RESERVE BANK OF VANUATU

PRESS RELEASE

Press Release No : 2003-04

Date : 25th July 2003

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STATEMENT BY THE RESERVE BANK OF VANUATU ON THE VANUATU ECONOMY

Overview

Vanuatu's economic growth in 2003 is forecasted to record a slight improvement as against a negative 2.8% in 2002. Development thus far is still slow with falls recorded so far in copra production in the first half of the year. It is envisaged that production will be on the rise again following the involvement of private sector in the industry. The opening of new markets for the beef industry is a silver lining for growth as beef production recovered in the first quarter of the year with hopeful prospects in the new markets opening up in the region. Kava, however, still struggles to keep up with its past records following the ban in the US and some countries in Europe.

Most economic indicators have pointed to an improvement in economic activities during the remainder of the year although the economy will remain sluggish. The current lead in the agricultural and optimistic prospects expected from tourism in the second half of the year could, however, foment the growth trajectory above the current outlook.

On the global front, developments in the first few months of 2003 was weak, a continuation on loss of momentum in the second half of last year in the face of a stronger first half of 2002.

Factors that adversely, but collectively weighed on global economy during the first few months of 2003 were more linked with the Iraqi War; weakening in the financial markets, brief oil price increases amid fears of supply disruption in the lead-up to the war and the rising fears of SARS (Severe Acute Respiratory Syndrome) effects on some of the major Asian economies. According to the International Monetary Fund (IMF), the outlook for the global economy for the remainder of the year has been revised downward due to weak outlook in the major industrialized countries.

International Economy

The global economy in the first quarter of 2003 slowed down partly linked with the loss of momentum in the second half of last year. This is in stark contrast to the stronger first half of 2002, underpinned by substantial easing of monetary policies around the world led by the United States' Federal Reserve. However, in the sequel, the global economic recovery slowed towards the close of the year and spilled over at a slower pace into the first quarter of 2003. Several factors, including the economic threat of the Iraqi War that led to rising oil prices and further drop in confidence as well as the continued weakening of the financial markets, have weighed heavily on the growth prospects for the global economy in 2003.

The global economy is expected to continue the recovery, albeit at a slow pace in 2003. In its April 2003 world economic outlook (WEO), the IMF projected a moderate growth of 3.2% in the global economy for this year, 0.2 percentage points above the 2002 growth rate.

According to the Fund, the United States will continue to lead the global economic recovery despite a lower GDP growth projected for 2003. The US economy is expected to grow by 2.2% in 2003, 0.2 percentage points below the 2002 growth rate. The US continues to be constrained by the conditions of the business sector, especially low profitability, which have contained spending. However, the latest interest rate cut in June, buttressed by Mr. Greenspan's testimony to Congress last week is seen as an extra impetus for that rising momentum.

For the Euro area, a weak economic recovery was projected in 2003. Domestic demand remains relatively weak and the recent appreciation of the Euro currency and fiscal tightening in some countries has dampened the growth prospects. For 2003, the Euro zone is expected to grow by 1.1%. The Japanese economy is expected to remain weak, as domestic demand is projected to decline further, due to difficult conditions in the labor market. However, latest forecasts depict slight recovery in 2003.

For the emerging markets, the prospects for GDP growth in 2003 have fallen moderately as the outlook for the industrial countries have further weakened. Developing countries as a whole are expected to grow by 5.0%, while the Asia economies (excluding Japan) that performed relatively well in 2002 are projected to grow by 6.3%, 0.2 basis points lower than last year's GDP performance. The current slowdown in the global economy and the outbreak of SARS had adverse effects on these economies.

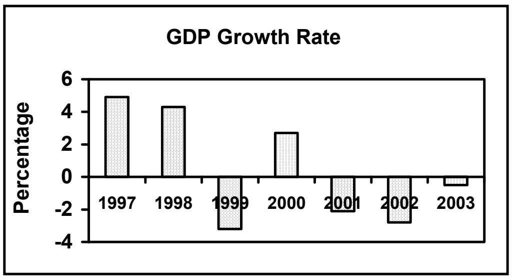
The Australian economy continues to perform well, despite the global economic slowdown. Although the export sector is experiencing some decline due to weak external demand, it was largely offset by a rapid increase in domestic demand. Consumer confidence remains high and household incomes were supported by rising employment and real wages. In light of its preponderancy in terms of Vanuatu's trade and tourism sector, the continuous stalwart position of the Australian economy portrays hopeful prospects for economic growth.

Available data have shown that New Zealand's external sector has weakened reflecting the weak international economy and the recent gains in the New Zealand dollar. On the other hand, the domestic economy remains relatively strong, led by the housing market.

Domestic demand remains strong, however, there are concerns the weaker external sector may affect domestic demand through declining exporters' income. Nevertheless, the outlook for the economy remains positive.

Domestic economy

The slight recovery in growth for this year is still within the forecasted to record a slight improvement in 2003, albeit still within the negative bounds of 0.5 percent, compared to the negative 2.8% posted in 2002. Due to higher weight share in the growth calculation, the falling activities in the industry (13.1%) and service (4.1%) sectors more than offset the improvement depicted in the agriculture sector by 6.6%. Increased productions were recorded in most of Vanuatu's main export commodities, particularly, copra, beef, cocoa and kava.



Copra production, following its decline by 6.7% in 2001, picked up in 2002 by around 12.3%, owing to increase in the production and export of coconut oil. The increase was largely associated with the continued price subsidization by the VCMB. Beef production also turned around to register a positive growth in 2002, increasing by 3.2% from a slow of 2.3% in the previous year. Cocoa production increased by 9.0% in 2002 following previous year's poor performance by around 50.3%. Thanks to the breakthrough in organic cocoa niche fillings. Kava production in 2002 recorded a significant increase and has been increasing since 1999.

Major growth is expected in the services sector with minor contributions from the industry and agriculture sectors. However, economic indicators in the first quarter of 2003 portrayed weak economic activity against the last quarter of 2002. There were noted declines in copra production, which fell by 15.7% from the preceding quarter. Likewise, the production and exports of coconut oil recorded significant falls, equaling 59.0%. The decline in the production and exports of copra and coconut oil was mainly attributed to the financial difficulties of VCMB, which resulted from unsustainably high subsidy prices on copra in 2001 and 2002. However, total production is expected to revitalize for the rest of the year following active participation by private individual marketers.

Beef production recovered in the first quarter owing to the recovery in the export market from low exports during the first half of 2002. Total beef output in the first quarter increased by 5.5 percent. The outlook for the beef industry is promising with the opening of new markets for organic beef in Australia and Tahiti later this year. Kava plunged during the first quarter due to the ban in the US and some countries in Europe. Export trend in recent years has been encouraging. The absence of major projects on the other hand continues to hollow out construction activities and therefore is not viewed deemed to contribute positively to the economy

Visitor arrivals over the first six months of the year ending June 2003 shows a decline of 6.3% over the same period of the preceding year. This downtrend was partly reflected in the decline in hotel room occupancy rate from 46.4 percent to 40.6 percent over the March quarter. Conversely, day visitors posted a positive development to record an impressive increase of 20.5% over the same period. Factor such as the threat of terrorist attacks, the recent Iraq War and the outbreak of SARS all contributed to the decline in tourist arrivals. With most of the fears almost fading, it is estimated that tourist number will most probably increase during the second half of the year, hinging on the steady growth of the New Caledonian market and increase in the number of cruise ships. Favorable developments in the Australian and New Zealand dollars, coupled with the robust Australian economy, will certainly provide extra impetus for the tourist sector. The other factors that are going to make impacts on the sector into 2004 include the possible extension of air services by Virgin Blue in early next year, opening of the new 80-room hotel, and new cruise ship schedule in 2004.

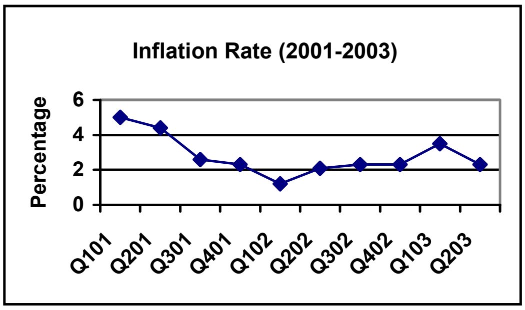
Developments in money supply between the January-June period of this year registered a 3.7% increase to VT36,286 million. The rise was principally attributed to inflows through the commercial banks by way of foreign currency deposits and increases in private sector credit, despite falls recorded in international liquidity through the Reserve Bank--the latter of which offset liquidity creation via monetization of government deficits. During the same period, credit recorded an increase of around 2%, particularly in manufacturing (14.3%), agricultural sector (3.2%), entertainment (4.4%), and tourism (1.7%). Credit extension to private sector in 2002 recorded an impressive 8.0% increase. Positive credit growth is generally a clear yardstick for economic progress.

Mirroring developments in the money and credit sector in 2002, the composition of total money supply significantly changed, depicting the share of narrow money (which comprises currency outside banks and demand deposits) expanded by 32.9 percent, while quasi-money (time and savings deposits in both vatu and foreign currency) plunged by 67.1 percent. The sharp increase in narrow money, especially demand deposits in foreign currency was largely impacted on by interest rate differential in favor of the foreign currencies over the vatu deposits. The fall in quasi-money was brought about by a decrease of 46.4%in time and saving deposits in foreign currency, which could partly match the closure of a number of offshore banks. This varied monetary aggregate component is largely connected with the international financial status of the country as an offshore.

The increase in demand deposits in foreign currency was reversed only slightly in the first quarter of 2003. Foreign currency demand deposits are viewed as a relevant part of the domestic economy and thus make up the Reserve Bank’s calculation bases for the statutory reserve deposits (SRD).

Interest rate developments over the first quarter of 2003 were characterized by declines in the weighted spread between bank loans and deposits. The spread over the first quarter of this year fell by 0.16 basis points to 9.35 percent, owing largely to a 0.14 percentage point decline in the weighted average interest rates for loans. On the other hand, the weighted average interest rates for all deposits edged up by 0.02 basis points. In December 2002, the interest rate spread fell to 9.51 percent from 12.00 percent in the September quarter. The fall reflected lower rates for housing loans and personal loans over the period.

The average price increase during the first half of the year portrayed a rise in the headline inflation of 2.9% (connoting 3.5% and 2.3%, respectively, for Q1 and Q2 of 2003), compared to 1.6% in the same period of 2002. These developments are clear results of higher oil prices associated with the Iraq War and excise tax impacts, the latter of which came into being in January this year. Developments in the first quarter of the year were



largely linked with increase in drink & tobacco (10.3%), transport & communication (8.0%), and recreation, education, & health (6.0%). Minor increases--ranging between 0.6 and 2.1% were noted in food, clothing, and household supplies.

Government fiscal position in the first half of 2003 portrayed a slight improvement over the corresponding period of last year with a fall of over 50% in the fiscal deficit. The balance mainly resulted from a decline of 55.7% in development expenditures, which slightly offset the increment in recurrent expenditure. Domestic revenue during the year increased by 7.6%, the bulk of which was due to 62.4% in non-tax revenue. The burgeoning fiscal imbalances up to the close of the first half are in part monetized by the Reserve Bank as well as through recourse to rollovers and issuing of new government bonds. The G-bonds outstanding in July 2003 increased to VT3.2 billion from VT3.1 billion at the close of 2002.

Given the adverse effects these imbalances are having on monetary conditions, it is important that the current policy coordination between the Bank and Ministry of Finance and Economic Management continues.

The overall external balance has been recording deficits since the fourth quarter of 2001. Central to this unfavorable development is the persistently high trade deficit, which is traditionally financed through commodity proceeds, aid transfers and tourist dollars.

Persistently high deficits in the external sector have consequently stagnated the official reserves to the extent that the level currently suffices to fund 4.5 months of visible merchandize imports. Whilst the Bank opines the present level to be satisfactory, it also imposes measures such as the current USD250,000.00 floor to fend off further deterioration.

Like any central bank, the Reserve Bank of Vanuatu utilizes monetary and exchange rate policies as the main operational instruments in a bid to attain the goals stipulated under its Act, particularly price stability and maintenance of a healthy and viable external balance of payments position.

In light of the sluggish economic conditions, the Reserve Bank of Vanuatu recently decided in its policy meeting in June this year to maintain the current policy stances, by keeping the official interest rates unchanged at 6.5 percent, despite adverse developments in other factors.

On the exchange rate policy, the Bank aims, among other things, at cushioning the economy from imported inflation--the central external policy component of price stability pursued by the institution. The present policy regime of pegging the Vatu to a basket of the country's major trading partners' currencies clearly signifies that statutory commitment. It is The determination of the vatu exchange rate is indeed a dependent variable of developments in the foreign exchange market. In this way, the Bank undertakes annual reviews of the currency basket to take account of circumstantial changes in the domestic economy with regard to international developments.

In a nutshell, the Bank's decisions on major policy changes are cautiously weighted against the general economic conditions. In other words, the Bank's policies are part and parcel of the macroeconomic management. It is to be noted that the effectiveness of the Bank's policy hinges largely on the economic policies of the Government and economic conditions.

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