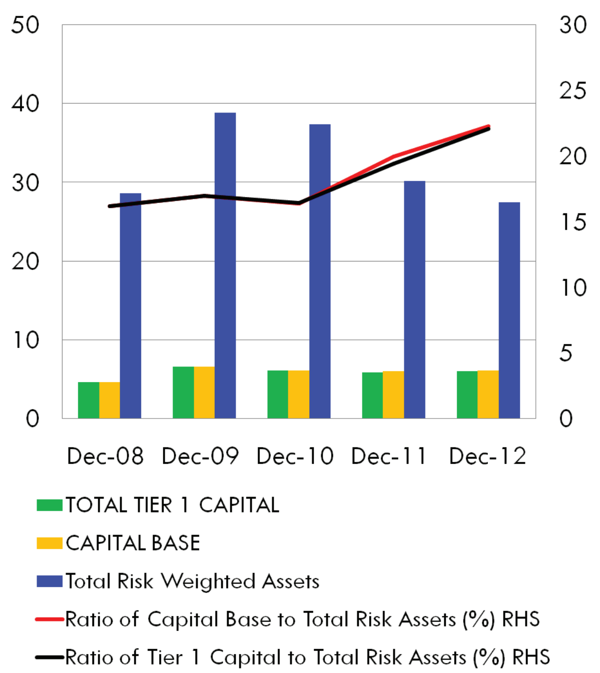
International banks continue to rely essentially on interest-making activities as their significant part of their operations.

Capital

For the year under review, the international banking industry is well capitalized, registering its capital adequacy ratio at 22.3 percent, with Tier 1 capital at 22.1 percent, up from 20.0 percent and 19.4 percent reported in the previous year respectively. This improvement reflected mainly reduction in total risk weight assets by 8.8 percent to USD27.5 million (Dec-11: USD30.2 million), due from declines in risk weighted on & off balance sheet assets by 10.2 percent to USD24.5 million.

At this level, the industry's combined capital was reported at USD6.1 million (Dec-11: USD6.0 million), an increase of 1.7 percent over the previous year. The increase was driven from growth in Tier 1 Capital by 3.6 percent to USD6.1 million, reflecting mainly growth in paid-up capital by 6.3 percent to USD4.8 million. Tier 2 Capital on the other hand, declined by 66.7 percent to USD54,000, sourced mostly from declines in unaudited profits by 72.2 percent to USD44,000. Refer to Figure 19.

Figure 20: Offshore Banking Industry - Capital (Millions of USD & Percent; Annual Data)



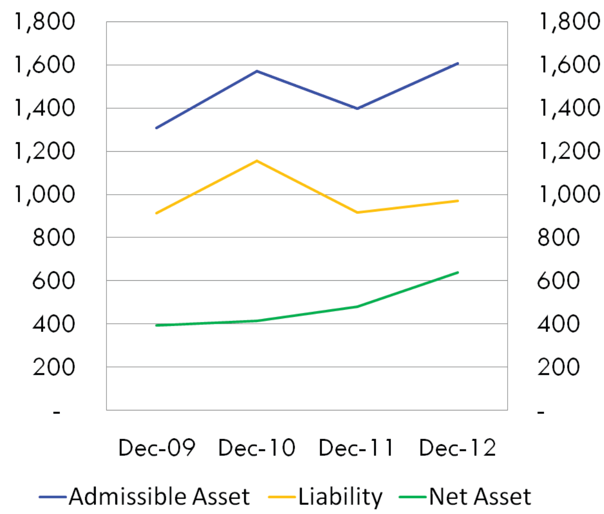
INSURANCE SECTOR DEVELOPMENTS

Domestic Insurers Financial Position

The admissible asset position of the domestic insurance industry for the year ended December 2012 increased by 13 percent to VT1.6 billion from 2011 compared to VT1.3 billion in 2011. This was due mainly to increase in cash deposits of 15 percent to VT1.3 billion from VT1.1 billion in the previous year.

Similarly, insurance liabilities have increased slightly by 5 percent to VT968 million. This was due to 21 percent increase in unearned premium. Refer to figure 21a.

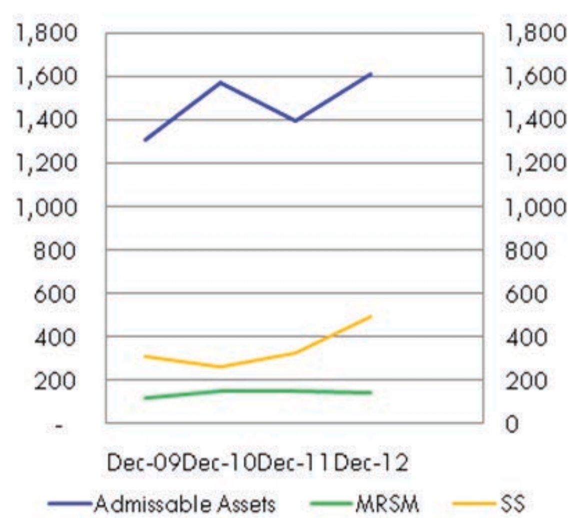
Figure 21a: Asset Position Domestic Insurers (Levels, Millions of Vatu)



Margin of Solvency

Over the year ended 31 December 2012, the total domestic industry surplus (admissible assets) increased by 33 percent from VT330 million to VT493million. The increase was attributed to the increase in net assets of 25 percent from VT 479 million in December 2011 to VT 637 million. Refer to Figure 21b.

Figure 21b: Margin of Solvency (Levels, Millions of Vatu)



MRSM – Minimum Required Solvency Margin
SS – Solvency Surplus

Annual Domestic Industry Performance

Gross Premium (GP)

The Vanuatu insurance industry gross premium grew by 10 percent to VT1.3 billion from VT1.2 billion in the preceding year. The increase was driven predominantly by fire, household, personal accident and health, marine, aviation and general accident. Fire and motor continues to be the largest classes written with gross premiums of VT443 million and VT277.9 million, representing 33.3 percent and 20.9 percent respectively.

Reinsurance Cessions

Reinsurance expenses had declined by 18 percent to VT378.6 million from VT463.9 million in 2011. The decline was recorded by all classes except personal accident and health, workers compensation and marine. Motor had recorded the largest decline of 66 percent followed by general accident of 60 percent. The most heavily reinsured classes in 2012 were fire and householders with cessions in fire totalling VT252.4 million (57.4 percent of gross premium received in the class) and in householders VT70 million (52.6 percent of gross premium received). Engineering was also a class heavily protected by reinsurance with cessions comprising 61 percent of the class gross premium.

Net Earned Premium (NEP)

Total net earned premium grew by 18 percent to VT847 million from VT716 million in 2011. The motor class NEP continues to dominate the distribution of the industry NEP holdings with the portfolio of VT247.9 million or 29.3 percent. This was followed by personal accident and health of 21 percent and fire 17 percent.

Claims

The industry recorded gross claims of VT339.7 million for the 12 months ending 31 December 2012 compared to VT223.4 million in 2011, showing an increase of 52 percent. The increase was recorded predominantly by personal accident and health, general accident and worker compensation. Personal accident recorded a total gross claims of VT144.3 million compared to VT91.5 million in 2011, an increase of 58 percent, while general accident recorded a total gross claims of VT21.4 million compared to VT6.3 million (240 percent) and workers compensation recorded an increase of 340 percent to VT13.9 million from VT3 million in 2011. Gross claims weighted showed that personal accident and health and motor holding the bulk of claims of 42.5 percent and 27.7 percent respectively.

Net Loss Ratio (LR)

The industry overall loss ratio in 2012 was 41 percent compared to 40 percent in 2011. Householders, engineering, fire, marine and motor have recorded substantial improvement in loss ratios while general accident, workers compensation, personal accident and health, aviation and liability have recoded deterioration in loss ratios with liability recording the highest loss ratio of 92 percent (-11 percent in 2011).

Expense Ratio (ER)

The industry expense ratio had improved significantly in 2012 to 14 percent compared to 32 percent in 2011. All classes of business had registered improvements with the highest improvement recorded by householders at 14 percent (60 percent in 2011) followed by fire at 17 percent (60 percent in 2011).

Combine Ratio (CR)

The combine ratio was recorded at 55 percent in 2012, a substantial improvement from the 72 percent in 2011. The improvement was recorded predominately by householders, fire, motor, engineering, and marine with the most significant improvement recorded by householders at 4 percent (109 percent in 2011). Fire had also improved significantly to 32 percent from 107 percent in 2011. Motor had also improved to 57 percent from 83 percent in 2011 and engineering had improved to 30 percent from 95 percent in 2011 while marine had improved to 6 percent from 48 percent in 2011. All other classes had recorded deterioration in combine ratios with the highest recorded by liability of 104 percent (12 percent in 2011).

[2]Non-performing loans is made up of doubtful and loss loans

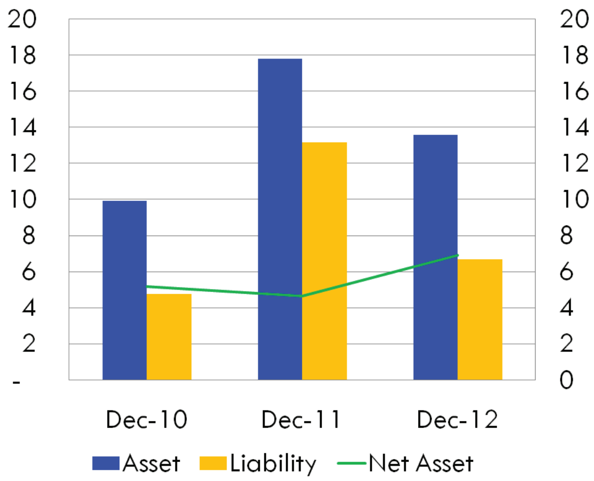
Underwriting Results

The underwriting result was 45 percent (VT378 million) in 2012 compared to 28 percent (VT200 million) in 2011. The improvement was possible due to a combination of factors despite the increase in net claims by 22 percent. It was a direct result of the increase in NEP of 18 percent to VT847 million (VT716 million in 2011), improvement in net commission of 4 percent to VT114 million (VT110 million in 2011) and the declined in underwriting and management expense of 48 percent to VT121 million from VT231 million in 2011. All classes of business except liability had recorded improvement in underwriting results with householders recording the highest underwriting result at 96 percent followed by marine (94 percent) and aviation (94 percent). Liability had recorded a negative 4 percent. Gross weighted underwriting result shows that motor and fire generated the most profit of VT106 (VT40 million in 2011) million and VT97 million (VT6.8 million in 2011) respectively.

Captives & International Insurers

Financial Position

Figure 22: Captives & International (Millions of USD, Annual Data)



The offshore insurance industry experienced a decline in assets of 31 percent from USD17 million in the previous year to USD 13 million. This was mainly due to two licensees exiting the market in 2011. Similarly, the year recorded a decline of 97 percent in liabilities, from USD13 million to USD6 million. Refer to Figure 22

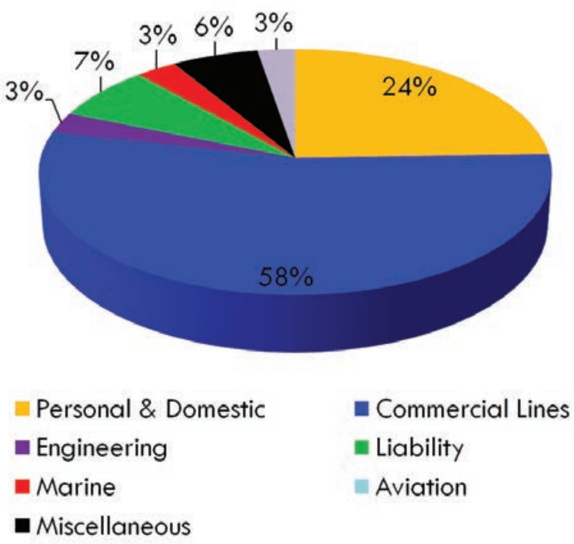
Insurance Brokers

Domestic Premium distribution according to class of risks

The total premiums transacted through brokers over the year ended December 2012, was recorded at VT802.8 million, a growth of 5 percent compared to VT761.8 million recorded in 2011.Total commission paid to brokers increased by 50 percent to VT206.9 million compared to VT103 million in 2011. This growth is attributed to more businesses being transacted through brokers across most classes of insurance.

Commercial Lines (comprising Fire & Perils, ISR, BI, and Combine Commercial Package) continues to record the highest premium placed through brokers in the domestic market at VT464.8 million in 2012, an increase of 8.6 percent from VT428 million recorded in 2011. Personal and domestics lines (comprising home & contents, private motor vehicles, medical and repatriation, personal accident, income protection and travel) transacted through brokers had increase by 4.6 percent to VT191.7 million from VT182.7 million in 2011. Liability class had also increased by 15 percent to VT54.5 million from VT46 million in 2011. Miscellaneous class (comprising Workers compensation, Group Life) recorded a total premium of VT48.3 million compared to VT41.4 million recorded in December 2011, an increase of 14 percent. This growth was attributed to more companies insuring their workers under the Workers Compensation policy. Total premium through brokers for engineering declined by 46 percent at VT21 million compared to VT39.2 million, recorded in December 2011. The decline was due to more policies being placed offshore due to unfavourable condition in the domestic market to accommodate this risk. Over the year ended December 2012, total premium recorded for marine was VT22.2 million compared to VT24 million in December 2011. This was due mainly to local insurers refusing to write this risk due to its high risk exposure. Refer to Figure 23.

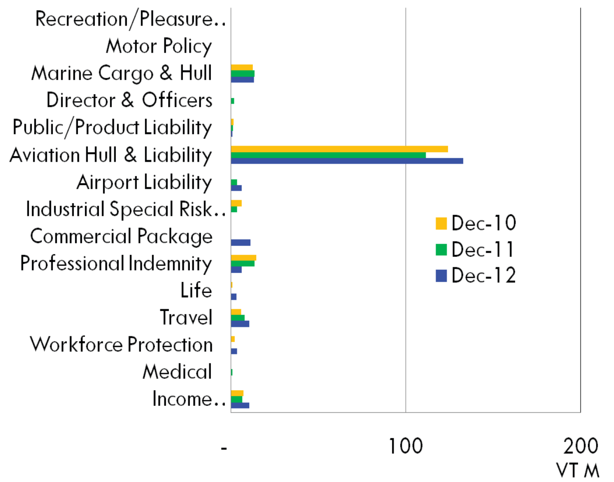
Figure 23: Risk Type Distribution



Domestic Risks **Placed Offshore**

Aviation risks which comprises hull, spares and combined liability continued to account for the highest premium remitted offshore at VT132.8 million, an increase of 16 percent compared to VT111.3 million in 2011. This risk had always been placed offshore due to lack of capacity from domestic insurers to carry the risk. The other major classes that have been placed offshore are marine cargo and hull with VT13.1 million, followed by commercial class comprising fire & perils, material damage (MD) & business interruption (BI) with a total premium of VT11.3 million. This is followed by travel (both corporate and individual) which comprises personal accident and repatriation at VT10 million. Other categories with significant amount of premiums in the offshore market are airport liability at VT6.4 million, professional indemnity at VT6.3 million and income protection at VT5.8 million. The remaining classes which had experienced slight increases are workforce protection, life and medical policies with premiums of VT3 million or less. Refer to Figure 24.

Figure 24: Offshore Broker Business



Total premium remitted offshore though brokers in 2012 had increased by 16 percent to VT195.9 million from VT165.8 million in 2011.

FISD's Brief Report

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. Offsite monitoring plays a major role during the year as the Department assessed and monitored the individual financial institutions' performances and where necessary initiate onsite reviews. The industries as a whole were also assessed and monitored.

Apart from the usual onsite reviews of different financial institutions, from 1-12 October 2012, the Reserve Bank of Vanuatu, through the Department, hosted its second 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 the National Bank of Vanuatu and the review focused on all risks that are inherent in any bank, including credit risk, operational risk and governance risk. It was a timely onsite review for the bank given the ongoing negotiations then to sell part of the Government shares to both VNPF (15%) and the IFC (15%). This particular onsite review's findings and recommendations provided an impetus for the current Management and Board to restructure the bank in line with some of the new shareholders requirements. Technical advice and training was provided by APRA while funding was provided by AUSAID. Participants came from Reserve Bank of

FISD's Brief Report

Fiji, Bank of Papua New Guinea, Central Bank of Solomon Islands and the Federated States of Micronesian Banking Commission. The onsite review took two weeks to complete. Given it was a capacity building program for supervisors, the program was full scope and began with the discussion of issues prior to onsite review, the onsite review, exit meeting and report writing. This program benefitted supervisors from Reserve Bank of Vanuatu and those from other Central Banks in the region.

From 13 August to 17 December 2012, the Department conducted an urgent on-site review on VNPF in response to media allegations, heightened in early August 2012, against the current Management and Board members' practices at the Fund. This was regarding recent recruitments, remunerations, investment decisions, tender processes, outsourcing procedures, and some business decisions. The report was later presented to the Minister of Finance and Chairman of the VNPF Board.

In terms of other major developments, in June 2012 the Department commenced discussions with banks and other financial institutions on the need to comprehensively revise the current prudential data returns to a more standardized one that would allow for better and deeper analysis for the purpose of supervision and regulation, allow for appropriate comparisons with other banks in other countries in the Pacific region, and enable Reserve Bank to meet its reporting requirements to IMF/World Bank and other relevant international bodies. Banks and other financial institutions were given the opportunity to comment on the new prudential data returns. A workshop was then held on 14 November 2012 with banks and other financial institutions to go through the returns. The tentative plan for implementation is June 2013 quarter. This should also enhance data integrity.

In terms of legislation and guidelines, the Bank has commenced putting together a few draft new prudential guidelines, including reporting, Uniform Financial Institutions Rating System and Foreign Currency Open Position. Prudential Guideline on Loans Classifications & Provisioning and Capital Adequacy were also reviewed to address the new standardized prudential data returns. These are yet to be finalised.

Last year the Bank received a number of enquiries from potential applicants for international banking licenses and insurance. The Bank also received some applications. On 28 June 2012, after monitoring the progress and negotiations on the proposed acquisition of shares by both VNPF and IFC on NBV, the Reserve Bank issued its approval.

In April 2012 the Bank granted approval for the acquisition of AFA Insurance Ltd by QBE. The formal acquisition took place in May 2012 and AFA became a subsidiary company of QBE Vanuatu Ltd. The acquisition was carried out smoothly and AFA staff members were then relocated to QBE offices in October 2012. AFA continues to exist as a separate company as the running-off process of policies is still on-going and will continue until mid 2013.

The Bank also granted two other licenses in October 2012: one to Edna Ratonel, in Luganville Santo as agent to Dominion Insurance Ltd and the other one to Centron Insurance ICC Ltd, a captive incorporated cell company. This type of captive is the first of its kind to be licensed in Vanuatu.

In November 2012, the Bank also granted a license to Ever best Re Corporation Ltd, a reinsurance company which is also a first reinsurance company to be licensed in Vanuatu.

Overview of Operations

The Bank has ended another successful year in 2012. Despite the gloomy global economic conditions which impacted on operating income the Bank managed to achieve its annual work plans reflecting its operations during the year.

Budget

The 2012 Budget stood at a forecasted net deficit of VT 81 million. This is a decline of 47 percent compared to the previous year budget that was forecasted at a net deficit of VT120 million. Revenue budget has slightly increased from VT608 million in 2011 to VT609.6 million and expenditure decreased from VT717 million in 2011 to VT690.8 million. The 2012 budget was approved by the board with the projection that the world economic crisis will continue to impact the off shore investments, thus the reductions of revenue and expenditure budget.

The year end results show an opposing view to the forecasted deficit. A net profit of VT108.1 million was achieved, though it was a decline of 34% in net profit compared to the 2011 net profit of VT165.2 million. Actual revenues were VT720.2 million compared to a budget of VT609.8 million; expenses were VT612.1 slightly lower than a budgeted amount of VT690.8 million.

Table 4: Budget against Actuals

	Budget(VTmillion)	Actual(VTmillion)
Revenue	609.8	720.2
Expenses	690.8	612.1
Net profit/Loss	(81)	108.1

Income

The Bank recorded an operating income of VT720.2 million in 2012. This is a slight decrease of 5% from the 2011 result of VT763.5 million.
Foreign interest earnings and other interest income accounts for 76% of the total income, while 8% is from other income and 16% is from realized gains on foreign exchange movements

Expenditure

Total expenditure for the year has slightly increased by 2% from VT598 million to VT612.1 million in the prior year. This is due to slight increases in some expenditure heads and also unrealized losses incurred from foreign exchange movements.

Operating Profit

The Bank recorded a net operating profit of VT108.1 million according to its performance for the year 2012. This is a decrease of VT57.1 million compared to an amount of VT165.2 million in the year 2011. The global financial crisis continues to pose a challenge to the Bank's financial performance

Payment to Government

According to section 7(3) of the RBV Act an amount of VT97.3 million was transferred to the Government being 90% of its profit. This is done after an allocation of 10% was done to the General reserve account of the Bank.

Security

The security officers ended another successful year providing security surveillance and support services to the Bank during the normal operations and important occasions organized by the Bank. The officers operated and maintained a 24 hours physical security Surveillance, CCTV and security system that assisted them to monitor and provide coverage during the currency Processing/Movement of Transactions and Storage facilities.
Two new security officers were recruited to the team this year after the transfer of an officer to the full time front officer and the release of Mr. Albert Bena to further his studies at the University of the South Pacific in Fiji.

Maintenance Work

The maintenance work covers two main areas namely; the general building maintenance and the grounds and landscaping maintenance.

During the year the maintenance section continued to provide daily maintenance work through the maintenance requisition process. Some of the works carried out in 2012 were:

A. Archive Room Tiling & Shelving

Work began in 2011 and completed by the Maintenance Officer in January 2012. The room has improved with door locks and also a filing room equipped with 40 x 4 drawer filling cabinets.

New shelves & tiles

Archiving is an outstanding issue which the Bank is working to complete the archive room with shelves and tiles to protect the room from dust. Work also started on Archive 2 and is expected to be completed in 2013.

B. Landscaping work

Work is ongoing to improve the landscaping of the Bank's property on the other side of the road. This includes the installation of three marble outdoor tables and stools for staff use during lunch and leisure.

New Garden Table & stools

C. Tiling and upgrade sink benches

The ceramic tiling of the veranda and replacement of the sink bench of the social club building were carried out during the year. These improvements were part of the plans to create a canteen for the Bank.

New kitchen sink & ceramic tiled floor

Cleaning Work

Cleaning is part of maintenance and as such the cleaning section which consists of 4 cleaners and a supervisor had been working hard daily to keep the Bank clean and tidy.

Quarterly cleaning sessions are carried out as part of the annual planned preventative maintenance. At the end of the quarterly cleaning session which takes at least 3 Saturdays, the bank also engage Ezzy Kill Pest Control to fumigate the building.

Vehicles

The Bank has added a Mazda BT50 to its vehicle fleet increasing it from four to five. The Bank has also trade in the Deputy Governor's Toyota double cap Hilux with a new Rav4. Two of the five vehicles are allocated for Governor and Deputy Governor for official use.

New Mazda BT50 single cap Utility

Conference Room Upgrading

The upgrading work of the Bank's conference room continued during the year. This year the Bank installed the new red floor carpet giving it the professional look and also making it more safer for meetings to be conducted in the room. The Bank has also invested in the improvement of a new PA system with a new goose neck conferencing microphone set.

The upgrading of the conference room facilities has attracted and increased the hiring of the conference room for meetings, trainings, conferences and workshops during the year. There are plans to add additional equipments and also set up an internet service.

New Carpet and new goose neck conferencing microphone set.

Earth Quake Damages

The new RBV building's structure strength was tested again with another earthquake this year which saw damages to the building that were identical to the ones caused from the 2010 earthquake. The main damages were caused to the ceiling frames and ceiling coverings on Levels 5 & 6.

Damaged Ceiling Frames – Secretary's Office L6

The damages caused by the previous and current earthquakes prompted the Bank this year to seriously look at upgrading the roof of the building to avoid further damage to the seventh floor.

Marquee

The Bank continues to support communities through donation of its marquee for special functions. It has contributed to special communities, NGOs and Government functions around Port Vila.

New Presbyterian Church building at the Club Hypique Area

The Bank has two large marquees and a small tent which it hires out to the public and charges a reasonable hiring fee in return. The fee collections are taken up in the Bank's other revenue sources.

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Fire Service Contract

The Bank continued to maintain its fire equipments at the high standards. This year the Bank renewed its service contract with Professional Fire Services for a further 12 months. The contract includes monthly service of fire extinguishers and monthly inspection/audit of hazards. This is part of the Bank's effort to provide a healthy and safe working environment for its staff.

New Fencing, Remedial Works, Renovations & Repainting of the Governor's Residence and Servant Quarters

The Board of Directors approved the renovation work to the servant's quarter and awarded the contract to CWR Constructions during the year. Work on the project commenced on the 24th September 2012 and is scheduled to complete in 2013.

Before After

Roof Upgrading **Project**

The Roof Upgrading Project was approved by the Board during the year to restructure the roof of the new 6 story building to a much smaller roof to correct the structural problem faced during earth-quakes. There will be two main phases to the project namely consultancy phase and the Construction phase.

The bank has completed the tender process for the first phase of the project and the award is expected in early 2013. The project team and consultant will put together the final document for the second phase and hopefully construction should be carried out towards the end of 2013.

View of Proposed Roof

Emergency Drill (ED)

The Bank's Emergency Response Team (ERT) has successfully planned a Full Deployment Exercise as outlined in the Bank's Operations and Safety Manual during the year.

Wardens presenting their head count reports to the Area Marshal

The exercise also involves mutual aid agents such as the Police, the PVM Wardens, the Fire Brigade, the NDMO and the ambulance's service to time their responses.

Such exercise as stated in the Operations Safety Manual will need to take place twice each year.

General Administration and Support Services

In 2012 the Bank continued to administer the travelling logistics for the Bank staff training and the Bank's official representations locally and overseas. There was a slight increase of staff travel from the previous year's figure; just over 20 of the total travel undertaken in 2012 were funded by the International Monetary Fund, PFTAC, De La Rue and other prominent institutions/organizations. The "Travelling Procedures" became effective in October 2012 to strengthen the operation of the Bank.

The Payroll and the purchasing services units within the Bank continued to be well coordinated, maintaining the standard required, with the available resources within the respective unit. The "Purchasing Procedures" also came into effect in October 2012 to standardize the process in place. The main imports for 2012 were the Bank's official uniform and the Bank's promotional items.

Library Services

The year 2012 has been another year of promoting the Bank's library and its resources, as well as continuously maintaining its relationship with other libraries and institutions. During the year the number of visitors, students and staff accessing the library resources increased compared to the previous year. The library also received 2 candidates from the Library of Congress Hawaii (Agent for the Pacific Islands), and the National Library of Australia (Acquisition Section) coming in to purchase the Bank's publications for their additional pacific collections.

The library also participated, in collaboration with other Departments, to represent the Bank in several events conducted during the year to promote informational activities/programs, such as:

- The Annual Port Vila Trade Fair for 2012 which was held on the 14th to 16th August 2012,

- The continuous awareness on the role of central banking, and careers talks conducted in schools and colleges around the country; made a total of 9 in 2012 (7 to colleges, including Torba Provincial Office, and 2 presentations done within the Bank's premises).

- The library's annual exhibition for the Bank staff was held in October 2012. The exhibition theme was on, "Climate Change, it's Causes and Responds Before and After Natural Disasters" with presentations from representatives from the Vanuatu Meteorological Department, Geo-Hazard and the Natural Disaster Management Office.

The library continuously maintains its relationship with other libraries from other central banks and the prominent international organizations such as the World Bank and the International Monetary Fund (IMF).

Banking and **Customer** Services

The Bank continues to serve its customers as part of its daily operations, and during the course of the year as part of improving its customer services, the Bank has embarked on a trial online statement access which has now being successfully utilized by the Government. Once formalized this will be an added value to the customer services provided to the Bank's customers.

The Banking office continues to conduct as part of the Bank's mandatory function, the clearing house. Clearing is conducted daily at 8.am each morning from Monday's to Friday and an additional time allocated at 2.30pm on Friday to accommodate for the increase in the number of transactions over the years. Table 5 below shows the 10 year summary of transactions conducted through the clearing house from 2003 to 2012.

Up until 2005 the value of transactions processed through the Port Vila Clearing House ranges from 28 billion vatu to 38 billion vatu. These were transactions processed between the three commercial banks namely ANZ Bank, National Bank of Vanuatu and Westpac Bank and the Reserve Bank of Vanuatu. There was huge increase in the value of transaction in 2006 to 67 billion. It indicated a healthy economy. Also during that period a forth commercial bank was established, BRED Vanuatu Ltd, in early 2007. During the period the number of effects increased dramatically to over 300, 000 cheques items and continued to be in that range.

A slight decrease was noted in the number of effects in 2012 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 2012.

Table 5: PORT VILA CLEARING SUMMARY from 2003 to 2013

Period	No. of Effects	Value(MVT)
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
2012	352,377	65,546

Accounts Office

The Accounts Office is one of the most important office in the Accounts and Customer Services Department (ACSD). The office objective is to keep a systematic report of the banks daily transactions to ascertaining its operating profit/loss, and its financial position at any given time. But most importantly, it helps to facilitate rational decision making within the Bank and its stakeholders.

To meet its objective, the Bank has continued to ensure that its financial reports are in compliance with the International Financial Reporting Standards (IFRS) and the Reserve Bank of Vanuatu Act. Furthermore, the Banks financial accounting information system, Epicor still maintains the mainframe of all data processing since its inception in 2007, supported by a hard working team to ensure efficiency and reliability. Auditing of the financial accounts is still conducted by PricewaterhouseCoopers, under the contract that was awarded to them in 2011 for another five (5) year term.

Currency Management

During the year, the Bank continues to perform its function of sole issuer of the Vatu currency.

(a) VT1/VT2 Coins

Following the Bank's decision to stop issuing the VT1/VT2 coins effective 31 March 2011, the Bank continues to monitor their performance in public circulation and accept the coins in its cash deposits.

(b) Counter Transactions

The total value of counter transactions increases from previous year by 14.0 percent to a new total of VT14,414 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 6,973 million which is an increase of 6.0 percent from previous year.

Denomination wise, the VT5000 continues to maintain the lead position of being the highest value denomination in circulation by 41 percent, followed by VT1000 at 35 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.

Table 6: 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
2012	6,956	7,458	14,414

(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.

Table 7: Counterfeits Summary

Denomination	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**Total**
10000	-	-	-	-	-	-	-	-	-
5000	31	9	4	1	-	4	2	2	53
1000	42	6	18	3	2	-	1	1	73
500	3	-	-	-	-	1	-	-	4
200	2	-	-	-	-	-	-	-	2
Total	**78**	**15**	**22**	**4**	**2**	**5**	**3**	**3**	**132**

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 Reserve Bank continues to operate the SWIFT system, a payment facility it offers as part of its payments system to carry out the office functions. This system is operated by the staff of the Settlement Office (Back Office) within the Accounts and Customer Services Department (ACSD). The functions of the Settlement Office include:

- processing of foreign currency invoice payments,
- processing of servicing of Government debt repayments,
- receiving and processing of settlement instructions from its customers, in particular the commercial banks and ;
- the confirmation and settlement of foreign currency trades.

By performing these functions, the Settlement Office continues to play an important role within the Banks payment and settlement system.

During the year, a mandatory patch version 7.0.50 was applied to the system. This enabled the latest changes and enhancement of features to be added to the SWIFT system. This process was carried out successfully, with assistance from ICT unit and the Settlement Office is now benefiting from the system enhancements this patch provided.

The Settlement Office went through a few challenges this year. However, in spite of the challenges, the team was able to effectively perform the functions of the office and meet the office's objectives and goals completing yet another successful year.

FINANCIAL STATEMENTS

Annual Report

2012

Financial Contents

RESERVE BANK OF VANUATU | **FINANCIAL STATEMENTS 31 DECEMBER 2012**

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 2012 and the related Statements of Comprehensive Income, 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 – resigned on 12 March 2012
Marinette Nial Molisa – resigned on 21 May 2012
Thomas Bayer – appointed on 12 March 2012
Anatole Hymak – appointed 4 December 2012

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 2012 was VT108.134m (2011: VT165.288m).

4. RESERVES

An amount of VT10.813m (2011: VT16.529m) was transferred to the General Reserve for the financial year ended 31 December 2012, 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 earnings 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 VT97.321m (2011:VT137.499m) is payable to the Government of the Republic of Vanuatu.

DIRECTORS' REPORT – continued

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.

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.

DIRECTORS' REPORT – continued

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 21st day of August 2013.

....

Acting Governor (Chairman)   **Director**

RESERVE BANK OF VANUATU

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 2012;

(b) 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 2012;

(c) 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 2012; and

(d) 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 2012.

For and on behalf of the Board of Directors by authority of a resolution of the Directors this 21st day of August 2013.

RESERVE BANK OF VANUATU

....

Acting Governor (Chairman) **Director**

pwc

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 Decembe 2012 and the statements of comprehensive income, changes in equity and cash flows for the yea 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 financia 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 managemen determines is necessary to enable the preparation of financial statements that are free from materia 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 o 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 o 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.

PricewaterhouseCoopers, Level 8 Civic Tower, 272 Victoria Parade, Suva, Fiji.
GPO Box 200, Suva, Fiji.
T: (679)3313955 / 3315199, F: (679) 3300981 / 3300947

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 2012, 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.

21 August 2013
Suva, Fiji

PricewaterhouseCoopers
PricewaterhouseCoopers
Chartered Accountants

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2012
(Expressed in 000's Vatu)

	Notes	2012	2011
Operating Revenue			
Interest income	7	602,303	626,399
Net unrealised gains in foreign securities market prices		26,884	77,027
Net foreign exchange gains		56,747	36,674
Other income		34,299	23,424
Total revenue		720,233	763,524
Operating Expenses			
Interest expense	8	19,483	41,992
Personnel expenses	9	316,269	291,297
Other operating expenses	10	276,347	264,947
Total expenses		612,099	598,236
Net profit for the year		108,134	165,288
Other comprehensive income			
Change in value of available for sale financial asset		2,128	9,169
Total comprehensive income		110,262	174,457

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 29.

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2012
(Expressed in 000's Vatu)

	Notes	2012	2011
Assets			
Cash and cash equivalents	11	10,819,144	10,419,308
Investment securities	11	5,296,960	5,267,712
Government securities	12	224,489	224,695
Government bonds	13	1,293,810	1,293,810
Other receivables	14	217,057	233,935
Currency stock (notes and coins)	15(a)	277,974	352,768
Property, plant and equipment	16	1,373,645	1,393,398
Intangible assets	17	12,992	18,277
International Monetary Fund (IMF):	21		
Reserve Tranche Position		350,521	359,332
Special Drawing Rights	11	214,263	214,925
Total Assets		20,080,855	19,778,160
Liabilities			
Other creditors and accruals		61,342	65,226
Demand deposits	18	10,841,725	10,116,180
Distribution payable to Vanuatu Government	19	97,321	137,499
Reserve Bank of Vanuatu notes		802,748	1,619,144
Reserve Tranche Position		350,521	359,332
Currency in circulation	15(b)	6,973,217	6,581,483
Employee provisions	20	243,743	201,999
Total Liabilities		19,370,617	19,080,863
Net Assets		710,238	697,297
Capital and Reserves			
Paid up capital	22	100,000	100,000
General Reserve	4	227,342	216,529
Retain Earnings Reserve	5	108,711	108,711
Fair Value Reserve	6(a)	49,388	47,260
Asset Revaluation Reserve	6(b)	224,797	224,797
Total Capital and Reserves		710,238	697,297

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 29.

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2012

(Expressed in 000's Vatu)

	Notes	Paid Up Capital	General Reserve	Retain Earnings Reserve	Fair Value Reserve	Asset Revaluation Reserve	Accumulated Profits	Total Capital and Reserves
Balance as at 31 December 2010		100,000	200,000	97,451	38,091	224,797	-	660,339
Net profit for the year		-	-	-	-	-	165,288	165,288
Other Comprehensive Income:								
Change in value of available for sale financial asset	6(a)	-	-	-	9,169	-	-	9,169
Total comprehensive income		-	-	-	9,169	-	165,288	174,457
Transfers out of profit for the year:								
- to General Reserve	4	-	16,529	-	-	-	(16,529)	-
- to Retain Earnings Reserve	5	-	-	11,260	-	-	(11,260)	-
- transfer to distribution payable to Vanuatu Government	4	-	-	-	-	-	(137,499)	(137,499)
Balance as at 31 December 2011		100,000	216,529	108,711	47,260	224,797	-	697,297
Net profit for the year		-	-	-	-	-	108,134	108,134
Other Comprehensive Income:								
Change in value of available for sale financial asset	6(a)	-	-	-	2,128	-	-	2,128
Total comprehensive income		-	-	-	2,128	-	108,134	110,262
Transfers out of profit for the year:								
- to General Reserve	4	-	10,813	-	-	-	(10,813)	-
- to Retain Earnings Reserve	5	-	-	-	-	-	-	-
- transfer to distribution payable to Vanuatu Government	4	-	-	-	-	-	(97,321)	(97,321)
Balance as at 31 December 2012		100,000	227,342	108,711	49,388	224,797	-	710,238

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 29.

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2012

(Expressed in 000's Vatu)

	Notes	2012	2011
Cash flows from operating activities			
Interest received		611,121	633,913
Interest paid		(24,986)	(38,290)
Other operating receipts		27,273	23,424
Other operating payments		(389,848)	(360,359)
Net cash provided by operating activities		223,560	258,688
Cash flows from investing activities			
Net movement in Special drawing rights		662	7,702
Net treasury notes and bonds (acquired) / matured		(236)	(655,617)
Interest received on Government securities		206	1,025
Net purchase of Government bonds		-	(100,160)
Net loans to staff		15,704	(10,595)
Purchase of property, plant and equipment		(61,428)	(39,993)
Purchase of computer software		(364)	(191)
Proceeds from sale of property plant & equipment		1,600	2,472
Net cash used in investing activities		(43,856)	(795,357)
Cash flows from financing activities			
Currency issued for circulation		391,734	700,597
Net movement in commercial banks deposits		720,476	25,278
Payments to Government		(76,042)	(117,780)
Net movement in international institutions and agencies deposits		(56,388)	(29,216)
(Payments for matured) / Proceeds for issuing Reserve Bank of Vanuatu notes		(816,396)	422,579
Net cash provided by financing activities		163,384	1,001,458
Net increase in cash and cash equivalents		343,088	464,789
Cash and cash equivalents at the beginning of the financial year		10,419,308	9,917,845
Effects of exchange rate changes on foreign currency balances	3(b)	56,748	36,674
Cash and cash equivalents at the end of the financial year	11	10,819,144	10,419,308

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 29.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012
(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 21 August 2013.

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) which is the Banks presentation and functional currency.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 - 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 2013 or later periods and have not been early adopted. Management has yet to assess whether the adoption of these standards and interpretations will have any significant impact on the Bank's financial statements.

Standard/ Interpretation	Content	Applicable for financial years beginning on/after
IAS 19 Amendment	Employee benefits	1 January 2013
IFRS 13	Fair Value Measurement	1 January 2013
IFRS 7 Amendment	Financial Instruments: Disclosures	1 January 2013
IAS 32 Amendment	Financial Instruments: Presentation	1 January 2013
IFRS 9	Financial instruments: Classification and measurement	1 January 2015

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 accrual basis and includes interest income, gains on foreign securities market prices, profit on foreign exchange dealing with commercial banks and other income.

(b) Foreign currency translation

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 2012 - 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 favor 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 2012 - 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 2012 - 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 2012 - 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 VT10.813m (2011:VT16.529m) was transferred out of net profit 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 net gains on foreign exchange are recognised in profit from ordinary activities and until such net gains 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.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 - continued

(Expressed in 000's Vatu)

7. INTEREST INCOME

	2012	2011
Overseas Investments	496,671	525,270
Domestic Investments	102,188	97,315
Staff Loans & Advances	3,444	3,814
	602,303	626,399

8. INTEREST EXPENSE

	2012	2011
Interest on Government accounts	2,053	989
Interest on Reserve Bank of Vanuatu notes	17,204	27,969
Other	226	13,034
	19,483	41,992

9. PERSONNEL EXPENSES

	2012	2011
Salaries and wages	166,102	163,791
Superannuation contribution (VNPF)	6,620	6,384
Staff training	19,405	26,296
Severance pay, long service leave, accrued annual leave and gratuity expense	64,147	44,258
Other	59,995	50,568
	316,269	291,297

10. OPERATING EXPENSES

	2012	2011
Auditor's remuneration	1,546	1,797
Depreciation and amortisation	86,830	85,107
Funds managers' fee	5,122	5,224
Amortisation of currency costs	74,794	54,128
Communication expenses	12,579	14,192
Gain on disposal of property, plant and equipment	(1,600)	(1,751)
Other expenses	97,076	106,250
	276,347	264,947

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 - continued
(Expressed in 000's Vatu)

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 2012, the value of the external reserves was 85.8 % (2011: 84.9%)

(a) External assets consists of the following:

	2012	2011
Cash	10,480	9,129
Current and call accounts	692,222	978,099
Short term deposits	7,579,007	6,786,571
Negotiable certificate of deposit	2,537,435	2,645,509
Total cash and cash equivalents	10,819,144	10,419,308
Treasury notes, bonds and bills		
- Financial assets at fair value through profit and loss	2,874,745	2,802,707
- Available for sale financial assets	2,422,215	2,465,005
Total Investment Securities	5,296,960	5,267,712
Special drawings rights	214,263	214,925
Total external assets	16,330,367	15,901,945

(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 VT32.743m (2011: VT21.928m) held with local banks in Vanuatu.

12. GOVERNMENT NON-NEGOTIABLE SECURITIES ISSUED TO THE BANK

	2012	2011
Balance at the beginning of the financial year	224,695	225,720
IMF remuneration credit	(206)	(1,025)
Balance at the end of the financial year	224,489	224,695

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 - continued
(Expressed in 000's Vatu)

13. GOVERNMENT BONDS

	2012	2011
Government bonds held with Reserve Bank	1,293,810	1,293,810

These bonds which are valued in accordance with note 3(k).

14. OTHER RECEIVABLES

	2012	2011
Interest receivable	114,141	115,936
Staff loans and advances	91,322	107,026
Sundry debtors	11,122	7,622
Other	472	3,351
	217,057	233,935

15. CURRENCY ACTIVITIES

(a) Currency Stock (notes and coins)

	2012	2011
Balance at the beginning of the financial year	352,768	406,896
Purchase of stock	-	-
Currency issued into circulation	(74,794)	(54,128)
Balance at the end of the financial year	277,974	352,768

(b) Currency in circulation

	2012	2011
Notes	6,223,530	5,876,498
Coins	749,687	704,985
Total currency in circulation	6,973,217	6,581,483

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

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 - continued
(Expressed in 000's Vatu)

16. PROPERTY, PLANT AND EQUIPMENT

	Land and Buildings	Computer and office equipment	Other	Work in progress	Total
At 1 January 2011					
Cost or valuation	1,337,497	234,849	125,808	-	1,698,154
Accumulated depreciation	(79,111)	(147,479)	(33,910)	-	(260,500)
Net book value	1,258,386	87,370	91,898	-	1,437,654
Year Ended 31 December 2011					
Opening net book value	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	(33,378)	(31,500)	(14,595)	-	(79,473)
Closing net book value	(1,235,933)	(67,838)	(89,627)	-	(1,393,398)
At 31 December 2011					
Cost or valuation	1,348,413	246,498	134,567	-	1,729,478
Accumulated depreciation	(112,480)	(178,660)	(44,940)	-	(336,080)
Net book value	1,235,933	67,838	89,627	-	1,393,398
Year Ended 31 December 2012					
Opening net book value	1,235,933	67,838	89,627		1,393,398
Additions	32,662	8,998	9,902	9,866	61,428
Depreciation	(33,392)	(31,467)	(16,322)	-	(81,181)
Closing net book value	1,235,203	45,369	83,207	9,866	1,373,645
At 31 December 2012					
Cost or valuation	1,381,075	255,496	144,469	9,866	1,790,906
Accumulated depreciation	(145,872)	(210,127)	(61,262)	-	(417,261)
Net book value	1,235,203	45,369	83,207	9,866	1,373,645
	=========	========	========	==========	==========

The Bank owns Land located at Nambatu Lagoon area (Title No.11/OB31/026). During the year, the Banl granted Starfish Limited easement to its Land in exchange for a plot of Land in the La Colline subdivision (Titl No. 12/0912/904). At the same time, the Bank acquired a further plot of Land (Title No. 12/0912/908) in th same subdivision for VT10,573,850.

The work in progress relates to RBV Tower Extension Project, Governors Residence Project and furniture fittings for the Vault.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 - continued
(Expressed in 000's Vatu)

17. INTANGIBLE ASSETS

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

	Computer Software	Work in progress	Total
At 1 January 2011			
Cost	39,561	-	39,561
Accumulated amortisation	(21,284)	-	(21,284)
Net book value	18,277	-	18,277
Year Ended 31 December 2011			
Opening net book value	23,720	-	23,720
Additions	191	-	191
Amortisation charge	(5,634)	-	(5,634)
Closing net book value	18,277	-	18,277
At 31 December 2011			
Cost	39,561	-	39,561
Accumulated amortisation	(21,284)	-	(21,284)
Net book value	18,277	-	18,277
Year Ended 31 December 2012			
Opening net book value	18,277	-	18,277
Additions	-	364	364
Amortisation charge	(5,649)	-	(5,649)
Closing net book value	12,628	364	12,992
At 31 December 2012			
Cost	39,561	364	39,925
Accumulated amortisation	(26,933)	-	(26,933)
Net book value	12,628	364	12,992

The work in progress relates to the payroll software project.

18. DEMAND DEPOSITS

	2012	2011
Due to commercial banks	6,029,199	5,308,723
Due to government	2,391,466	2,330,009
Due to international institutions and agencies	2,421,060	2,477,448
	10,841,725	10,116,180

19. DISTRIBUTION PAYABLE TO GOVERNMENT OF VANUATU

In accordance with the Reserve Bank of Vanuatu Act [CAP 125] section 7(3), the balance of the earnings 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 VT97.321m (2011:VT137.499m) is payable to the Government of the Republic of Vanuatu.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 - continued

(Expressed in 000's Vatu)

20. EMPLOYEE PROVISIONS

	2012	2011
Opening balance	201,999	174,638
Additional provisions recognised	64,707	40,950
Utilised/ reversals	(22,963)	(13,589)
Closing balance	243,743	201,999

21. 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, refer to Note 12;

(ii) the funding of accounts in favour of the IMF in the books of the Bank by the Government.

22. SHARE CAPITAL

	2012	2011
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

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 2012 were Odo Tevi (Chairman), Georges Maniuri, Jimmy Nipo, Tom Bayer and Anatole Hymak.

During the year, key management personnel consisted of the following executives: Odo Tevi (Governor), Peter Tari (Deputy Governor), Nelson Shem (Director Corporate Services), Florinda Aru (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.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 - continued
(Expressed in 000's Vatu)

23. RELATED PARTY INFORMATION - continued

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

Total remuneration paid to Directors and key management personnel is as follows:

	2012	2011
Directors sitting allowances	105	405
Executive officers	53,050	47,246
	53,155	47,651

The Bank also provides loans to its staff. Total loans owing by the executive officers as at balance date equals VT23.233m (2011: VT24.489m). The loans attract interest which range from 2% 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 2012 was 84 (2011: 84).

25. CONTINGENT LIABILITIES

The directors are not aware of any contingent liabilities at balance sheet date (2011: nil).

26. COMMITMENTS

The directors are not aware of any commitments at balance sheet date (2011: nil).

27. 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.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 - continued
(Expressed in 000's Vatu)

27. FINANCIAL RISK MANAGEMENT POLICIES - continued

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.

The total exposure of credit risk in the Bank's portfolio is as follows:

	2012	2011
Foreign currency assets		
Cash and cash equivalents	10,819,144	10,419,308
Investment securities	5,296,960	5,267,712
International Monetary Fund (IMF):		
Special Drawing Rights	214,263	214,925
	16,330,367	15,901,945
Local currency assets		
Government securities	224,489	224,695
Government bonds	1,293,810	1,293,810
	1,518,299	1,518,505
	17,848,666	17,420,450

Based on the country in which the counterparty is resident, the Bank's end of year concentration of credit exposure expressed as a percentage of the total exposure above, is as follows:

	2012 %	2011 %
Australia	39	36
New Zealand	1	1
United States of America	3	2
Switzerland	8	8
United Kingdom	5	3
Supranational	31	30
Vanuatu	9	9
Others	4	11
	100	100

The following table presents the Bank's above credit exposure based on Moody's credit rating of the foreign counterparties. AAA is the highest quality rating possible and indicates the counterparty has a strong capacity to pay interest and principal. N/R indicates that the counterparty has not been rated by Moody's.

	2012 %	2011 %
AAA – AA3	16	24
A1 – A3	13	7
BAA1 – BAA3	8	9
N/R	63	60
	100	100

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 - continued
(Expressed in 000's Vatu)

27. 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 Government bonds to support payment obligations and contingent funding in a stressed environment. The Bank's comfortable level of liquidity is equated to 6 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 issued by foreign Governments which are easily converted to cash.

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

2012 Maturity Analysis

	0 - 3 months	3 - 6 months	6 – 12 months	Over 1 year	No specific maturity	Total
ASSETS						
Financial Assets:						
Cash and cash equivalents	5,883,802	4,376,287	559,055	-	-	10,819,144
Treasury notes, bonds & bills	-	-	682,677	4,614,283	-	5,296,960
Government securities	-	-	-	224,489	-	224,489
Government bonds	1,293,810	-	-	-	-	1,293,810
Other receivables	37,176	49,129	14,540	116,212	-	217,057
Special drawings rights	-	-	-	-	214,263	214,263
Non Financial Assets	-	-	-	-	2,015,132	2,015,132
	7,214,788	**4,425,416**	**1,256,272**	**4,954,984**	**2,229,395**	**20,080,855**
LIABILITIES						
Financial Liabilities:						
Other creditors and accruals	40,351	20,991	-	-	-	61,342
Demand deposits	6,742,575	722	1,813,927	2,284,501	-	10,841,725
Reserve Bank of Vanuatu Notes	802,748	-	-	-	-	802,748
Currency in Circulation	6,973,217	-	-	-	-	6,973,217
Non Financial Liabilities	-	-	-	-	691,585	691,585
	14,558,891	**21,713**	**1,813,927**	**2,284,501**	**691,585**	**19,370,617**
Net Liquidity Gap	**(7,344,103)**	**4,403,703**	**(557,655)**	**2,670,483**	**1,537,810**	**710,238**

(Expressed in 000's Vatu)

27. FINANCIAL RISK MANAGEMENT POLICIES - continued

Liquidity risk - continued

2011 Maturity Analysis

	0 - 3 months	3 - 6 months	6 – 12 months	Over 1 year	No specific maturity	Total
ASSETS						
Financial 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
Special drawings rights	-	-	-	-	214,925	214,925
Non Financial Assets	-	-	-	-	2,123,775	2,123,775
	9,290,449	**1,255,768**	**-**	**6,893,243**	**2,338,700**	**19,778,160**
LIABILITIES						
Financial Liabilities:						
Other creditors and accruals	53,957	11,269	-	-	-	65,226
Demand deposits	5,509,747	736	2,263,774	2,341,923	-	10,116,180
Reserve Bank of Vanuatu Notes	1,619,144	-	-	-	-	1,619,144
Currency in circulation	6,581,483	-	-	-	-	6,581,483
Non Financial Liabilities	-	-	-	-	698,830	698,830
	13,764,331	**12,005**	**2,263,774**	**2,341,923**	**698,830**	**19,080,863**
Net Liquidity Gap	**(4,473,882)**	**1,243,763**	**(2,263,774)**	**4,551,320**	**(483,905)**	**697,297**

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 foreign exchange risk and interest rate risk; and other price risk.

(i) Foreign exchange risk

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

The Bank attracts foreign exchange 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.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 - continued
(Expressed in 000's Vatu)

27. FINANCIAL RISK MANAGEMENT POLICIES - continued

Market Risk - continued

(i) Foreign exchange risk - continued

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 net exposure to major currencies as at 31 December 2012 and 2011 in Vatu equivalents.

	2012 %	2011 %
United States dollar	29	28
Australian dollar	65	62
Euro	2	6
British pound	3	3
Other currencies	1	1
NET OPEN POSITION	**100**	**100**

(ii) Interest rate risk

Interest rate risk refers to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes to market interest rates. 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 in 90 days or less.
Staff loans	-	fixed interest rates, maturing in 15 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.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 – continued
(Expressed in 000's Vatu)

27. FINANCIAL RISK MANAGEMENT POLICIES – continued

Market Risk - continued

(ii) Sensitivity to foreign exchange risk and Interest rate risk

The sensitivity of the Bank's financial assets and liabilities to assumed across the board changes in interest rates and the exchange rate with all other variables held constant is shown below:

Impact of:	2012	2011
Change in profit due to a 5% appreciation of the Vatu	785,177	788,564
Change in profit due to a rise of 1 percentage point in interest rate	146,939	137,848

A 5% depreciation of the Vatu against the respective currencies and fall of 1 percentage in the interest rates would have the opposite effect of an equal amount.

28. 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.

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 carried at fair value. Refer to page 29 for details of classification by valuation hierarchy.

Government bonds
The reported value of government bonds is considered to approximate its fair value as they are redeemable on demand.

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.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012 – continued
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28. FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES – continued

The table below shows the Banks financial assets carried at fair value by valuation method. There are no financial liabilities carried at fair value at balance date (2011: Nil).

The different levels have been defined as follows:

Level 1	Valued using quoted prices (unadjusted) in active markets for identical financial assets or liabilities. A market is regarded as active if quoted prices are readily and regularly available and those prices represent actual and regularly occurring market transactions on an arm's length basis.
Level 2	Valued using inputs other than quoted prices included within level 1 that are observable for the financial asset or liability
Level 3	Valued using inputs for the financial asset or liability that are not based on observable market data (unobservable inputs)

	Level 1	Level 2	Level 3	Total
As at 31 December 2012				
Assets				
Treasury notes, bonds & bills				
- Financial assets at fair value through profit and loss	2,874,745	-	-	2,874,745
- Available for sale financial assets	-	-	2,422,215	2,422,215
	2,874,745	**-**	**2,422,215**	**5,296,960**
As at 31 December 2011				
Assets				
Treasury notes, bonds & bills				
- Financial assets at fair value through profit and loss	2,802,707	-	-	2,802,707
- Available for sale financial assets	-	-	2,465,005	2,465,005
	2,802,707	**-**	**2,465,005**	**5,267,712**

29. EVENTS AFTER BALANCE DATE

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