

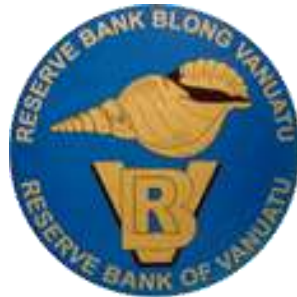
RESERVE BANK OF VANUATU



HALF YEAR MONETARY POLICY STATEMENT

SEPTEMBER 2018

Reserve Bank of Vanuatu



Half-Yearly Monetary Policy Statement

September 2018

- 1. Statement by Governor**
- 2. Monetary Policy Objectives**
- 3. International and Domestic Economic Overview**
- 4. Monetary Policy Objectives: Results and Outlook**
 - a. Inflation**
 - b. Balance of Payments & International Reserves**
- 5. Monetary Policy Decision**
- 6. Conclusion**

1.0 Statement by Governor

The global economic growth remained robust since the March 2018 Monetary Policy Statement. Global economic growth, forecasted to be 3.7 percent in 2018, was highest since 2011. Nonetheless, the growth remained uneven across countries and regions. The improvement in economic growth provides opportunities for countries to focus on economic reforms that will address macroeconomic imbalances, but at the same time keeping growth largely stable. Growing uncertainty stemming from the world's largest economies pursuing varying policies on tariffs and currency valuations have dampen the outlook for fiscal, monetary and trade policies. Following the Fed's pursuit for policy normalization, there is a global bias towards monetary policy tightening in response to not only changing financial conditions, but also rising import commodity prices.

Over the past six months, the overall domestic macroeconomic fundamentals remained sound and indicators of macroeconomic stability in inflation and foreign reserve, remained tenable.

The 2018 real GDP forecast of 3.4 percent remained relatively concentrated in infrastructure, construction (Industry) and services sectors (Tourism). The partial indicators are suggesting that growth will further slowdown in 2019 as infrastructure reconstruction projects wrap-up and assuming implementation delays in some new infrastructure projects. The Government's fiscal position remained favourable over the year to June 2018. VAT collections and imports level for consumption remained stable, suggesting a stable domestic demand over the past 6 months. Growth in credit to the private sector picked up, but remained weak and highly concentrated towards borrowings for household consumption. Overall, the monetary and financial conditions remained supportive of growth. The

banking sector continued to be sound as evidenced by high liquidity and a sound capital position.

The forecasts for inflation for the rest of 2018 and 2019 remained within the bounds of the RBV target range of 0-4 percent and for import cover remained above the 4 months of import cover threshold. Domestic inflation eased, falling to 2.3 percent in the June quarter from 3.2 percent in the March quarter. Increasing fuel prices and the appreciating USD posed upside risks to inflation. Official foreign reserve remained above the threshold level of 4 months of import cover at 10.5 months at the end of June 2018.

In view of the above developments, the Board of Directors of The Reserve Bank of Vanuatu (RBV) considered it appropriate to make no change to its monetary policy stance until further notice.

The RBV will continue to monitor developments and adjust its monetary policy stances accordingly.



Simeon MATHY
Governor
The Reserve Bank of Vanuatu

2.0 Monetary Policy Objectives

The RBV is responsible for the formulation and implementation of monetary policy in Vanuatu. Through the conduct of monetary policy, the RBV seeks to promote monetary stability and economic growth by maintaining a stable value of the Vatu, both domestically and externally. Central to this is the need to maintain a low and stable rate of inflation and sufficient international reserves to meet the country's external obligations. More specifically, the RBV strives to keep year-end inflation rate contained between 0-4 percent and to maintain international reserves at a minimum threshold level of 4 months of import cover.

The RBV monetary policy stance is reviewed bi-annually on the basis of international and domestic developments and their associating impact on RBV's outlook for inflation and foreign reserves.

Over the past six months both these targets have been comfortably met. At the end of June 2018, foreign reserves amounted to well above the minimum threshold of 4 months of import cover at approximately 10.5 months and inflation was recorded at 2.3 percent and within the target range of 0-4 percent.

The RBV changed its monetary stance in April 2018 and envisaged a gradual tightening over the course of 2018. Accordingly, the policy rate was increased to 2.90 percent and SRD ratio to 5.25 percent. However, during its meeting on October 2nd 2018, it endorsed a no change on its monetary stance.

3.0 International and Domestic Economic Overview

Global growth has levelled out and become uneven amid rising tensions over international trade and rising fuel prices
 Global growth is projected to reach 3.7 percent in 2018 and is broadly in line with the IMF's April 2018 World Economic Outlook (WEO). For Vanuatu, the economy was forecasted to expand by 3.4 percent in 2018 and by 3.2 percent in 2019 by the Macroeconomic Committee (MEC) on 8th August 2018.

3.1 The International Economy Development & Outlook

The global economic outlook remain robust in 2018 and 2019. Risks, however, are growing and inflation accelerating
 The global economy is projected by IMF¹ to expand by 3.9 percent in 2018 and 2019, respectively. Recent data shows US economic growth remaining strong, whilst the rest of the world appeared to be decelerating. The leading indicators show the global growth to remain robust. The IMF projected growths of 2.4 percent in

2018 and 2.2 percent in 2019 however, there are signs of uneven expansion from an anticipated slowdown in the Euro area, Japan and United Kingdom.

Risk and vulnerabilities facing global economy have increased

Risks to the global outlook has increased. Growing uncertainty stemming from the world's largest economies pursuing varying policies on tariffs and currency valuations have dampened the outlook for fiscal, monetary and trade policies. The US is trailing expansionary fiscal policy, blended with a restrictive monetary policy, driving the USD higher, at the same time imposing tariffs to lessen external trade deficit. In contrast, China has pursued a loose monetary policy to allow its currency to depreciate and shield it from higher US tariffs and slower economic growth. Countries with weak economic fundamentals are becoming vulnerable to policy shocks including Argentina, Venezuela and Turkey sparking a concern for global contagion effect. The oil prices had risen, increasing burdens of importing countries and fuelling inflation growth.

Global Inflation accelerated

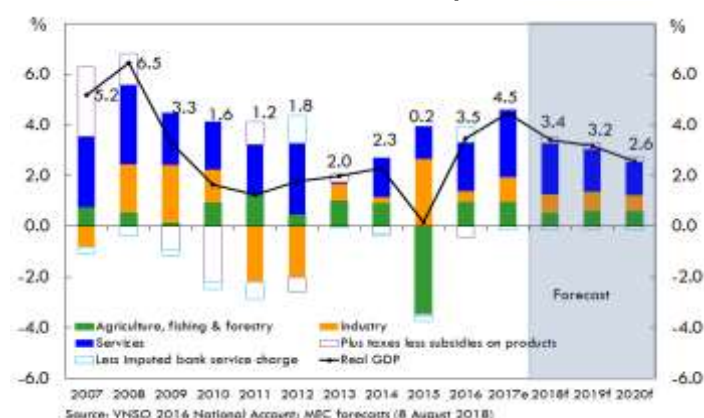
Annual inflation rates have accelerated in the majority of advanced economies and large economies' compared to previous years. Euro area annual inflation rose to 2 percent, which is the highest since December 2012. Japan's annual inflation increased to 1.3 percent above market expectations. US annual inflation slowed from 2.9 percent to 2.7 percent, however, it remained high. Inflation amounted to 2.1 percent in Australia, the highest since quarter one of 2017. In contrast, New Zealand's inflation recorded 1.5 percent in quarter two, a second lowest in 6 years.

3.2 The Domestic Economy Development & Outlook

MEC forecast for domestic economic growth remained unchanged from its April 2018 forecast

The MEC, in its August 2018 meeting, continued to project a domestic economic expansion of 4.5 percent in 2017, 3.4 percent in 2018 and 3.2 percent in 2019.

Figure 1: Vanuatu GDP (Contribution to Annual Growth; Major Sectors)



¹ World Economic Outlook July 2018

MEC forecast for domestic economy to expand in 2018 by 3.4 percent, largely supported by services and industry sectors

Data remains broadly in line with the April 2018 MEC forecast as per table 1 below. Growth in the Agriculture, Fisheries & Forestry and Services sectors are expected to decelerate in 2018 and 2019. Agriculture sector underperformed due to impact of natural disasters and fall in commodity prices, especially for copra. For the Industry sector, growth is forecasted to plateau in 2018 and 2019. The Industry sector continues to be driven by infrastructure projects, which are expected to wrap-up in 2018 and 2019.

Table 1: Real GDP Growth (%)

| Sector | 2016 | 2017e | 2018f | 2019f |
|-------------------------------------|------------|------------|------------|------------|
| Agriculture, Fisheries and Forestry | 5.1 | 5.1 | 2.7 | 3.1 |
| Industry | 4.2 | 9.5 | 7.0 | 7.0 |
| Services | 2.9 | 4.0 | 3.1 | 2.6 |
| Total GDP | 3.5 | 4.5 | 3.4 | 3.2 |

Source: VNSO 2016 National Accounts, Macroeconomic Committee Forecast (August 2018)

Private sector credit growth remained weak and in line with current economic development

The banking system remained well supportive of growth as evidenced by high liquidity holdings and sound capital position. Money growth picked up at the end of June 2018 relative to March 2018. This increase was driven mainly by persistent accumulation of net foreign reserves, and a slight growth in loans extended to the private sector. The growth in private sector credit was driven mainly by loans extended to the household and individual sectors while loans to commercial purposes remained low. Overall, however, credit growth continued to remain weak.

Fiscal surplus recorded for the period of January-June 2018

The central government recorded a fiscal surplus over the period from January to June 2018. This is attributable to increased tax collections and high non-tax revenue mainly from the other government services. Though Government remuneration expenses increased following the implementation of GRT, other expenditures appear to be well managed.

4.0 Monetary Policy Objectives: Results and Outlook

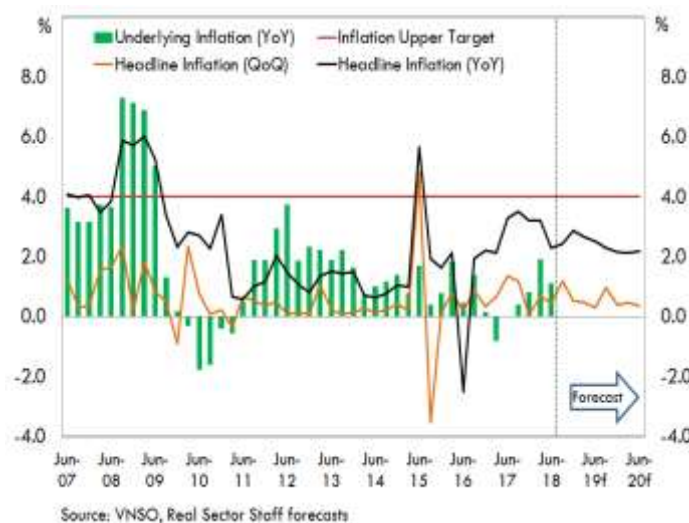
a. Inflation

Annual inflation is projected to remain within the 0-4 percent target range in 2018 and 2019.

The RBV aims to maintain inflation rate within the range 0-4 percent. The inflation was recorded at 2.3 percent in the 2nd quarter of 2018 compared to 3.2 percent in 1st quarter. Average annual inflation for the period of

June 2017 and June 2018 was 3.1 percent (Refer to figure 3).

Figure 3: Inflation forecasts



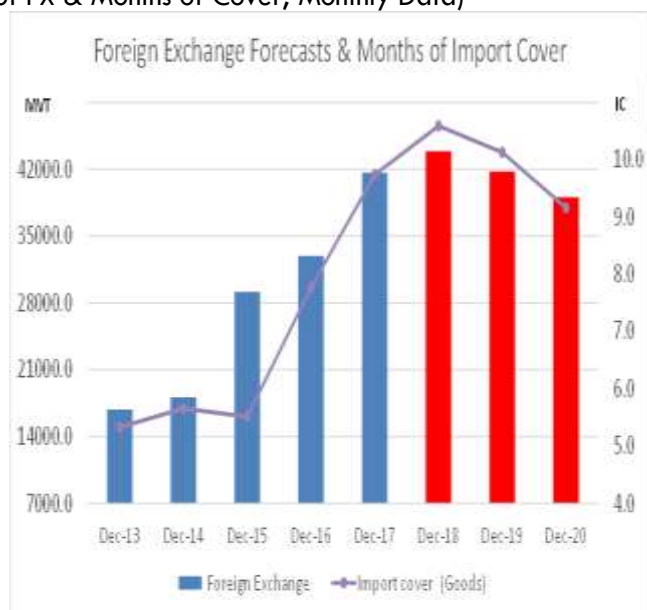
Upside risks to the outlook for inflation include rising imported fuel and rice prices as well as appreciation of the USD, which have the potential to drive domestic food costs higher, although there was some offsetting impact from a depreciation of the NZD. On the downside, the introduction of government subsidized school fees will reduce education prices and a decrease in the demand for imports for construction activities will narrow the positive output gap. The forecast for CPI inflation for year-ended 2018 remains within the 0-4 percent range at 2.8 percent and 2.5 percent in 2019.

b. Balance of Payments and Foreign Reserves

Foreign reserves continue to grow and outlook for the medium term indicates months of import cover to remain above the minimum threshold of 4 months of import cover

The RBV is mandated to maintain an adequate level of foreign reserves, of a minimum threshold of at least 4 months of import cover at any one time. The excess of foreign currency reserves in the overall banking system contributed to an accumulated official reserves of VT43.0 billion at the end of June 2018, supported largely by the accumulation of net foreign assets of Other Depository Corporations (ODCs) and the RBV. Most foreign exchange inflows stemmed from donor support of Government capital expenditures. It is expected that the months of import cover will remain above the threshold of 4 months at the end of 2018. Pressures on foreign exchange are expected to increase over the medium term, both to finance imports relating to infrastructure projects and for servicing external public debt.

Figure 4: Reserves and Months of Import Cover_(Levels of FX & Months of Cover; Monthly Data)



5.0 Monetary Policy Decision

The RBV endorsed no change monetary policy stance until further notice

Since the last meeting of the MPC and the RBV Board of Directors in April 2018, monetary policy stances in both the Advanced Economies, Emerging Markets and Developing Economies generally remained accommodative compared to the US. The US Federal Reserve increased its interest rate to a range of 2.0 – 2.5 percent and expected to continue to tighten policy in 2019. The European Central Bank (ECB), on the other hand, has maintained its benchmark interest rate at 0.0 percent, but signalled to end quantitative easing (QE) from October 2018. The ECB will halve monthly bond purchases to 15 Billion Euros and end asset purchases worth of 2.6 Trillion Euros by year end. Similarly, both the Reserve Bank of Australia and the Reserve Bank of New Zealand made no changes to their policy cash rates.

Considering the recent international and domestic economic developments, the RBV Board endorsed no change to monetary policy stance:

- The Statutory Reserve Deposit (SRD) remained at 5.25 percent;
- The RBV rediscount rate remained unchange at 2.90 percent;
- The RBV secured advance facility interest rates remained unchanged;
- Liquid Asset Ratio (LAR) continued to be maintained at 5 percent;
- The Import Substitution and Export Financing Facility (ISEFF) & the Disaster Financing Credit Facility (DRCF) remained active.

The Reserve Bank will remain vigilant to changes in international and domestic developments that may have a potential impact on the Vanuatu economy and the monetary policy settings of the RBV.

6.0 Conclusion

Global growth remains robust but uneven across economies and amidst rising trade tensions. Growing uncertainties stemming from the world’s largest economies pursuing varying policies on tariffs and currency valuations have dampened the outlook for fiscal, monetary and trade policies. On the domestic front, the Vanuatu economic growth is expected to decelerate in 2019 and beyond. The 2018 growth forecast remains at 3.4 percent.

Of the two main policy targets, inflation is forecasted to remain within the target range of 0-4 percent in 2018/2019. Similarly, foreign reserves are forecasted to remain sufficient above the minimum threshold of 4 months of import cover in 2018.

The RBV will continue to monitor both domestic and international developments and bring into line monetary policy settings where necessary.

| KEY INDICATORS | 2015 | 2016 | 2017 | 2018 | |
|--|----------|----------|----------|---------------|---------------|
| | | | | Mar-18 | Jun-18 |
| Gross Domestic Product (Annual % Change) | | | | | |
| Real GDP | 0.2 | 3.5 | 4.5 | 3.4 | 3.4 |
| Nominal GDP | 4.7 | 5.4 | 8.8 | 9.5 | 9.5 |
| | | | | | |
| Consumer Price Index | | | | | |
| Inflation (%) – year-ended | 1.5 | 2.1 | 3.2 | 3.2 | 2.3 |
| Inflation (%) – average | 2.5 | 0.9 | 3.0 | 3.3 | 3.1 |
| | | | | | |
| Foreign Reserves (VT Millions) | 29,149 | 32,920 | 41,656 | 42,819 | 42,518 |
| Months of Import Cover (months) | 9 | 8 | 10 | 10 | 10.5 |
| | | | | | |
| Money and Banking | | | | | |
| M2 (VT Millions) | 65,060.5 | 71,969.0 | 78,660.7 | 81,418.9 | 87,456.3 |
| Private Sector Credit (VT Millions) | 55,412.3 | 55,508.1 | 58,688.3 | 59,274.7 | 60,407.5 |
| Statutory Required Deposit - SRD (%) | 5.00 | 5.00 | 5.00 | 5.00 | 5.25 |
| Capital Adequacy Ratio - CAR (%) | 12.0 | 12.0 | 12.0 | 12.0 | 12.0 |
| Liquid Asset Ratio - LAR (%) | 5.00 | 5.00 | 5.00 | 5.00 | 5.00 |
| | | | | | |
| Interest Rates (%) | | | | | |
| Policy Rate | 2.85 | 2.85 | 2.85 | 2.85 | 2.90 |
| 91 Days RBV Notes | 1.85 | 1.85 | 1.85 | 1.85 | 1.90 |
| Weighted Average Deposit Rates | 2.25 | 1.58 | 1.39 | 1.31 | 1.54 |
| Weighted Average Lending Rates | 10.01 | 9.92 | 10.26 | 10.31 | 10.08 |
| ISEFF ² | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 |
| DRCF ³ | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 |
| | | | | | |
| Balance of Payments (VT Millions) | | | | | |
| Current Account Surplus (Deficit) | - 2,088 | - 798 | -3,692 | 1,312 | 1,852 |
| Balance of Payments Surplus (Deficit) | 10,676 | 3,371 | 9,012 | 1,292 | - 244 |
| | | | | | |
| Fiscal Operations of the Government | | | | Jan-Mar 18 | Jan-Jun 18 |
| Fiscal Surplus (Deficit) - VT Millions | 1,100.9 | 1,249.8 | 1,912.0 | 1,120.3 | 4,043.6 |
| Revenue – VT Millions | 17,331.8 | 19,651.3 | 21,602.8 | 7,251.5 | 14,545.5 |
| Expenses – VT Millions | 15,810.7 | 17,805.8 | 19,931.4 | 5,204.5 | 10,268.5 |
| Net Acquisition of Non-Financial Assets | 420.2 | 595.8 | 2,284.8 | 405.9 | 2,42.8 |

² Import Substitution & Export Financing Facility

³ RBV Disaster Financing Credit Facility

