

Vanuatu Macroeconomic Developments and Prospects

The Reserve Bank of Vanuatu

Department of Research and Statistics

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Contributions in this booklet is composed of reports collected from onsite visits and interviews compiled by staff of the Research and Statistics Department

Disclaimer: The views presented are of the authors and do not necessarily reflect the entire view of the Reserve Bank of Vanuatu

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I. EXECUTIVE SUMMARY

The domestic economy is in low gear against a backdrop of slow regional economic performance, and a prolonged knock-on effect of the 2008 Global Financial Crisis (GFC). The economy has seen positive growth for the past five years, weathering the impacts of the GFC, thanks to the twin sectors that performed well over the 2008 to 2010 period. One of these is the tourism sector, which held up well during the financial crisis (although this was not helped by the depreciation of the USD, which made Europe and the US destinations cheaper for Australians). The other is the industry sector that saw a huge inflow of donor funds for construction projects, especially the Efate and Santo tar seal roads, and improvement of roads on Tanna and Malekula. Growth tapered off in 2011, dipping to 1.2 percent from 1.6 percent in 2010. The slowdown marked the winding up of aid funded projects, most of which began in 2008. After this period, economic activity has since picked up after bottoming out in 2011.

The domestic economy started trending up in 2012 recording gross domestic product (GDP) of 1.8 percent. During this period, growth was driven softly by tourism and the agriculture sector. In 2013 a slight increase of 0.2 percentage points to 2.0 percent was noted. The agriculture sector was responsible for underpinning growth in 2013. Although the performance of the services sector was weak in 2013, the industry sector showed signs of strengthening on the back of strong construction growth. In 2014 growth is expected to increase by 3.7 percent, in response to a number of construction projects to be implemented, both private and public. However, it is now evident that these will only begin in 2015 through to 2016; hence growth in 2014 may be lower than expected.

While reasonable economic activity has taken place in Port Vila, the Northern Provinces have also contributed, especially towards the agricultural sector production and tourism. Other major islands visited such as Malekula and Tanna are also noted for their modest contribution to growth. This review covers four major islands in terms of economic activity and population, including Efate and Santo the two islands hosting the two urban centers of Port Vila and Luganville respectively with Malekula and Tanna, the two islands

with resource potentials capable of developing into mini townships in the MALAMPA and TAFEA Provinces soon. The recent visit indicated mixed business confidence in the four islands. There is however a gradual slowdown noted for Port Vila, while Luganville, Tanna and Malekula are perceived to have performed well. In terms of growth prospects for Santo, most companies generally commented that Luganville town is progressing slowly, particularly early this year when international commodity prices was high, this boosted the agriculture sector, leading to increases in trade and transport industries in the Northern Province. However, going forward continuous reforms targeting growth impediments will gradually assist future business confidences and increase investments in these islands.

II. INTRODUCTION

Below is a overview of business sentiments gathered by the Research and Statistics Department (RSD) of the Reserve Bank of Vanuatu (RBV) during its annual visitations and companies' survey. It includes prospects collected from Port Vila (Efate), Luganville (Santo) Lakatoro-Norsup (Malekula) and Lenakel (Tanna). Such visits are done once a year and aim to bring together sectoral prospects of the economy from: **Agriculture, Forestry and Fishing**, this sector includes crop production, animal production, forestry and fishery; **Industry**, comprising quarrying, mining, manufacturing, electricity, water, and construction; and the **Services** sector, include the wholesale trade, motor vehicle, retail trade, transport, telecommunication, accommodation, food services, professional, financial services, real estate, administrative services, public services and other services.

This booklet aims to capture views presented by each respective sector during the visit. The aim is to collect views of current economic conditions, particularly reviewing development activities from 6-12 months of this year and the outlook for the next 6-12 months.

In publishing this summary, it is hoped that this will meet the objective of the RBV in continuously monitoring the economic conditions of various sectors of the economy, as well as providing timely information for the Bank on GDP. The results contained herein may be useful for policy coordination and macroeconomic

management. The report contains updates on the global economy and domestic development as well as progress made to major sectors¹; and finally a general overview of sentiments presented by companies on the outlook of the domestic economy.

III. ECONOMIC DEVELOPMENT

a. International Development

Global activity continues to recover at a moderate pace although growth in the first half of the year was lower than expected. The pace of growth remains uneven and country specific. The US economy is showing signs of strengthening, whilst activity in the Euro area and Japan remains weak. Growth in China remained on target, driven by investment, following an expansion of credit and government spending in the first half of the year. The IMF's October 2014 update on the World Economic Outlook (WEO) projected growth of 3.3 percent in 2014, rising to 3.8 percent in 2015.

Advanced economies are expected to grow by 1.8 percent in 2014, rising to 2.3 percent in 2015. Emerging and developing economies are expected to grow by 4.4 percent in 2014, picking up to 5.0 percent in 2015. There was a downward revision from earlier forecasts made in April 2014, owing to a number of downgrades for emerging markets, particularly in Latin America, the Middle East, as well as the euro area and Japan. Downside risks to growth remain including heightened geopolitical tensions, weaker demand and risks of low inflation in advanced economies, as well as a reversal of recent risk spread and volatility compression in financial markets. The persistence of conflict in the Middle East and the worsening situation in Russia and Ukraine threatens growth and risk disruption to oil production which could result in sharp increases in energy prices.

Over the year, most central banks continued to maintain very accommodative monetary policy stances

while inflationary pressures remained contained globally. The Reserve Bank of New Zealand is the only central bank to have increase rates; raising their OCR rate from 2.75 percent to 3.50 this year. The United States have started reducing its monthly volume of asset purchases ending in October this year, although the Federal Reserve continue to hold interest rates unchanged at 0 – 0.25 percent. The European Central Bank has cut its key re-financing rate twice in an effort to stimulate economies in the euro area. Short-term interest rates in the United States remained stable over the year, while New Zealand recorded an increase whereas Australia recorded only marginal increase in their short term interest rates.

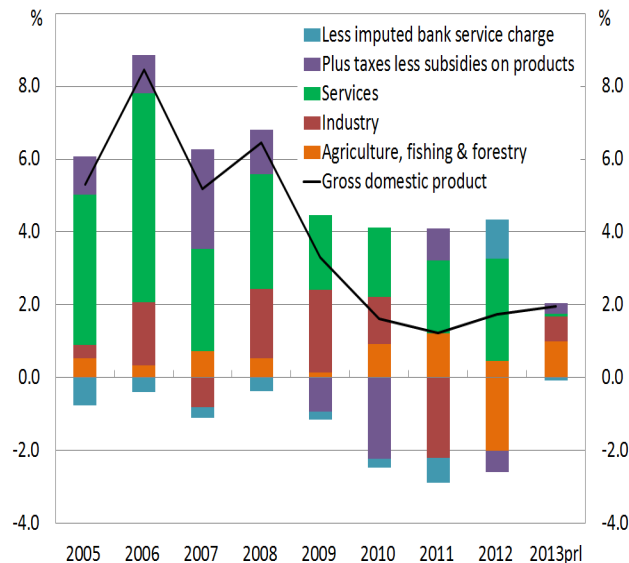
b. Domestic Development

i. Overall prospects

Since the last review of the overall economic prospects in November of 2013, the overall economic growth has remained positive but at a moderate pace. From 2005 to 2008, the overall growth was higher than the earliest part of 2009 through to 2013. Growth between 2005 and 2008 is attributed mainly to the good performance of the Industry Sector; particularly the construction industry having implemented many donor funded projects including the MCA road project around Efate and some parts of Santo that ended in 2008.

¹ Regional perspective of those in Port Vila (Efate), Luganville (Santo), Norsup-Lakatoro (Malekula) and Lenakel (Tanna).

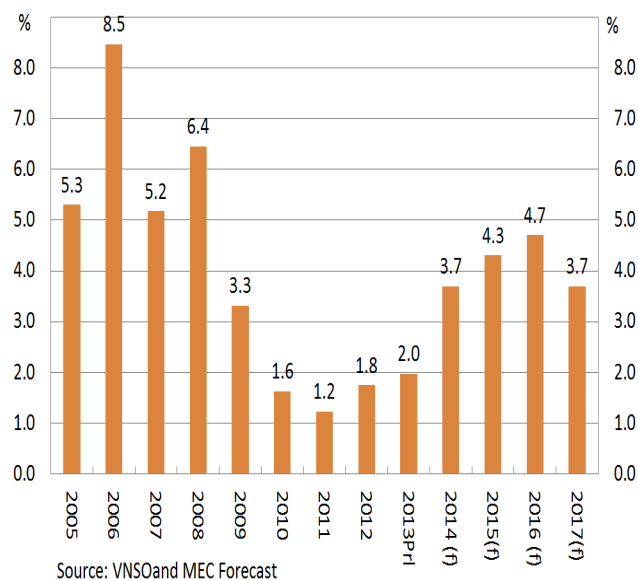
Figure 1: Vanuatu's GDP Growth
(Contribution to growth)



The preliminary growth of 2.0 percent in 2013 was attributed to all sectors of the economy with the agriculture sector (crop production, fishery and forestry) underpinning growth. A modest growth was reflected in the industry sector while services sector contribution slowed, owing to a weak tourism sector performance.

Growth prospects for 2014 remains positive and is expected to pick up in 2015. In the July Macroeconomic Committee (MEC) meeting; 2014 growth forecast was revised upwards to 3.7 percent from 3.6 percent. However, other indicators of growth and private consumption such as Value Added Tax (VAT) and Private Sector Credit (PSC) all indicated a slowdown in 2014. Meanwhile the Vanuatu National Statistics Office (VNSO) has given preliminary growth figure for 2013 at 2.0 percent. This figure is lower than the Macroeconomic Committee (MEC) forecast of 2.2 percent in its July sitting.

Figure 2: Vanuatu's Overall Economic Outlook.



Source: VNSO and MEC Forecast

Prospects for the overall economy looked positive and a possible pick up is expected if construction of planned public infrastructure projects begins in 2015 and beyond.

ii. Characteristics of major economic sectors

The agriculture sector continues to be the main stay of the economy. It continues to retain positive growth over the years with the exception of 2012; this is when growth was affected mainly by low world commodity prices. Crop production, particularly copra and cocoa depended largely on world prices which have been fluctuating over the years. In 2014, copra prices picked up in the first and second quarters of the year but have significantly slowed in the third quarter and this trend is likely to continue in the fourth quarter. It is expected that crop production will remain stable compared to last year. Similarly growth moderated in animal production, fishery and forestry.

The industry sector is heavily reliant on construction activity; it has been contributing positively to growth over past decades. Going forward, this sector will remain strong in the medium to long term.

The services sector underperformed in 2013 because of low tourism arrivals caused by competition from other destinations. The services sector of the economy (whole sale, retail trade, repair of motor vehicles, transport accommodation and food services) depends on other sectors to perform well. It is expected to be stable in 2014 compared to 2013.

IV. SECTOR PERFORMANCE BY REGION

a. Business Development – Efate

Efate is centrally located in Vanuatu and is where the main town of Port Vila is situated; it hosts many services activity and is the central business district of Vanuatu:

- *Port Vila has an approximated population of 44,039, accounting for 77 percent of the total urban population (57,195, according to the 2009 Population Census);*
- *Port Vila has the main Port of Entry for air visitor arrivals (approximately 106,466 visitors in 2013) and cruise ship visitors with around 240,483 visitors in 2013 (approximately 5-9 cruise-ship visits per month); Exports from Port Vila account for approximately 39 percent of total exports (approximately 1,419 MVT in 2013); Imports to Port Vila accounted for approximately 83 percent of total imports (approx 25,262 MVT in 2013).*

The general perspective on business development for Port Vila for the first half of 2014 was slow. Business sentiment for tourism was negative and similarly for other services with an exception of trading and shipping services in the northern islands. Despite this, the general prospect for the second half of the year looks promising.

The tourism sector activity in Port Vila is slightly down from the previous year; despite an expectedly busy peak period from June to September. The total number of visitor arrivals was down by slightly more than 2 percent; consequently earnings from tourism also plunged. Notably, the period of January-June is usually a slack period for tourist arrivals. This means hotels and accommodations have to discount their prices to maintain competitiveness. The tourism sector reported finding it hard because of competition from

other destinations such as Bali and Hawaii. Other factors noted as a result of this poor performance including the depreciation of AUD against Vatu, the lack of external marketing and advertising initiative undertaken by relevant authorities, and the negative impact of dengue fever outbreak early this year.

The construction industry performance has dropped except for those construction companies involved in pre-arranged contracts in 2014. The majority of the 2014 planned construction initiatives were either delayed awaiting better economic conditions or cancelled.

Companies involved in building material supplies indicated that there are very few projects to support because of the overall slowdown in activity hence a reduction in demand for construction material. Likewise this sector also mentioned that public-funded projects did not eventuate according to schedule. However, few projects are underway including the Tana Russet Commercial Shopping Complex, the extension of Vila Central Hospital and the new Chinese funded Convention Center that started in the third quarter of 2013.

In the services sector, wholesale distribution and retail trade sectors indicated that business was slow for the first six months, with the exception of those involved in the distribution to the northern part of the country. This partially reflected developments in copra and cocoa trading which has boosted consumer confidence in the northern town. Evidence of this can be seen from those companies dealing directly with cargo ships trading in the nearby outer islands in the north. Other businesses such as consulting firms indicated that businesses have slowed down, affected by rising over-head costs due to slow economic activity. It was suggested that the government should intervene in providing avenues for the private sector to be involved in its planning and budgeting and also makes available regular reliable information on its operation.

The response from the shipping industry was mixed, following low activity in this industry, and the tough competition the players are facing. The response was that there are more vessels entering the market with better standard of services. The traditional local owned companies confirmed a reduction in their

operating profit because of increasing competition, and to the ever increasing cost of maintenance coupled with appropriate infrastructure and repair facilities. However, northern island ship owners admitted that business conditions could have been worst, had it not been for the high global commodity prices.

The information and telecommunication industry continues an on-going battle of the giants, which elicit innovative investment initiatives to keep up with the competition. However, high operating costs in urban and rural areas are some of the challenges that they need to be contended with, while striving to expand and maintain telecommunication services to uncovered remote areas.

The real estate sector reported a much fairer performance in the first six months of the year and better prospects with new sub-divisions coming up. The industry has been quiet in 2013 and early 2014 due to the delay in Government infrastructure projects and the new Land Lease Amendment Act to be tabled in Parliament soon. This sector is showing signs of improvement with a potential for high class genuine investors as reported by the real estate companies.

b. Business Development – Santo

Santo is the largest island in Vanuatu and is where the second town (Luganville) is located:

- *Luganville has a population of approximately 13,156, accounting for 23 percent of urban total population of 57,195 according to the 2009 Population Census;*
- *It has the second International Port of Entry for sea and air transports;*
- *Exports from Luganville accounts for approximately 61 percent of total exports (approx 3,653 MVT in 2013);*
- *It has also accounted for approximately 14 percent of total imports, approximately 4,184 MVT in 2013. It is an important export Port for exporting of many domestic agricultural commodities (VNSO);*
- *Luganville International airport accounted for 3 percent of the total air visitor arrivals (2,643*

visitors in 2013; despite this, many more visitors transited in Vila while extending their holiday in Santo. Over the last two years, Luganville and Champagne beach, the two major Ports of call for cruise ships in the northern island receive about 2-3 cruise ships per month (VNSO)

The general perspective and business confidence in Luganville look positive on the back of high global commodity prices. The overall performance of the agriculture sector is better than Port Vila. This reflected the prospects of high global commodity prices with potential spill-over effects to various other sectors, particularly hardware shops, retail trade, sea and land transport services.

The agriculture sector performance has improved during the first half of the year. Findings from visits to copra and cocoa traders showed a significant increase in both copra and cocoa production. The doubling of the volume of copra production for the first six months was also reported by VNSO, this is in line with the report from major copra and cocoa traders.

The abattoirs reported a contraction in the beef production, this is confirmed by the first six months cattle slaughter statistics. One reason given is a drop in the order from butcheries. This drop may be related in the fall in the number of overseas visitors and overseas orders. The abattoirs mentioned potential for expansion in external markets, but have no intention to explore for fear of sustainable supplies. The sentiment for Vanuatu cattle industry looks promising as seen by major cattle plantation owners. However, they stressed that more help is required to assist the small holders and some poorly managed plantations to increase their production.

The trading industry in general had a slight improvement. The spillover effect of increase global commodity prices from copra and cocoa trading was reported by respondents. Overall, the wholesalers and retail traders reported that, although the commodity prices had increased, people do not shop as they normally do. Only hardware shops and the agricultural suppliers had experienced noticeable increases in sales, especially for construction materials and farming tools. The replanting of kava in particular was

mentioned by kava traders and the agricultural suppliers. Orders have reportedly been received from both Santo and the other islands. This high demand may be related to the increase in copra and cocoa prices, but it may also be partly attributed to the RSE and the SWP schemes. Kava traders highlighted a reduction in stocks of kava planting material, reporting that no replanting had occurred during the past four or five years due to shortages in the planting material. This has led to increases in the domestic prices for green kava resulting in a drop of kava exports, but now the farmers have realized this leading to replanting.

The manufacturing industry in Luganville is predominantly made up of coconut oil processing. The improvement in international coconut oil prices in early 2014 was the main driver for doubling the production of coconut oil and exports. The high utility cost is now being addressed as an opportunity for investment. A new coconut oil refinery plant has been constructed for refining the crude coconut oil into bio-fuel production. Several plants and ships have seen gleams of hope in renewable energy and some have even taken the risk to shift to using bio-fuel in order to reduce operational cost.

In the shipping industry, vessel number has significantly increased during the past two years. In 2014, following the delay in the implementation of infrastructure projects, the inter-island shipping industry began to face new challenges attributed to new ships that have recently entered the competition. Regular shipping services to the remote islands remained an issue. The current Inter-Island Shipping Project co-funded by NZ-AID and the Vanuatu Government is designed to improve shipping services to remote islands. According to the project, the two successful bidders (ship companies) will benefit from institutional strengthening and capacity building programs as well as financial support to establish regular and quality shipping services to the remote islands. This is by way of subsidizing for any losses incurred when extending services to remote areas.

The visit to Luganville was undertaken in May, at the time when expected tourism did not show any sign of

picking up. This had created a negative perspective for the tourism industry. The main reason given for the poor performance was the lack of external marketing initiatives undertaken by the government. Other reasons mentioned included the delay in government infrastructure projects, and the adverse impact of the dengue fever outbreak in Port Vila and Luganville, since January this year.

There are, however, promising developments in the Province that have been realized such as the establishment of hotels, resorts, tour associations, the establishment of a one-stop-shop tourism information centre, tasked with the responsibility of collating and disseminating tourism information on behalf of hotels and resorts, and the tour operators associations.

c. Business Development – Malekula

Malekula is the second biggest island in Vanuatu:

- *It is a major producer (apart from the SANMA Province or a compound production from Santo Malo and Aore) of copra and cocoa, producing approximately 45 percent of annual national copra production and approximately 62 percent of national cocoa production;*
- *It has a large kava production potential;*
- *There is reportedly a vast untapped area of production that is yet to be reached due to inaccessibility;*

The indicator and business sentiment in Malekula points to a positive growth in 2014; this will be driven mainly by commodity production.

Agriculture production has improved while fishery, livestock and forestry have been fairly stable over the past six months. It was confirmed that global increase in the world market has direct impact on copra production, compared to the previous 6 months (August 2013 – August 2014) this year production will be higher. Some companies are anticipating production of copra for exports to double. Cocoa buyers have also indicated a similar trend. The Metenesel Company Limited has indicated an increase in production and export of cocoa compared to the previous six months. Most of this is attributed to better management,

boosting employees' productivity. This is further stressed by the cocoa growers association. They have seen a slight increase in a number of small cocoa farmers joining the association during the past six months. The cocoa growers association has sought support from the National Bank of Vanuatu's (NBV) for an overdraft of over VT 4 million to assist its members. The cocoa growers association exported more cocoa from Malekula to Santo compared to previous years.

Activities in the Fishery and Forestry sector are steady. The fishing industry in Malekula is slowly picking up with the help of non-government organizations like Adventist Development and Reliefs Assistance (ADRA) and Vanuatu Rural Development Training Centre (VRDTC), educating fisherman around Malekula. The Malekula Fish Market and Butchery is looking at opening a point of sale for fish in Port Vila at the Malekula Guest House.

The livestock department is still struggling with limited funds to help boost cattle production. Land issues remain a challenge for cattle farming. Current cattle slaughter as indicated by Lakatoro Fish Market and Butchery has remained steady with increase in sales. The company has made a slight increase in profit as compared to six months ago. The company usually buys cattle for slaughter from small holder cattle farmers and uses the ex-Plantations Réunies du Vanuatu (PRV) as a last resort if small farmers failed to meet the demand. Local farmers during the past six months have experienced fewer failures compared to a year ago; this shows an improvement in conducting farmer awareness and increase small holder cattle farming.

Construction activity in Malekula has been low for the past six months. Public Works Department in Malekula confirmed that Vanuatu Transport Sector Strengthening Program (VTSSP) phase II will begin in July 2014. A pick up in construction work is expected, driven mainly by VTSSP. There is evidence of increase quarrying activity due to the VTSSP phase II. Water supply systems are also increasing. With the help of NGOs, water supply systems have been established in many villages around Malekula, improving livelihoods of many villagers. Electricity usage as confirmed by UNELCO is stable.

The services sector is fairly stable over the past six months with little improvement in finance related services. Cruise ship visits to Walla Island have dropped drastically; there were only two visits so far over the past six months. The Tourism Department at Lakatoro explained that this drop is to do with management disputes over the landing site. Attempts are being made to restore normalcy to allow for more visits in the future. P&O has also stressed the importance of underwater mapping which is lacking for Wala Island and is an obstacle to cruise ship visits. The government is reportedly planning to carry out this in the medium term. Meanwhile, air visitor numbers to Malekula have seen a slight improvement, attributed to mainly by the establishment of the Malampa Travel at the Tourism Office in Malekula.

Visits to financial service providers such as the NBV and the Vanuatu Women Development Scheme (VANWODS) have indicated an increase in financial services to the locals. NBV confirmed an increase in the private sector lending, similar to VANWODS. NBV confirmed that, there is an increase in the number of new accounts during the past six months compared to a year ago. In terms of deposits other than salaries and wages, NBV takes more deposits than any NBV branch in Vanuatu including the head branch in Port Vila. Likewise, VANWODS have recorded big increases in private lending to its members. The number of registered VANWODS members in Malekula is said to be increasing every month. VANWODS has increased its coverage by around 60 percent and is currently competing with NBV Microfinance scheme. Both institutions have successfully conducted financial literacy trainings around Vanuatu.

Similarly, retail and wholesale trade related services have also seen increases in their sales and operations. During consultation with retail and wholesale businesses at Lakatoro, there is confirmation that the increase is attributed to an increase in copra and cocoa production. Compared to six months ago, the Lakatoro Consumer Cooperative has indicated improvement in its retail sales. Philemon store having more than 50 percent sales in wholesale has indicated an increase in the wholesale trade compared to a year ago.

Likewise, the transport sector has also increased over the past six months, supported mainly by increased commodity prices and production. Seven local transport drivers from Northwest Malekula were interviewed and all have indicated positive activity during the past six months compared to past periods.

In real estate development, VNPF has partnered with the government to sub-divide the land at Lakatoro directly opposite the market house. The land will be subdivided and put on sale with all lots having access to water and electricity.

d. Business Development – Tanna

- *Economic prospects for Tanna within the sectors of tourism, agriculture and retail trade services are given below;*
- *There is a vast potential for all sectors to increase; but particularly so for the tourists activity to increase because of its exotic active volcano, and rich custom and cultural practices.*

In 2014, growth prospects are positive in tourism and banking services. However, trade and industry sectors remain stagnant while the agriculture sector has declined. The contraction in the agriculture sector is attributed to by a fall in coffee production. The slow development of the agriculture sector reflects the land tenure status of the area. Land in the East and South-East Tanna is parched with volcanic dust, thus unsuitable for agricultural crop production. Cattle farmers have fallen in numbers, while coffee production has contracted following a high yield last year. Annual coffee production is cyclical; meaning that after a high production, one would expect the subsequent year to be lower. The 2013 production reached eighty (80) metric tons; the 2014 harvest is forecasted to barely exceed 60 tons.

Tanna has benefited from the Vanuatu Transport Sector Strengthening Program (VTSSP), and has positive prospects for new infrastructure development projects. The first phase from White Grass to Middle Bush, and from Lenakel to Snake Hill (Louanialu) includes improving and upgrading of land transportation routes. The second phase of the project

is expected to begin early this year (a five year project) has been delayed, although the tendering process for a contractor to build roads had been completed. As part of the new rural electrification development prospect, UNELCO (electricity supplier) has now anticipated the extension of its network to the Lmaialone subdivision and from Lenakel to Tuhu School. The ENTANI's market building which is to be built on the way up to the volcano tour sight is a project jointly funded by the Neko Entani Company and the UNDP.

In terms of services, tourism air arrival figures were low in the first 6 months of 2014. There is potential for an increase in the next six months. The number of day visitors had increased significant due to larger ATR plane and more flights including two privately owned airline companies. There were 3 cruise ship visits during the first six months. Private sector loans had notable increases. Seventy percent of the private sector loan goes for personal loan, ten percent for school fees, and twenty percent intended for business support. The extension of the banking services to the rural areas has seen the establishment of the White Grass NBA branch opening its door in April this year. There are also positive prospects of real estate development specifically at the recent subdivision at Lmaialone.

Lenakel town is slowly expanding its retail sector, with tougher competition as more retail shops enter the market. The retail prices have gradually increased due to high shipping freight costs, attributed to by a lack of competition in the shipping industry. Despite the high prices, people still buy as they are more dependent on basic food items sold in retail outlets than gardens. The increasing demand for imported items has become notable, with reports that retail shops would run out of stocks in just two weeks.

In general, prospects for increase development activity remains bright for the next 2-3 years attributed to by the second phase of the VTSSP project, extending to 2015, Chinese funded roads also in 2015 and maintenance of Lenakel Wharf around the same time. The services sector should see support from the forthcoming new tourism development projects currently undertaken by UNDP and ENTANI Company, the rural banking opportunities, the extension and upgrade of airport including developments to improve road infrastructure. This should support tourism arrivals

and increase services of air taxis from Port Vila to Tanna. There is also a huge potential for telecommunications development which requires the restoration and extension of telephone land line to Lenakel Hospital and Isangel Provincial Council. However, limitations and development constraints to growth remain, amongst them are the inadequate infrastructure, inadequate government facilities and inadequate provision of services. There is reportedly limited budget allocated to the Provincial Government Council and land issues persisted.

V. OVERALL ECONOMIC PROSPECT

Business Sentiment Outlook

The domestic economy is expected to remain flat, with a potential of moderate growth in 2014. The general business sentiment is mixed for Port Vila, with expectations of gradual growth towards the end of the year. The positive outlook for businesses was evident in the Northern town (Luganville, Santo) particularly in copra and cocoa production and related businesses. Various developments including the impact of high copra and cocoa prices, and spill-over effects to retail shops, land and sea transport services have supported growth in Luganville, Malekula and in the northern outer-islands despite the negative tourism sector sentiment during the first half of the year.

The preliminary estimates for growth in 2014 will be above 2 percent. The drivers of growth included Government projects, most of which are now postponed to 2015. The expected rebound in the construction activity could not eventuate due to further delay in the implementation process of various donor-financed development projects that should have brought growth up to above the 3 to 4 percent range. According to the June updates the only obvious driver was the high commodities prices with some positive impacts in manufacturing, sea and land transport services and the retail sectors, whereas activity from other industries remain flat with increasing positive outlook for the tourism sector and construction industry peaking towards the end of 2015.

VI. APPENDIX 1: BUSINESS SENTIMENT SURVEY RESULTS

a. Business Sentiment by Selected Industries

Figures 3 and 4 are showing sentiments on the 2013 economic growth, and outlook for 2014, grouped by main industrial activity of the respondent.

Figure 3: Business sentiments by Industry

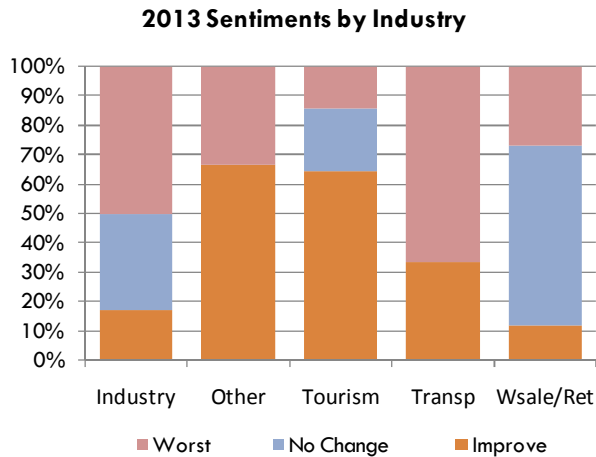


Figure 3 shows the business perceptions for economic performance in 2013, grouped by responding industry. The responses indicated positive sentiments for 2013 in the tourism industry, and the other businesses in general; whereas the sentiments were low

for the industry sector, transport and wholesale & retail industries.

Figure 4: Business Expectations by Industry

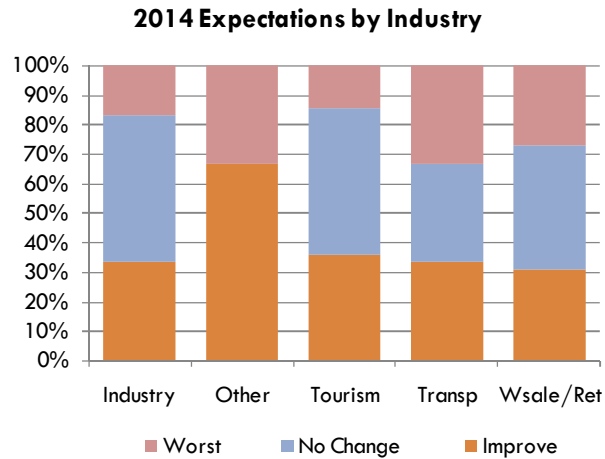
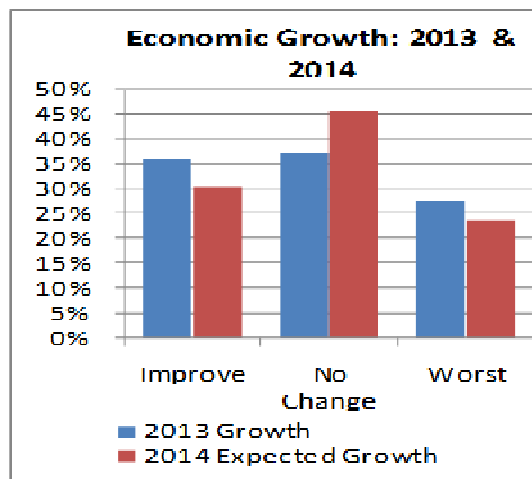


Figure 4 gives some indications of the business expectations for economic performance in 2014. The 2014 outlook by industry is similar to 2013. Most industries perceived a better performance; but responses from the tourism industry indicated signs of uncertainty.

b. 2014 Business Sentiment

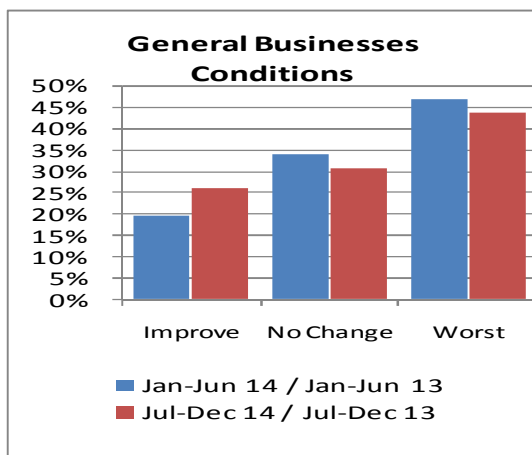
i. Economic Growth as perceived by all industries.



The perception for 2013 economic growth was mixed: 35 percent of the respondents stated no changes in the 2013 economic development, 35 percent expressed a positive sentiment, and slightly more than a quarter thought the economic activities had contracted.

Likewise, the response for 2014 economic outlook was mixed. Forty five percent did not expect any change, 30 percent foresaw an improvement and almost a quarter reported the economy to worsen.

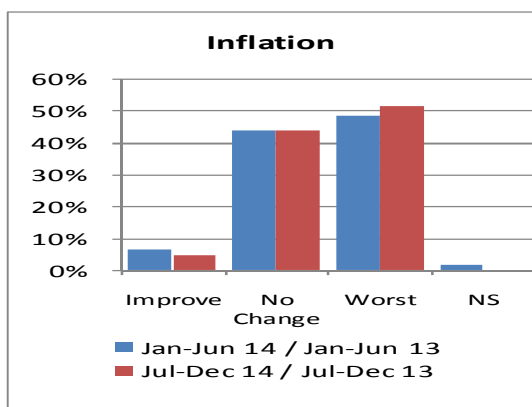
ii. General conditions



The business sentiment on general business condition was negative. Forty five percent of the respondents thought the general business conditions had worsened during the first six months compare to the same period of 2013.

The perception for the second half of the year was similar to the first half of the year, but with signs of confidence as a large proportion of respondents saw conditions improving.

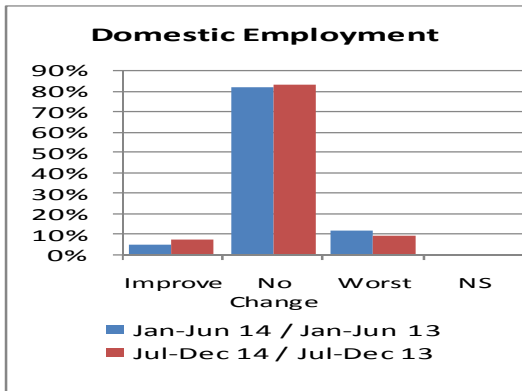
iii. Inflation



The perception for inflation was mixed: mainly “no change” and “worse”, with somewhat more weight for worsening. About fifty per cent of the respondents thought inflation had worsened, and slightly more than 40 percent had not seen any change “no change”.

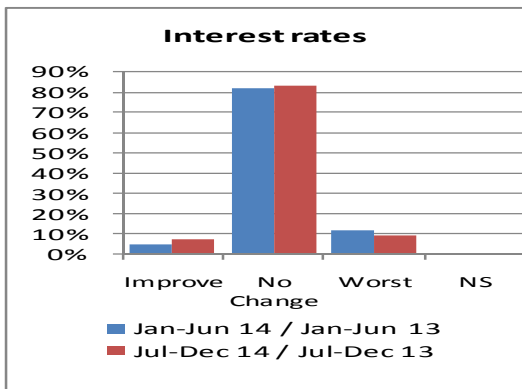
The outlook for the second half of the year remained mixed with fifty percent negative or expecting higher inflation, and 40 percent expecting no change.

iv. Domestic Employment



The majority (80 percent) of the respondents indicated minor movement in the level of domestic employment in both first and second half of the year. The domestic employment captures the sentiment for employment in general, whereas the employment in “business employment” is specific to the responding industry (ref. h. business employment).

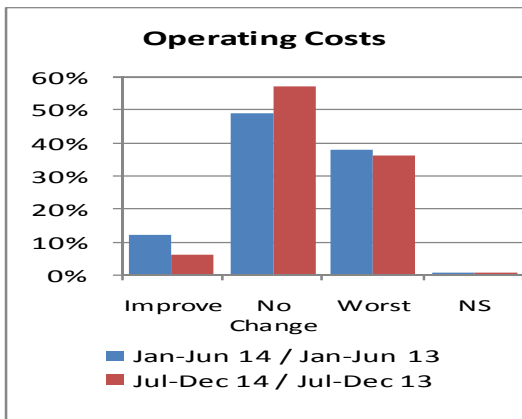
v. Interest Rates



The majority (80 percent) of the respondents indicated that commercial banks’ lending rates have not changed during the first half of the year.

The outlook for 2014 is expected to remain unchanged for the next six months.

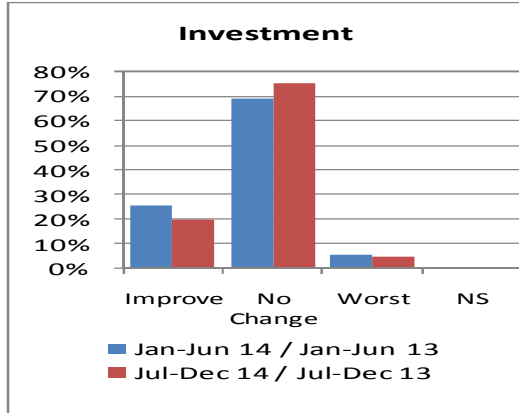
vi. Operating costs



Half of the respondents indicated that their operating costs had not changed during the first six months of the year, and more than a third expressed a negative perception.

The perception for the second half of the year was similar to the first half of the year, with more people indicating “No change”. Many respondents are somewhat more skeptical as they are not expecting any changes in the second half of the year.

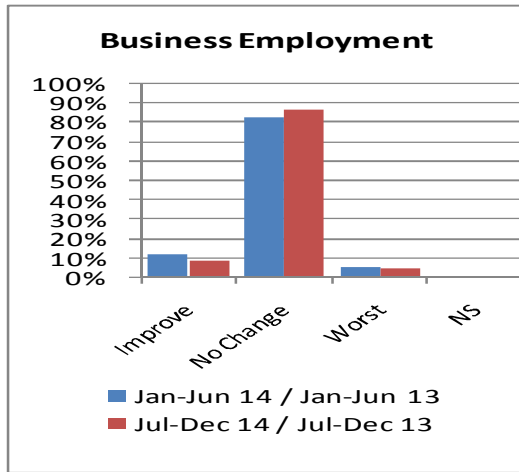
vii. Investment



The majority of the respondents (70 percent) have indicated investment levels to remain unchanged, and a quarter of the respondents confirmed increasing their investments.

However, the six months outlook had no indication of any improvement, uncertainty.

viii. Employment for responding Industry



Business employment sentiment is similar to that for Domestic Employment, and Investment. The majority (80 percent) of respondents have confirmed keeping the level of their staffing unchanged, and a mere 10 percent indicated an increase in the number of employees in their respective industry.

The outlook for the second half of the year will be similar to the first half of the year.