

Peter Tari: Overview of the Vanuatu economic performance

Presentation by Mr Peter Tari, Deputy Governor of the Reserve Bank of Vanuatu, at the Reserve Bank of Vanuatu, Port Vila, 7 June 2006.

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Overview and performance

- Vanuatu's economic performance has been affected by a number of factors, including the smallness and isolations of the islands, globalizations and gradual loss of preferential markets, natural calamities, lack of capacity and political instability.
- Vanuatu is made up of some 80 mostly volcanic islands that extend approximately 1,176km in a north-south direction. The total land area is 12,281.25 Km² and the current crude population density is estimated at 17 persons per Km². The country's population growth rate is 2.6 percent per annum and a real GDP per capita estimated at USD718 in 2004. The current population is estimated to be around 240,000, of which 80% are said to be living in rural areas and are engaging agriculture.
- Agriculture is the mainstay of the economy, and it makes up approximately 70 percent of the country's exports. Despite the fact that agriculture supports the bulk of the population, it is not the leading contributor to GDP. In the last six years agriculture make up on average 18.3 percent of GDP. The services sector dominates the economy, accounting for around 73% of total GDP followed by the agriculture. Within the services sector, the wholesale and retail sector dominates with around 40%. Tourism, which makes up around 16% of GDP, is becoming an important sector of the economy generating around 75% of the total foreign exchange earned by the country.
- Economic growth since independence in 1980 has been erratic. The fluctuating trend in Vanuatu's economic growth was caused by a number of factors including political instability, the country's vulnerability to natural disasters and changing international prices for Vanuatu's exports, and a whole of other factors.
- The last five years also saw marked variations in growth. After two successive years of contraction in 2001 and 2002, real GDP rebounded in 2003 and has since been recording positive growth. Growth in 2003 and 2004 ranged from 4-5% and has been driven by Agriculture and Services sectors. Positive real GDP growth continued in 2005 but at lower magnitude compared the preceding two years. In 2005, the services and industry sectors continue to grow therefore more than offset a negative contribution from the Agriculture sector. The services sector grew by 4.7 percent in 2005, with much of the growth being attributed to growth in transport and communication by 12.1 percent and in Finance and Insurance by 16.3 percent.
- The Agriculture sector declined in 2005 after experiencing growth for 2003 and 2004. The downturn in Agriculture is driven by copra which in turn was caused by a drop in copra prices which had an effect on production. Cocoa also indicated a decline in 2005, mainly due to a drop in export prices. Kava also experienced a decline in 2005, following a temporary ban in Fiji for Vanuatu kava. This lower decline in agriculture output continues towards the first half of 2006 but is expected to improve towards the end of the year.
- On the fiscal front, the Government has for the past few years achieved fiscal consolidation. Much of the improvement has been attributed to improving economic conditions and inflows of donor funds but also to good control measures over expenditures. Reflecting the good outturn in fiscal operations the Government managed to retire some of its domestic debts in 2005. Also the Government is no longer heavily dependent on the overdraft facility at the Reserve Bank of Vanuatu given its improve fiscal management.
- The Reserve Bank makes regular assessment of the economy and adjusts its monetary policy stance accordingly. Last year in June 2005, the Bank, following its regular assessment of the economy was satisfied that macroeconomic stability has been achieved and that the macroeconomic variables that it monitors against its policy settings have improved. Based on this assessment it relaxed its monetary policy stance by reducing its rediscount rate from

6.5 to 6.25 percent. On 15th March 2006 the Bank further relaxed its monetary policy stance by reducing its official interest rate from 6.25 percent to 6.00 percent.

Challenges for Vanuatu

1. Continue to maintaining macroeconomic stability in order to promote growth;
2. Promoting private sector development as an engine of growth;
3. Political Stability has to be maintained for a conducive investment climate;
4. Raising investments by removing impediments
5. Promoting Small and Medium Enterprises so that economic growth is more balanced and broad based;

The private sector development is more challenged because of good governance issues, unpredictable policy environment, poor infrastructure and the need for improvement of law and order.

Outlook

- The current favorable performance of the economy is expected to continue in 2006 and for the next two years. In 2006, the economy has been forecasted to grow by 3.9 percent and by 4.3 percent during 2007. The services sector is expected to continue to drive the economy forward but also the industry sector is expected to contribute favorably if the Millennium Challenge Account projects are implemented. The agriculture sector is also anticipated to improve in 2006.
- The Balance of Payment of the country outlook appears favorable. Official international reserves have increased to a comfortable level of 6 months of import cover in May 2006, and are expected to continue to increase in 2006.