



# VANUATU

September 2024

## 2024 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR VANUATU

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2024 Article IV consultation with Vanuatu, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its August 28, 2024 consideration of the staff report that concluded the Article IV consultation with Vanuatu.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on August 28, 2024, following discussions that ended on June 21, 2024, with the officials of Vanuatu on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 23, 2024.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staff[s] of the IMF [and the World Bank].
- A **Statement by the Executive Director** for Vanuatu.

The documents listed below have been or will be separately released.

### Selected Issues

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## IMF Executive Board Concludes 2024 Article IV Consultation with Vanuatu

FOR IMMEDIATE RELEASE

**Washington, DC – September 3, 2024:** On August 28, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation<sup>1</sup> with Vanuatu.

As Vanuatu was recovering from the natural disasters of 2023 and prolonged disturbance from the pandemic, the voluntary liquidation of Air Vanuatu in May 2024 created a major shock to the economy with substantial implications for growth and confidence. The loss of air connectivity has significant direct effects on economic activity through the decline in tourism and services, and on domestic and international labor mobility and cargo networks. Adverse developments in the Economic Citizenship Program (ECP) are also creating significant impairments to fiscal revenue and financial integrity.

Assuming a resumption of international air connectivity by 2024Q3 and domestic connections to be restored gradually by end-2024, real GDP growth is expected to slow to 0.9 percent y/y in 2024 and recover to 1½ percent y/y in 2025 (from an estimated 2.2 percent y/y in 2023). Limited fiscal revenue and high costs associated with the airline liquidation are expected to exacerbate the deficit and reduce the government's fiscal space. Consequently, capital spending will likely decline as expenditures are reprioritized, affecting medium- and long-term growth. Although foreign reserves will remain above the RBV's benchmark, they are forecast to decline due to lower tourism earnings and remittances.

While the loss of connectivity may produce price shocks, inflation, which peaked in 2023, will continue to decelerate as internal and external price pressures ease, supported by reduced demand from tourism and investment. Risks to the outlook remain tilted to the downside, including a worse-than-expected resolution of Air Vanuatu's liquidation, political instability, geopolitical tensions, China's slowdown, and severe natural disasters.

### Executive Board Assessment<sup>2</sup>

Executive Directors agreed with the thrust of the staff appraisal. They noted the significant economic shock created by the voluntary liquidation of Air Vanuatu just as the economy was recovering from the multiple natural disasters of 2023. With real GDP growth expected to decelerate markedly in 2024, and the balance of risks tilted to the downside, Directors called for urgent measures to address the immediate risks to growth and stability, and then to rebuild buffers and tackle structural issues with accelerated policy reforms.

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

<sup>2</sup> At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.IMF.org/external/np/sec/misc/qualifiers.htm>.

Directors agreed that in the near term targeted and strategic support is needed to help stabilize the economy. Starting in 2025, they called for urgent fiscal consolidation to reduce sustainability concerns, including re-establishing and adhering to the fiscal anchor. Against the backdrop of the voluntary liquidation of Air Vanuatu, as well as declining Economic Citizenship Program (ECP) proceeds, Directors also highlighted the structural revenue weakness in Vanuatu and supported calls to strengthen public finances. They emphasized the importance of stronger revenue mobilization, expenditure rationalization, efficiency enhancements for spending, and a strong adherence to the principles of responsible public financial management.

Directors agreed that monetary policy remains appropriately accommodative, but fiscal dominance needs to be reduced. While recognizing that the exchange rate has acted as a buffer, they noted that it requires close monitoring, and welcomed the authorities' efforts to review the currency basket.

Directors stressed the importance of addressing bank asset quality concerns and enhancing safeguards against financial vulnerabilities, including through upgrading regulatory, supervisory, and monitoring practices. They also agreed that improving governance and reducing vulnerabilities to corruption should remain a priority. In this context, Directors emphasized the crucial importance of enhancing anti-corruption frameworks and the transparency and supervision of SOEs, including through ensuring an expedited approval of the Commercial Government Business Enterprises Act.

Directors commended the authorities' efforts to adapt to climate impacts and build resilience against future disasters and called for these efforts to be accelerated. They agreed that investing in quality education and skills training and improving the ease of doing business are crucial to addressing labor and skills shortages in Vanuatu.



# VANUATU

## STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

July 23, 2024

### KEY ISSUES

**Overview.** As Vanuatu was recovering from the multiple natural disasters of 2023, the voluntary liquidation of Air Vanuatu in May 2024 created a major shock with significant effects on growth and business confidence. The negotiations about the future of the airline, along with developments linked to the Economic Citizenship Program (ECP) will have significant economic, social, fiscal, and financial integrity implications. Disruptions to connectivity, tourism, and services will likely affect economic activity in 2024: real GDP growth is expected to grow only by around 1 percent y/y, and the current account deficit will likely widen around 7½ percent of GDP, although there is significant uncertainty to forecasts. Ongoing vulnerabilities and exposure to other risks keep the balance of risks to the downside. Structural vulnerabilities to governance, corruption, and natural disasters remain.

**Main Policy Recommendations.** There is a strong need to address immediate risks to growth and stability, and then redouble efforts to rebuild buffers and tackle structural issues with policy reforms.

- **Fiscal challenges** abound and call for urgent and comprehensive action. In the near term, targeted and strategic support is needed to help stabilize the economy, while ensuring fiscal accounts remain under control. Fiscal consolidation should start in 2025, by addressing structural deficiencies and adopting necessary reforms to ensure debt sustainability and strengthen public finances. Vanuatu needs more revenue to replace the decline in ECP proceeds through stronger tax administration and additional sources. Expenditure rationalization is also urgently needed.
- **Improving governance, reducing corruption, and preserving financial integrity** remain highest priorities regarding SOEs, the central bank (RBV), and AML/CFT.
- **Monetary policy** is appropriately accommodative but monetary financing needs to be reduced and eventually stopped. The currency basket needs close monitoring.
- Greater **financial supervisory scrutiny** and an upgrade to practices will allow the RBV to tackle the high level of non-performing loans and reduce risks.
- **Structural issues** remain ever important, and action is needed such as reprioritization of investment needs and integration to the medium-term fiscal strategy, and an increase in efforts to address labor shortages and skills drain.

Approved By  
**Maria Gonzalez (APD)**  
**and Fabian Bornhorst**  
**(SPR)**

A mission took place in Port Vila, June 10-21, 2024. The mission team comprised Evan Papageorgiou (Head), Narayan Suryakumar, Julia Estefania-Flores (all APD), and Kalolaini Ranadi (Resident Representative Office, Fiji). Neil Saker (Resident Representative, Fiji) and Lodewijk Smets (World Bank) joined some of the meetings. Tanuja Doss (OED) attended the mission. Emanuele Massetti (FAD) and To-Nhu Dao (APD) performed analysis and supported the team, and Nadine Dubost and Connor Kinsella (both APD) helped in the preparation of this report.

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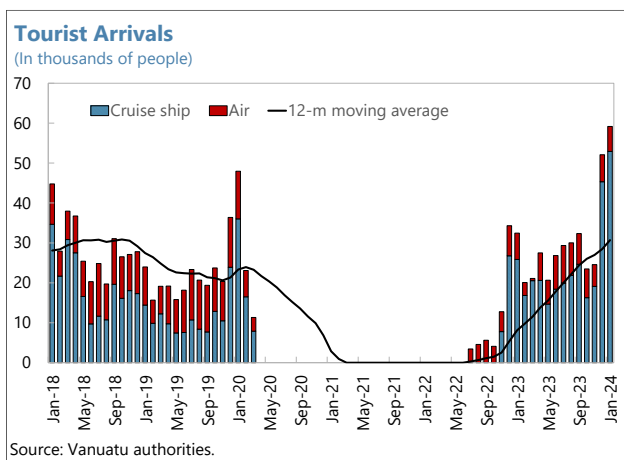
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## RECENT DEVELOPMENTS: GROWTH RISKS MATERIALIZING

**1. Vanuatu was hit by multiple natural disasters in 2023, with cyclone-related damages impacting the domestic supply chain and near-term growth outlook.** The country—a small developing state, highly exposed to natural disasters—was struck by two back-to-back tropical cyclones in March 2023 (Judy and Kevin), with damages estimated at around VT16 billion (estimated at 12 percent of 2023 GDP) with the agriculture sector being particularly impacted.<sup>1</sup> This was followed by category 5 Tropical Cyclone Lola in Q4 2023, with a smaller impact; several earthquakes and volcanic eruptions in 2023 were less damaging.

**2. The liquidation of Air Vanuatu has created a further significant shock to the economy.** On May 9, the Vanuatu government placed Air Vanuatu, the state-owned airline, under voluntary liquidation and all operations halted.<sup>2</sup> The airline had a major role as an international carrier into Vanuatu and controlled virtually all domestic air connectivity within the archipelago. The significant hits to revenue with the collapse of tourism due to the two-year pandemic lockdowns, weak governance practices, and financial and technical challenges have led to the accumulation of arrears and compromised operations of the airline in recent years. Negotiations are ongoing and the administrator is considering several options, including the resumption of domestic-only operations. Depending on the outcome, in addition to the direct fiscal implications that may stem from the liquidation, the current shock to the economy—evident through disruptions in tourism, commerce, and delay in the implementation of projects—may persist and result in more severe consequences for the fiscal, financial, and external sectors (see following sections).

**3. Up until Air Vanuatu’s liquidation, growth was gradually recovering from last year’s shocks supported by government measures and a tourism rebound.** The economy likely grew by 2.2 percent y/y in 2023 despite the twin cyclones. The sharp recovery of tourism following the lockdowns (see text figure), the government’s emergency response (see Annex I), and recovery programs in the aftermath of the cyclones were effective in partially mitigating their negative impact on



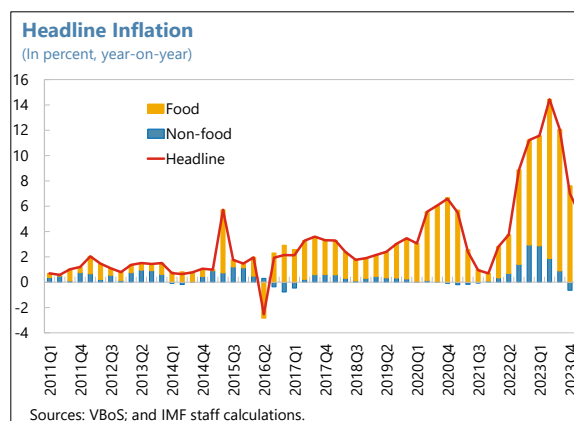
<sup>1</sup> See the 2023 Post Disaster Needs Assessment (PDNA).

<sup>2</sup> *Voluntary liquidation* is the term used by the Vanuatu authorities with respect to the procedural and legal processes planned in corporate resolution. Management of Air Vanuatu (Operations) Ltd (AVL) was assumed by Ernst & Young (EY) Australia, as an independent administrator, with the role of investigating and reporting to shareholders and creditors the company’s financial state, and later managing a sale or liquidation of the company.

growth.<sup>3</sup> Recovering growth in trade partners, and sustained remittance inflows further buffered the negative impact of the cyclones.

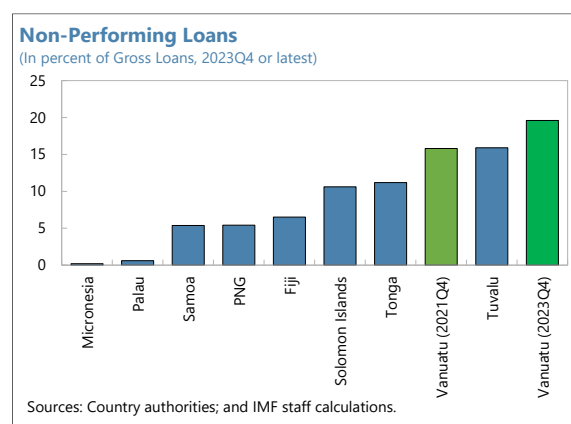
#### 4. After peaking in mid-2023, inflation continued to decelerate by early 2024. Inflation

rose from 3.7 percent y/y in 2022Q2 to 14.4 percent y/y in 2023Q2. The rapid acceleration was driven largely by food prices, which were significantly affected by the cyclones' impact on the agricultural sector. Led by declines in electricity and gas prices, the consumer price index (CPI) decelerated in the second half of 2023 to 7 percent y/y in 2023Q4 (see text figure) and to 5.3 percent y/y in 2024Q1. Vanuatu's sustained price pressures, in contrast to the global disinflation trends, were driven by factors including persistent food price stickiness and delayed transmission of global prices due to supply contract re-negotiations. Additionally, a recalibration of CPI weights in 2023 may have led to higher inflation readings.<sup>4</sup>



**5. Stronger tax revenue and lower spending resulted in a smaller deficit in 2023, based on preliminary estimates.** The overall balance narrowed to -3.6 percent of GDP in 2023, from -6.4 percent of GDP in 2022, as revenues held up. Resilience in tourism arrivals boosted value-added tax (VAT) receipts. Expenditures were somewhat slower to materialize, mostly due to delays in the execution and completion of infrastructure projects. Total public and publicly guaranteed debt grew to VT54 billion in 2023 (43 percent of GDP).

**6. Financial system metrics remained stable, but asset quality concerns persisted.** The banking system is reportedly profitable, liquid, and adequately capitalized. As of 2023Q4, the capital adequacy ratio and the liquid asset ratio stood at 24.1 percent and 46.3 percent, respectively, both well above their minimum regulatory thresholds of 10 percent and 5 percent. Bank asset quality has further deteriorated. Non-performing loans (NPLs) were 19.8 percent of total loans in 2023Q4, up from



<sup>3</sup> The cyclone recovery initiatives, like agricultural subsidies to support rural farmers, helped mitigate the shock on domestic crops, animal and fishing production. Similarly, the VAT exemption for construction materials helped the post-cyclone reconstructions efforts. Support to the hospitality industry helped continue the post pandemic rebound in the tourism sector.

<sup>4</sup> The Vanuatu Bureau of Statistics revised the CPI weights in 2023 to more accurately reflect the basket composition. Inflationary pressures were likely underestimated in earlier periods, as the basket had become outdated (see the discussion in the 2023 Vanuatu Article IV consultation)

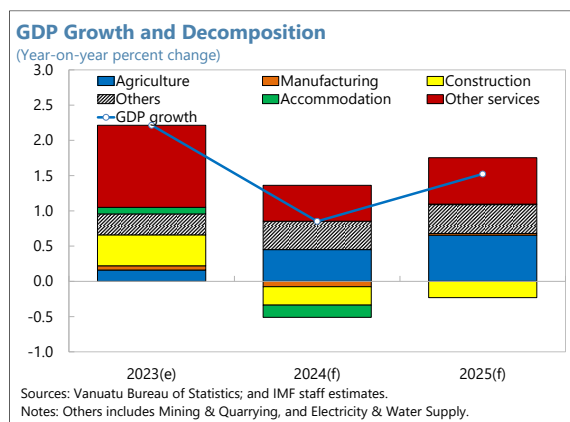


around 16 percent in late 2021, and still among the highest compared to peer economies (see text figure). Furthermore, the system-wide loan loss coverage ratio remains below other Pacific Island countries. Private sector credit grew by 5.6 percent y/y in 2023, driven by household lending, which accounted for 54 percent of total loans. In September 2023, the Reserve Bank of Vanuatu (RBV) launched VANKLIA, a long-awaited RTGS payments system set to enhance financial development.<sup>5</sup>

**7. The external position was moderately stronger than the level implied by medium-term fundamentals and desirable policies (Annex II).** The current account deficit narrowed to 2.2 percent of GDP in 2023, following an average deficit of 9.1 percent of GDP in 2021 and 2022, supported by tourism recovery and income from seasonal workers. Capital and financial account flows in 2023 were mainly driven by project-related capital grants and foreign direct investment, respectively. Gross international reserves remained adequate with 12 months of import cover in 2023 and above the minimum level of 4 months of imports targeted by the Reserve Bank, but early estimates indicate a small notional decline in the first quarter of 2024 coinciding with the increase in demand for foreign currency (see Monetary and Exchange Rate Policies section below).

## OUTLOOK AND RISKS

**8. Air Vanuatu’s liquidation creates a highly uncertain outlook with prolonged and deep risks.** The outcome of the airline liquidation process is yet to be determined. Considering the authorities’ stated objectives in collaboration with partners, staff has adopted a set of assumptions for the forecast on connectivity disruptions. Three international carriers have increased the frequency or capacity of flights servicing the main island, Efate, while more airlines may commence operations to the country in the near term, and by 2024Q3, it is expected that foreign airlines will have reinstated overseas flight capacity to pre-liquidation levels.<sup>6</sup> There is higher uncertainty on the prospects of restoring domestic connectivity amid ongoing negotiations, but staff assumes that domestic flights will resume slowly and will be restored by end-2024.<sup>7</sup> Seaborne links remain unchanged—and a mitigating factor—but cannot replace air connectivity. Overall, the connectivity shock will have a substantial effect on growth for



<sup>5</sup> By removing the manual cheque clearances that previously delayed transactions, VANKLIA is expected to lower fees, improve access to the financial sector, and help streamline financial operations.

<sup>6</sup> Fiji Airways and Virgin Australia have increased number of flights or aircraft capacity to alleviate demand for international connections to Port Vila, the capital city, from Nadi, Fiji and Brisbane, Australia. Solomon Airlines offers flights to Auckland via Port Vila, and Santo via Brisbane. Qantas and Jetstar have also announced they will start to operate services to Vanuatu through the last quarter of 2024 from Brisbane and Sydney (respectively).

<sup>7</sup> The bulk of travel volume is normally between Efate, Santo, and Tanna islands (out of 24 domestic ports). International connections can also help tourism (such as between Brisbane and Santo initiated by Solomon Airlines in July), but they are not replacements for domestic connectivity.

2024, with spillovers to 2025 due to the lag in restoring tourism confidence and expanding capacity. Based on these assumptions,<sup>8</sup> real GDP growth will decelerate markedly in 2024 to around 1 percent y/y (still supported by the carryover effect of early 2024) and recover gradually to around 1½ percent in 2025 (see text figure).<sup>9</sup> The current account deficit is projected to widen to around 7½ percent of GDP in 2024 and 6½ percent of GDP in 2025, reflecting the significant decline in tourism and travel, and dwindling Economic Citizenship Program (ECP) revenue. Foreign reserves are forecast to fall slightly over the same period due to lower tourism earnings and remittances but still well above the RBV's benchmark (4 months of import cover). Although temporary price shocks related to the loss of connectivity are likely, inflation will continue decelerating as internal (supply chain disruptions due to natural disasters) and external (import prices) price pressures ease, and as the fall in tourism and investment reduces demand. Staff estimate inflation to decline to around 3.2 percent y/y by end-2024, and 2.3 percent y/y by end-2025 (inside RBV's target).

**9. The channels of transmission of Air Vanuatu's voluntary liquidation to the economy are far-reaching and they affect output directly and indirectly.** More specifically:

- The decline in tourism will directly affect the **services sector** through hospitality (lodging, restaurants, recreational activities), transport (tour operators and general transportation), retail trade, and other activities.<sup>10</sup> Although Vanuatu benefits from both air and seaborne arrivals (primarily cruiseships from Australia and New Zealand), the value-added to the economy from airline-related tourism is significantly higher as tourists stay longer (at an average of 12 nights per person), and utilize a greater share of domestic resources,<sup>11</sup> including away from initial ports of entry.<sup>12</sup> A greater substitution of international flights by other airlines is vital to maintain connection to the main source countries for visitors,<sup>13</sup> but not sufficient to offset the impact on tourism. Air Vanuatu was nearly the only carrier that connected Efate (the island where Port Vila

<sup>8</sup> Staff project that the airline tourism's contribution to growth for the remainder of 2024 will be reduced by ¾ relative to a no-liquidation baseline scenario. More specifically, the airline tourism's value-added to GDP is assumed to be zero in Q2 and show a gradual resumption of contribution thereafter through Q4 2024, with full domestic and international connectivity restored by year-end. The forecast also assumes about ⅓ reduction in the GDP contribution from the industrial sector, attributed to delays in project implementation stemming from decreased air connectivity and spillovers due to overall diminished economic activity.

<sup>9</sup> "Other services" in the chart refer to transportation and retail sales, drawing from the growth in the tourism sector.

<sup>10</sup> The Vanuatu Chamber of Commerce and Industry carried out a survey on the effects of Air Vanuatu crisis on the private sector. Preliminary results show that 92 percent of respondents were affected by the crisis with 70 percent of them reporting a minimum of 30 percent drop in turnover for the same period. Most affected services businesses also include non-tourism directly related businesses such as real estate, education, health, and professional services.

<sup>11</sup> The authorities estimate that tourists arriving by air spend nearly ten times more than cruise ship tourists.

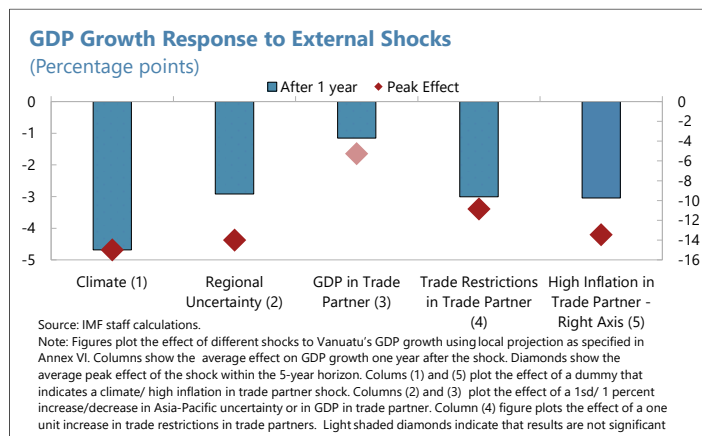
<sup>12</sup> Vanuatu is an archipelago of 83 islands, many of which benefit from or depend on foreign tourism. See Annex V of the 2023 Vanuatu Article IV [Staff Report](#) for more on the role of tourism in Vanuatu.

<sup>13</sup> Australia, New Zealand, New Caledonia, EU and the US.

is located) to the rest of the country, and the disruptions to its domestic operations are affecting tourism overall, as a significant share of foreign tourists travel to the outer islands.<sup>14</sup>

- Disruptions in air transportation are likely to affect the availability and mobility of labor and cargo networks for infrastructure investment and commerce, and will directly affect the **industry sector** through delays in project implementation. The disruptions will also have indirect effects to other industry sectors, including manufacturing, due to diminished overall economic activity.<sup>15</sup>
- Production in the **agriculture, fishing, and forestry sector** is likely to be less impacted. While most food and foodstuffs consumed by tourists are imported, some effects have been noted due to air transport disruptions (particularly for high-value exports). Additionally, other structural factors are expected to negatively affect copra and coconut crop production.<sup>16</sup>
- Beyond the measurable economic shocks, there may also be **social and welfare effects** via disrupted access to healthcare, education, and public services, including aid, which could compress domestic demand further. The lack of connectivity would exacerbate vulnerabilities in the face of possible natural disasters, which are frequent in Vanuatu.

**10. The Economic Citizenship Program (ECP) continues to raise financial integrity concerns and scrutiny, while its revenue is trending down, rising fiscal strains.** ECP projected revenue has fallen 60 percent below the authorities' 2024 target, partly due to the reactivation of a cheaper citizenship-by-investment program. The upcoming national risk assessment for AML/CFT ahead of the 2026 FATF/APG Mutual Evaluation has highlighted the ECP as an important risk to Vanuatu's financial integrity, and the [EU announced](#) the permanent removal of visa-free travel for Vanuatu citizens from February 2025. Limited revenue sources (along with elevated spending from Air Vanuatu's liquidation) are expected to worsen the deficit, reducing the government's fiscal space. Capital spending is likely to decline as the government reprioritizes expenditures, potentially depressing growth and affecting potential output in the medium to long term.



## 11. Beyond the Air Vanuatu and ECP developments and their impact on

<sup>14</sup> Some 30-40 percent of tourists who flew to Port Vila also vacationed in other islands. The private air charter carriers that connect some islands do not have enough capacity to replace Air Vanuatu's domestic operations.

<sup>15</sup> A Vanuatu Chamber of Commerce and Industry survey reports that over half of construction and manufacturing businesses experienced a turnover drop of more than 30 percent y/y due to Air Vanuatu's impact on activity.

<sup>16</sup> The Vanuatu Coconut Copra Exporters (VCCE) on Santo and Malekula islands reported a 50 percent decline in copra production (Vanuatu Budget Book 2024). This drop is due to several factors, including labor shortages, lower prices, reduced income opportunities, adverse weather patterns and the Coconut Rhinoceros Beetle pest.

**growth, there is uncertainty around the macroeconomic outlook.** The balance of risks is tilted to the downside. Being dependent on tourism and imports, Vanuatu's growth is subject to external conditions and shocks (see Annexes III and VI and summary chart aside). Key materializing shocks, such as labor shortages and labor disruptions (strikes) and skills drain, limited capacity, as well as governance and structural deficiencies, are incorporated in the baseline and discussed further below, but there are additional risks that can create more downside to the outlook, such as:

- **Political instability.** The country had three changes of government in the second half of 2023. Political instability might lead to delays in the implementation of infrastructure projects, deter potential future investments, and disrupt donor-led programs.<sup>17</sup> A national referendum in end-May regarding the political process and rules for early elections or changes in government passed with strong support, but political analysts suggest that it is not sufficient to prevent political instability. A constitutional amendment is likely to follow.
- **Severe natural disasters** including those induced by climate change could cause large economic damages and price volatility. Furthermore, climate events can exacerbate the spread of invasive pests on crop production, posing increased risks for food supply and inflation.<sup>18</sup>
- **China slowdown.** Weaker-than-envisaged economic activity in China, a key trading partner and source of global growth, would have negative spillovers to Vanuatu. Second round effects may emerge as China's slowdown would also dampen regional growth, indirectly affecting Vanuatu through its trade partners.
- **Geopolitical tensions and trade fragmentation.** Pacific Island countries are particularly vulnerable to shipping costs and trade disruptions given their heavy reliance on imports and limited connectivity within global trade networks. Geopolitical events as well as trade restrictions could strain global supply chains potentially fueling domestic inflation.

## Authorities' Views

**12. The authorities agreed with staff on the uncertain outlook and significant downside risks for 2024.** The Macroeconomic Committee (MEC) is currently working on a new set of projections, and it will downgrade GDP growth (from their April MEC round projection of 4 percent y/y for 2024). They expect the effects of Air Vanuatu's liquidation on the economy to be contained within the accommodation and transport sectors, with larger effects on tourism-related and other service sectors, including retail. The authorities are more optimistic than staff for 2025, expecting that the resuming air connectivity will catalyze more robust economic growth. Headline inflation is expected to fall below the RBV's upper end of the target of 4 percent later in 2024.

<sup>17</sup> Vanuatu's Private Sector Economic Update survey from December 2023 mentions companies underline political and Air Vanuatu instability as one of the main risks for future investments in the hospitality sector.

<sup>18</sup> The Vanuatu Coconut Copra Exporters (VCCE) on Santo and Malekula islands report a 50 percent decline in copra production (Vanuatu Budget Book 2024). This drop is due to several factors, including labor shortages, lower prices, reduced income opportunities, adverse weather patterns and the Coconut Rhinoceros Beetle pest.

## POLICIES FOR RESILIENT GROWTH

### A. Fiscal Policy

**13. The voluntary liquidation of Air Vanuatu is expected to significantly affect the already precarious fiscal position.** Although there is considerable uncertainty on the range of outcomes from the liquidation of the airline and the scale of its impact on the economy, it will likely result in a significant deterioration of fiscal revenue. Weaker tourism and services activity will have a direct impact on value-added tax (VAT) revenue, excise duty receipts, and associated fees (even assuming that all air travel, including domestic is fully restored by end-2024). Revenue is also likely to be affected by the delayed implementation of industrial projects and investment (through foregone VAT and import fees), and the general slowdown in commercial activity. Spillovers from the shock into the economy will require urgent and targeted government support to the tourism sector, possibly in the form of subsidies and fee exemptions, that could create some spending pressures. Additionally, the costs related to restructuring the airline and possibly reviving domestic operations are likely to have a significant impact on expenses in 2024 and possibly even in later years. Development partners have expressed willingness to increase assistance via direct budget support, concessional loans and reprioritization of other grants that will likely fund some needed spending.

**14. The staff forecast envisages a significant deterioration of the fiscal position in the near term.** The impact of the economic shock is likely to reduce domestic revenue by 6 percentage points of GDP in 2024 (to 20 percent of GDP) from 2023. The recovery in revenue is expected to be gradual and subdued into the medium term. Even before the airline liquidation, the ongoing structural decline in ECP revenue limited the government's fiscal options. Based on recent outturns staff estimate that ECP revenues will remain permanently subdued into the future, averaging around 2½ percent of GDP, from around 14 percent of GDP at its peak in 2020. Direct budget support in concessional terms from donors seems forthcoming, but this will only partially offset the post-cyclone decline in grants previously envisaged. Overall, staff forecasts budget support grants from all development partners to remain at relatively high levels in 2024-25, while project grants are expected to gradually ease as the government scales down capital spending in the aftermath of the reconstruction support from the 2023 natural disasters and due to tighter policy room.<sup>19</sup> Expenditures are expected to remain elevated in 2024 to reflect the restructuring costs of the airline, and some modest social transfers and support to the economy. Capital expenditure is likely to decline from 2025 reflecting longstanding delays and capacity constraints in project execution.<sup>20</sup> Overall, this implies a deterioration of the fiscal deficit to about 6½ percent of GDP in 2024, and a path of gradual improvement through the medium term.

<sup>19</sup> While all major donors have indicated support, specific commitments remain fluid and will be reconfirmed in size and horizon.

<sup>20</sup> The envisaged budget spending on airport upgrades and related infrastructure could be partially or fully suspended contingent on whether domestic air traffic resumes. Additionally, capital spending might be supplanted by more urgent expenditure related the airline bankruptcy.

**15. Vanuatu’s debt trajectory has worsened since the previous Debt Sustainability Analysis (DSA).**<sup>21</sup> While the immediate fallout from Air Vanuatu’s liquidation will hit tourism and growth prospects, the longer-term fiscal implications will likely be protracted and severe, accompanied by a worsening of the public debt trajectory. The DSA indicates that debt remains sustainable, however both external and public debt distress risk indicators are now rated ‘high’,<sup>22</sup> as key indicators breach the relevant thresholds under the baseline scenario (see the Debt Sustainability Analysis). The sustainability of public debt in this scenario hinges to a large extent on the success of the Air Vanuatu restructuring, to restore its commercial viability for domestic operations, and the government’s sustained ability to comfortably access highly concessional external loans. The breaches primarily reflect the following baseline assumptions, based on available information (see DSA): (a) the increase in the external debt level, as the government absorbs some of Air Vanuatu’s liabilities; (b) increased fiscal deficits—albeit on a gradual declining trend—attributed to the sharp decline in ECP revenues and the recurring expenses linked to sustaining the airline’s domestic operations; (c) larger fiscal deficits over the medium term that are financed using primarily external debt and expensive domestic borrowing; and (d) weaker service exports attributed to the airline liquidation. Given the limited fiscal revenue channels, domestic debt issuance is also expected to increase to finance the higher deficits; this will likely test the absorption capacity of government bonds by the domestic financial sector. Additionally, the increased government borrowing from domestic banks could potentially crowd out credit to the private sector and exacerbate the sovereign-bank nexus. The financing would also be subject to risks of fiscal dominance, as already ongoing central bank financing could increase if risks materialize.<sup>23</sup> Urgent corrective measures are critical to prevent the rapid deterioration of fiscal metrics that could threaten debt sustainability.

**16. The major driver of the persistent fiscal deficits and debt sustainability is a structural weakness in revenue.** The government should continue to explore new revenue measures and improve the collection or administration of existing fees, levies, and taxes. While there are no easy gains, additional revenue can be found through income taxes (particularly on the corporate sector), capital gains taxes on real estate transactions, fisheries licenses, a widening of the tax base, and a better targeted or higher VAT rates.<sup>24</sup> Vanuatu’s VAT collection is relatively low compared to the feasible sources as evidenced by government surveys of efficiency and missed revenue. There are several options for a better VAT system, including through reforms that can reduce informality, help improve compliance, and boost VAT collection. VAT refunds and credits can create a self-enforcing

<sup>21</sup> Signs of the deterioration were evident soon after the twin cyclones in 2023, and an interim standalone DSA in June 2023 (at the request of the authorities) incorporated a partial post-disaster assessment. The June 2023 DSA pointed to increased risks from the larger-than-previously-expected fiscal deficit and the deterioration in medium-term fiscal prospects.

<sup>22</sup> In the previous DSA (June 2023), the risk of external and public debt distress was rated ‘moderate’ and ‘high’ respectively.

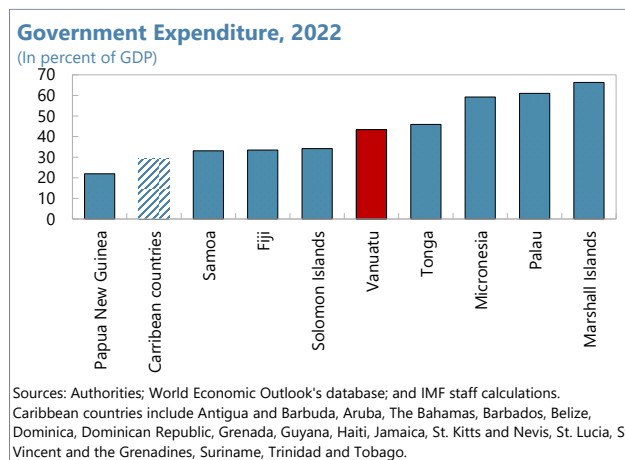
<sup>23</sup> Currently, RBV’s holdings of government debt exceed the threshold of 20 percent of average government revenues stipulated by the original RBV Act. An amendment to the Act in 2022 raised this threshold to 40 percent. The IMF has recommended to the government to revert to the previous 20 percent cap.

<sup>24</sup> The IMF has suggested in the past (see Annex VI of the [2023 Vanuatu Article IV](#) Staff Report) that a 2 percent of GDP increase in revenue was achievable through a combination of new income taxes and VAT rates that would improve efficiency, reduce inequality and achieve better distributional outcomes than VAT rate increases alone.



system, while better tax administration (including via electronic solutions) can help jumpstart collections (see also [Sy et.al, 2022](#))

**17. Reducing expenses rapidly to better align with the new revenue outlook is a high priority.** Although Vanuatu’s government spending is not significantly out of place compared to peers (see text figure), spending remains elevated and there’s considerable room for careful re-evaluation of expenditures with a view toward rationalization, especially with regards to the size of the public sector that has grown in recent years. To ensure that expenditures do not spiral out of control, any interim spending measures related to Air Vanuatu should be based on prudent expenditure prioritization. This will require commensurate cuts in non-priority spending. Any interim spending measures currently envisaged—such as increases to public employee compensation and allowances (especially those pertaining to the Government Remuneration Tribunal)—should be paused. Careful reprioritization of investment spending should also be undertaken.



**18. Initiating the process of an early fiscal consolidation is needed to reduce sustainability concerns, and re-establishing the fiscal anchor would further help ensure debt sustainability.** While a wider deficit in 2024 will be justified by the economic support needed and one-off costs related to the airline, ambitious fiscal consolidation should start as early as possible but no later than 2025—and be sustained decisively over the medium term. In particular, the gradual consolidation envisaged under the baseline remains insufficient to reduce high debt sustainability risks, with the primary deficit creating large debt-creating inflows over the next five years (Tables 1-2, DSA Annex, Figure 3). Bringing the primary balance further under control will be critical. Defining a fiscal anchor that is clearly linked to securing debt sustainability and adhering to it is critical—the overall deficit and/or the primary balance are possible options. In this context, adherence to principles of responsible public financial management, as laid out in the country’s PFEM Act would strengthen fiscal administration. This includes reliable and realistic forecasting, compliance with the fiscal rules (see Annex VII),<sup>25</sup> and greater accountability in all parts of public finance, including auditing. In the medium-term, the anchor provided by the primary balance will help stabilize debt.

<sup>25</sup> According to legislation and Budget Policy statements, the current fiscal rule requires the authorities to maintain a balanced budget. Additionally, the Budget documents set indicative targets for debt management and monitoring purposes, including on public debt (60 percent of GDP) and external debt (40 percent of GDP). However, implementation of the fiscal rule (balanced budget) and debt management targets has been weak.

## Authorities' Views

**19. The authorities agreed with staff on the need to secure medium term fiscal sustainability.** The authorities attributed the decline of ECP revenue to payment-clearance delays related to AML/CFT checks, and the re-activation of an older, lower-cost program. They are considering a revamp to the ECP to allow the government to keep a higher share of the fees that is currently allocated to third-party agents. In the face of a structural decline in ECP revenue, they are evaluating the introduction of a capital gains tax. They acknowledged staff's recommendation for income tax, but pointed to political considerations and may consider capital gains tax. Given that tax reforms would take time to implement, they acknowledged the urgent need for expenditure rationalization. Authorities concurred with staff on the fiscal slippages in the recent past, especially due to discretionary government spending on items such as wages, allowances, travel, and vehicles, and are keen to pursue a "reset budget" in 2025 around fiscal consolidation.

## B. Monetary and Exchange Rate Policies

**20. Monetary policy remains broadly accommodative and fiscal dominance needs to be reduced.** Although the RBV increased the Statutory Reserve Deposit ratio by 25 basis points in December 2023, monetary policy is still broadly accommodative to help support economic activity, including amid the current shock. The RBV carries out open market operations (OMOs)<sup>26</sup> with the objective of reducing excess liquidity and elevated inflation. However, central bank financing to the Government is increasing, and at VT6 bn (4.5 percent of GDP), it has exceeded the previous 20 percent limit for lending to the government (which was amended in 2022 to 40 percent). This fiscal dominance is rendering monetary policy, in particular OMOs, ineffective in reducing liquidity. In the near term, the most urgent priority is the need for effective liquidity management, and a better coordination with debt policy. Fiscal consolidation is an opportunity for the RBV to reduce its exposure and lower its holdings of government debt over the medium term, with the objective to stop monetary financing. It remains critical to repeal the 2022 Reserve Bank Act, including the increase of the amount the government can borrow from the RBV, which were made unilaterally by the government and weakened the financial autonomy of the central bank.

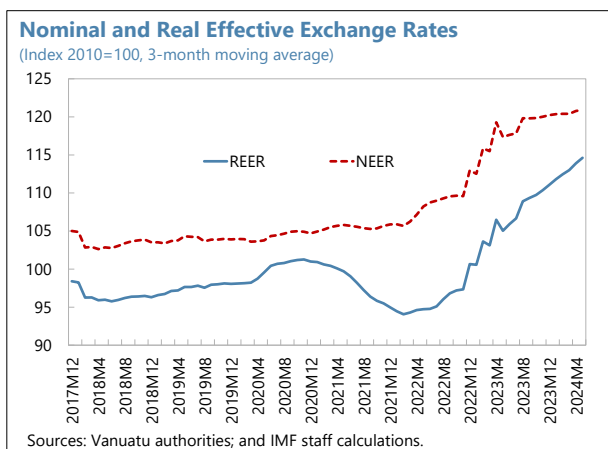
**21. The exchange rate has acted as a buffer but requires close monitoring, and there is scope to review the currency basket.** The nominal exchange rate of the vatu is pegged to an undisclosed basket of currencies corresponding to the bilateral exchange rates of the main trade partners and serves as a key inflation anchor. The REER has appreciated considerably since late 2021, which helped cushion the impact of rising import prices. However, the limited supply of foreign currency in the interbank market, exacerbated by the RBV limits on foreign exchange interventions, highlights concerns about a possible currency overvaluation.<sup>27</sup> The liquidation of Air Vanuatu could

<sup>26</sup> In October 2023, the RBV tightened its open market operation through increasing the volume of new RBV notes issued from VT100 million to VT200 million.

<sup>27</sup> The current account model-derived REER gap implies an undervaluation of 8.4 percent, but this assessment carries significant uncertainty due to measurement errors reflecting large revisions in the current account. The rapid structural change in ECP revenues may also play a role, especially going forward.



lead to a significant protracted reduction in exports and reserves, further limiting foreign exchange availability and heightening exchange rate pressures. While the RBV has comfortable reserve buffers to manage short-term shocks (notwithstanding indications of a small nominal drop in early 2024), it will be important for the RBV to carefully monitor for possible currency misalignments and continue to review the currency basket to ensure the exchange rate remains well-aligned.



**22. Resolving governance issues at the RBV remains a priority.** The pace of implementation of the 2016 Safeguard Assessment recommendations remains slow, and there is an urgent need for enhanced action. Although authorities have committed to amending the Reserve Bank Act and to adopt leading practices, the establishment of a definitive timeline for these initiatives is missing. Swift legislative action and the resolution of outstanding governance issues at the RBV are crucial to ensure and strengthen the integrity and autonomy of the central bank. A National Risk Assessment is currently ongoing which will seek to address AML/CFT related issues.

### Authorities' Views

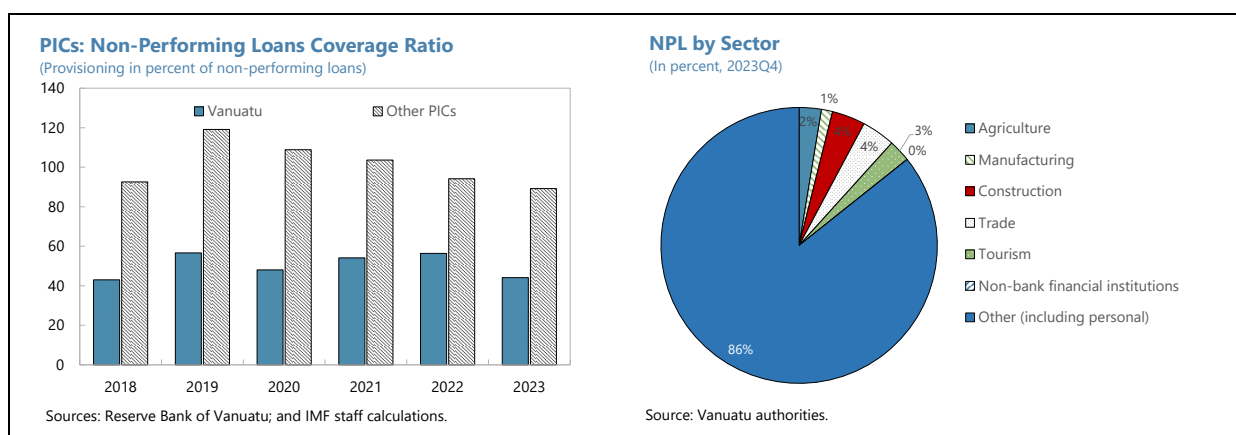
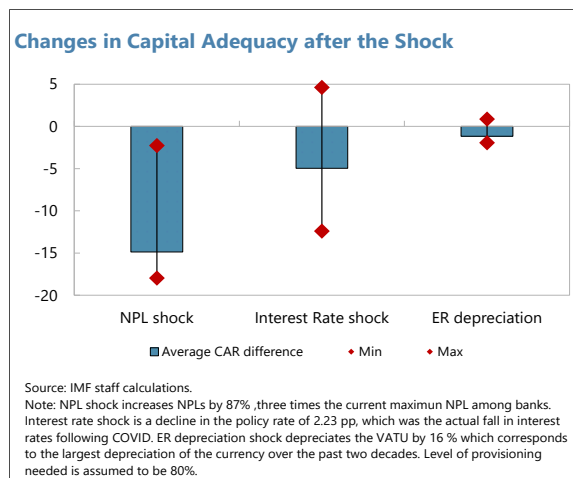
**23. The RBV is likely to continue tightening monetary policy, given ongoing high excess liquidity.** The authorities acknowledged that central bank financing to the government poses significant risks. However, they contend that alternative options to finance government debt domestically are limited. They intend to repeal most of the 2022 Reserve Bank Act, but did not commit to reduce the government borrowing cap. The authorities consider that, although the exchange rate has helped cushion the passthrough of import prices to inflation, it shows signs of possible overvaluation. A review of the currency basket weights is likely to continue with possible externally sourced technical assistance.

## C. Financial Sector Policies

**24. The financial sector appears broadly stable, but enhancing safeguards against financial vulnerabilities remains essential.** Staff analysis involving a financial sector sensitivity exercise (see Annex V) suggests potential risks that could amplify certain vulnerabilities (text chart). Given elevated NPLs, the most significant vulnerability is to a further large increase of impaired loans. In a severe downside scenario, this surge could lead to an average decline of 14.9 percentage points in the capital adequacy ratio, pushing certain banks below the regulatory minimum of 10 percent. Efforts should focus on strengthening the supervisory and resolution frameworks and incentivizing improved loan recovery and workouts.<sup>28</sup> The large sovereign-financial sector nexus, reflected in the

<sup>28</sup> The RBV is currently working in developing a new prudential guideline in line with Basel III and it has requested assistance from the Pacific Financial Technical Assistance Center (PFTAC).

significant holdings of government liabilities by state-owned entities, can amplify financial stability risks. Air Vanuatu’s ongoing voluntary liquidation could also increase macro-financial stability risks given its significant impact on tourism and economic activity. The RBV is not considering any temporary forbearance measures at this time. As evidenced by the negative real credit growth in 2023, banks' ability to lend remains limited, primarily due to weak demand, with most credit growth occurring through loan refinancing rather than new lending.



**25. Greater supervisory scrutiny is needed.** A small domestic bank was placed into administration in June 2023 to preserve its operations and protect depositors. The bank remains without an appointed administrator due to inadequate coordination between supervisors, and its funding is precarious with consequences for the supervisor. Beyond the administrative deficiencies, the event also underscores the need for an upgrade in regulatory, supervisory, and monitoring practices, reinstating regular on-site inspections, and boosting RBV’s capacity. The IMF will assist with an upcoming Financial Sector Stability Review (FSSR) in 2024-25 that will recommend and augment relevant technical assistance.

**26. Improving financial integrity is crucial for the development of the financial sector.** Risks to financial integrity posed by the ECP are highlighted by the decision to revoke visa free travel by UK in August 2023 and Ireland in March 2024. The European Union is expected to permanently reinstate visa requirements in February 2025.<sup>29</sup> Ongoing pressure on correspondent banking relationships (CBRs) and risks from cryptoasset activity highlight the need for more effective

<sup>29</sup> The EU will implement a full suspension of the visa waiver agreement (for all Vanuatu passports) starting February 2025. Governance issues identified by the EU include concerns about due diligence, the low rejection rate, and speed of approvals, granting citizenships to persons listed in Interpol databases, and lack of information exchange with applicants’ country of origin.

financial integrity measures.<sup>30</sup> While there has been progress toward strengthening Vanuatu's AML/CFT framework in recent years, there are ongoing deficiencies. Vanuatu's AML/CFT framework and its effectiveness are due to be assessed in 2026 by the Asia Pacific Group on Money Laundering (APG). Enhancing the effectiveness of the AML/CFT regime ahead of the APG evaluation is important to mitigate the risks to financial integrity.

### Authorities' Views

**27. The RBV assessed the banking system to be profitable and liquid but acknowledged that the high level of NPLs and de-risking of CBRs are significant concerns.** The RBV agrees that enhanced supervision, streamlining of NPL resolution mechanisms and improving loan recovery could help address the high level of NPLs. The authorities are also aware that the impact of continuous delays in registering land leases over mortgages has continued to weigh down the value of NPLs. The RBV also recognizes that the sovereign-financial nexus can amplify financial risks and that the liquidation of Air Vanuatu, given the critical importance of air connectivity to the real economy, could increase macro-financial stability risks. The RBV concurs that measures to enhance governance and transparency within the banking sector and SOEs are crucial for improving CBRs and addressing AML/CFT concerns.

## D. Structural Policies

**28. Improving governance and reducing corruption in SOEs remains essential.** Air Vanuatu's liquidation highlights the risks associated with the opacity of SOE operations in Vanuatu. Enhancing anti-corruption frameworks and the transparency and oversight of SOEs is crucial to help reduce corruption vulnerabilities and fiscal risks. An urgent priority would be to strengthen SOE performance, monitoring and evaluations, and greater transparency of the contingent liabilities to the Government. Rapid approval and implementation of the Commercial Government Business Enterprises (GBE) Act is needed to enforce regular reporting to the Government for higher-frequency monitoring. This will also give needed greater oversight and autonomy to the GBE Unit with greater accountability to the Minister of Finance. However, in its current form, the draft legislation lacks important transparency and integrity best practices, including stricter conflict of interest measures, prohibition on political spending, procurement regulations, and timely release of audited financial statements. Corporate governance practices for state-owned enterprises also need to be improved.

**29. Urgent and decisive actions are needed to tackle growing risks from climate change (Annex IV).** Vanuatu is already experiencing the severe impact of various climate disasters and is expected to worsen. In this regard, the country is taking steps to adapt to climate impacts and build resilience for the future. These include enhancing capacity and climate literacy through community education and awareness, strengthening coastal defenses against sea-level rise and developing resilient infrastructure by adhering to climate-proofed building codes, environmental impact

<sup>30</sup> [Copestake et al](#) (2023) explore risks associated with a large-scale crypto asset adoption in a small open economy.

assessments and regulations. An IMF staff analysis estimates the costs of three different adaptation strategies against sea level rise in Vanuatu (see Selected Issues Paper).<sup>31</sup> Moreover, the execution of the updated Nationally Determined Contribution which outlines priority areas for mitigation, adaptation and loss & damages over the next decade could lessen the impact from climate hazards. Despite progress, current adaptation efforts and resources are still inadequate, requiring greater stakeholder collaboration, scaling up access to climate finance, technology, technical support, and capacity building, improving governance and institutional structures and effective laws and policies. Climate investment needs or disaster response should also be integrated into a medium-term fiscal strategy. Adequate prioritization of projects to maximize efficiency is also critical given capacity constraints and debt sustainability risks.

### **30. Other structural issues include labor shortages and skills drain from high emigration.**

Notwithstanding the boost in remittances, the severe labor shortages across a wide range of job types lost often to seasonal worker programs (primarily to Australia and New Zealand) could impede private sector growth, an important catalyst to lift economic growth and development.<sup>32</sup> In June 2023, the minimum wage was increased (by 36 percent to VT300 per hour) to help ease the high cost of living. However, this could create undesired second-round effects on inflation and more unskilled workers losing their jobs and forced into the informal sector.<sup>33</sup> The authorities need to accelerate efforts to enhance the benefits of labor mobility, improve the business environment and domestic labor market conditions. These include raising the skill level of ni-Vanuatu workforce including youths through continued investment in education, provision of scholarships and targeted technical and vocational training, as well as enhancing the business environment. The commenced reviews of labor law and immigration policy by the authorities in early 2023 is a step forward to promoting a conducive business environment for investment and job creation.<sup>34</sup> Additionally, recruitment of seasonal workers could target areas where skills development is needed and towards women in rural and the informal sector and unemployed youths. Unlocking the potential of increased female labor participation could help address the skills deficit and deliver large socio-economic gains for Vanuatu. Promoting entrepreneurship and the formalization of the informal sector can also provide alternative employment pathway for local workers.

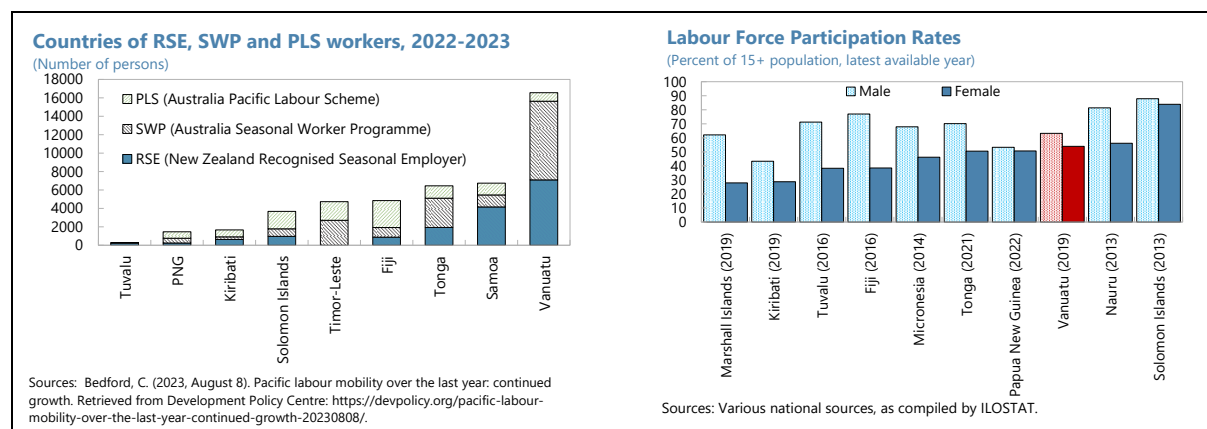
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<sup>31</sup> Preliminary results show that sea-level rise costs around 0.8 percent of GDP annually without planned adaptation. Complete protection of coastal areas can reduce average losses by approximately 50 percent, but it is expensive, with an estimated annual average cost of around 5.3 percent of GDP. However, a positive finding is that given the mountainous nature of the islands, only small areas of the main population centers of Port Vila and Luganville are at risk of being permanently inundated. Planned retreat from areas at risk of inundation is estimated to cost 0.16 percent of GDP annually on average.

<sup>32</sup> To fill the labor gaps, employers in Vanuatu have temporarily sought foreign workers under the Emergency Employment, which allows at least 1,500 foreign workers into the country to work for a year. However, the take-up has been quite slow with only 172 visas have been issued as of January 2024 (Judge, December 2023).

<sup>33</sup> Based on the Vanuatu Private Sector Economic Update 2023, a few firms reported that they had slightly reduced working hours and staff numbers in response to the minimum wage increase.

<sup>34</sup> The reviews cover the 2007 Seasonal Employment Act and the 2019 National Labor Mobility Policy.



## Authorities' Views

**31. Structural issues remain high priority for the authorities.** The authorities acknowledged repeated delays in passing the GBE Act and aim to pass it this year to strengthen the management and monitoring of Vanuatu's state-owned enterprises. On climate, the authorities acknowledged that lack of technical capacity and onerous requirements to access climate funding hinder project implementation. They noted that proper enforcement of building codes, strengthening climate risk screening and assessment of projects, and enhancing the resilience of infrastructure need to be prioritized. On labor issues, the authorities observed that coordinated efforts are needed to effectively address the current labor and skills shortages. They agreed that investing in quality education and skills training, including expanding the domestic pool of workers, are crucial solutions. Improving the ease of doing business is also essential for private sector growth and job creation. Reintegration programs should help returned seasonal workers to establish entrepreneurial activities in the local economy.

## CAPACITY DEVELOPMENT INTEGRATION AND DATA ISSUES

**32. Technical assistance (TA) needs remain critical on many areas.** Earlier and ongoing TA administered on financial supervision and regulation, national accounts statistics, and government finance (see Table 8) were much needed and have positive effect on boosting and building capacity. The authorities continue to examine additional needs and have expressed interest in assistance with examining the vatu basket of currencies, revenue administration, and additional financial sector supervision.<sup>35</sup>

**33. The Data Adequacy Assessment (DAA) reveals that data provided to the Fund have some shortcomings that somewhat hamper surveillance.** Annex VIII describes the data quality issues on national accounts, balance of payments, fiscal accounts and statistics that somewhat

<sup>35</sup> Vanuatu is assisted by many development partners and benefits from a Joint Policy Reforms Group that discusses, among other topics, technical assistance for reforms.

impede timely surveillance. Ongoing technical assistance (TA) programs from STA, ICD, and PFTAC are addressing some of these issues, which should help improve data quality in the future.

## STAFF APPRAISAL

**34. The voluntary liquidation of Air Vanuatu in May 2024 is a major shock with significant growth spillovers.** The channels of transmission of the liquidation to the economy are far-reaching and they affect output directly and indirectly. The loss of connectivity is triggering a decline in tourism with a direct impact on the services sector and is likely to limit the availability and mobility of labor and cargo networks that affects the industry sector. Given the breadth of the disruption, the loss of air connectivity is expected to have significant adverse spillovers (i.e., further indirect effects) into most sectors of production, and cause a severe impact on domestic demand and net exports. It is positive that multiple carriers have increased, or will, increase air travel capacity on some routes, partially mitigating the impact of the disruption, but disruptions will likely persist in 2024.

**35. Real GDP growth is expected to decelerate markedly in 2024.** The fiscal deficit is envisaged to deteriorate in 2024 given reduced revenues and elevated current spending related to the one-off estimated resolution costs and contingent liabilities of the airline. Modest social transfers and support to the economy through 2024 also contribute to the deficit. Capital expenditure is likely to decline as the Government reprioritizes spending due to limited fiscal space.

**36. The balance of risks is tilted to the downside.** A key risk is related to a protracted or failed resolution of Air Vanuatu that could severely deepen the economic shock. In addition, large fiscal costs related to the liquidation of Air Vanuatu would complicate debt sustainability. Other major domestic sources of downside risks include labor disruptions (relating to strikes) and skill shortages, political instability, and weak governance and corruption. On the external front, geopolitical tensions, and trade fragmentation, including slowdown in trading partners could also hamper growth and foster further terms of trade (and price) shocks. Natural disasters remain a key risk.

**37. Stronger revenue mobilization and consolidation efforts to rebuild fiscal buffers are crucial.** ECP revenues have declined significantly, and the recent decision by the EU Commission to permanently remove visa-free travel for Vanuatu passport holders may further erode interest in the program. Given the limited revenue sources, Government should aim for better VAT collection, and continue to explore new revenue measures, for example, via income tax and capital gains tax, fisheries licenses, higher VAT rates, and a widening of the tax base. To ensure that expenditures do not spiral out of control in the near term, spending prioritization and reallocation will be needed. This will require commensurate cuts in non-priority spending; any interim spending measures currently envisaged—such as increases to public employee compensation and allowances—should be paused.

**38. Urgent fiscal consolidation is needed to reduce sustainability concerns; re-establishing the fiscal anchor would further help ensure debt sustainability.** Ambitious fiscal consolidation should initiate in 2025—and be sustained decisively over the medium term to address heightened risks to debt sustainability. Defining a fiscal anchor that is clearly linked to securing debt sustainability and adhering to it is critical—the overall deficit and/or the primary balance are

possible options. Adherence to the principles of responsible public financial management such as reliable and realistic forecasting, compliance with the PFEM Act and greater accountability in all parts of government public finances, including auditing, are essential. Capacity development in improving data quality, monitoring, and implementation can help achieve these objectives.

**39. Improving governance and reducing vulnerabilities to corruption remain a priority.** Air Vanuatu's liquidation highlights the risks associated with the opacity of SOE administration in Vanuatu. Enhancing anti-corruption frameworks and the transparency and supervision of SOEs is crucial to help reduce corruption vulnerabilities and fiscal risks. To that end, there is a need to strengthen management and monitoring of SOEs and achieve greater transparency of the contingent liabilities to the government. Effective financial integrity measures are also needed to address ongoing pressures on correspondent banking relationships, risks from crypto asset activities, and structural weaknesses in the ECP.

**40. Monetary policy remains appropriately accommodative, but fiscal dominance needs to be reduced and caution is needed for the external sector.** In the near term, the most urgent priority is the need for effective liquidity management, and a better coordination with debt policy. However, fiscal dominance is rendering monetary policy, in particular OMOs, ineffective in reducing liquidity. Fiscal consolidation entails an opportunity for the RBV to reduce its exposure and lower its holdings of government debt over the medium term, with the objective to stop monetary financing. The external position in 2023 was moderately stronger than the level implied by fundamentals and desirable policies, but given the anticipated decline in exports (tourism) and foreign receipts (ECP) in 2024 there is a need to improve exports, enhance productivity and rebuild fiscal buffers.

**41. Enhancing safeguards against financial vulnerabilities is essential.** The financial sector appears broadly stable, but non-performing loans (NPLs) are high. The large sovereign-financial sector nexus, reflected in the significant holdings of Government liabilities by state-owned entities, can amplify financial stability risks. Improving the supervisory function, including increasing loan-loss provisioning for impaired loans, and enhancing capital requirements could encourage banks to accumulate additional buffers. In addition, improving loan recovery (including through improved legal processes) and realizing losses on nonperforming assets can help banks strengthen their balance sheet. The authorities' intended enhancements to the credit reporting bureau can also yield better lending decisions and lower future NPLs. Greater efforts are also needed to improve the regulatory and supervisory capacity and practices and reinstate regular on-site inspections.

**42. The authorities need to accelerate efforts to address structural challenges such as labor shortages and skills drain, and growing climate risks.** Development partner-funded investment in quality education and skills development through targeted technical and vocational trainings should help deliver productivity gains and long-term growth. Policies aimed at promoting a conducive business environment for investment, entrepreneurship and job creation also need to be expedited. Climate investment needs should be integrated into the medium-term fiscal strategy, with the adequate prioritization of projects given financial and capacity constraints.

**43. It is recommended that the next Article IV Consultation takes place on the standard 12-month cycle.**

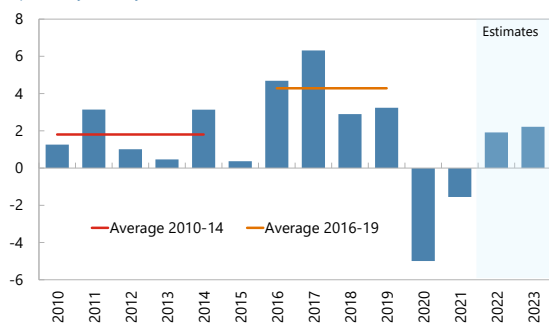


**Figure 1. Vanuatu: Real Sector Developments**

Before Air Vanuatu liquidation, Vanuatu recovered from the pandemic GDP contraction...

**Real GDP Growth, 2006-23**

(In percent, year-on-year)

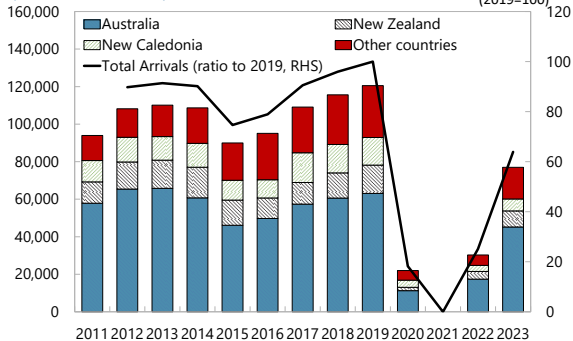


Sources: Authorities; and IMF staff estimates.

... and a recovery in the tourism sector, although it will slow down significantly in 2024.

**Tourist Arrivals by Key Source Markets**

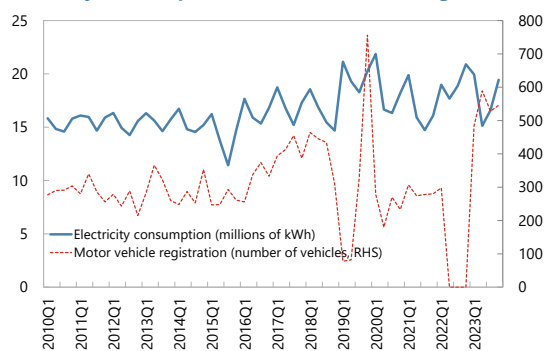
(Annual Visitor Arrivals)



Source: Vanuatu Authorities.

Economic indicators are stagnant...

**Electricity Consumption and Motor Vehicle Registration**

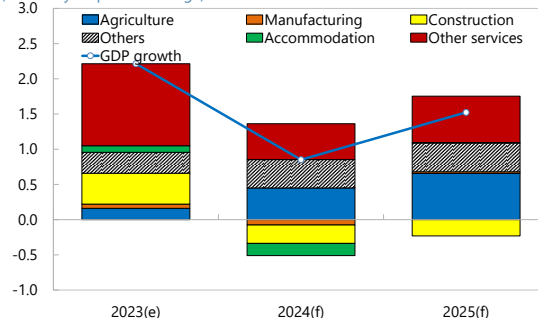


Source: Vanuatu authorities.

... mostly through a large impulse in services, ...

**GDP Growth and Decomposition**

(Year-on-year percent change)



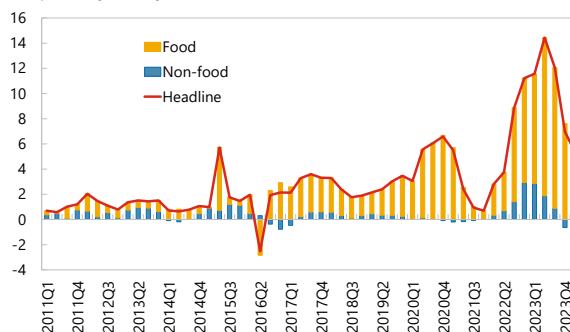
Sources: Vanuatu Bureau of Statistics; and IMF staff estimates.

Notes: Others includes Mining & Quarrying, and Electricity & Water Supply.

Inflation spiked trough 2023 driven by external shocks, but it recently started to decelerate.

**Headline Inflation**

(In percent, year-on-year)

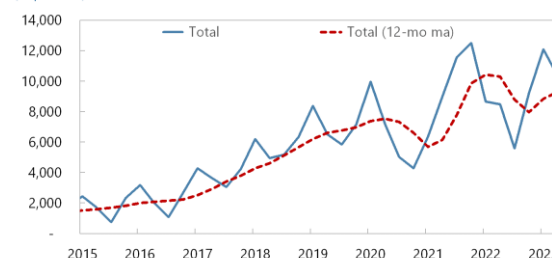


Sources: VBoS; and IMF staff calculations.

...and labor shortages due to increased participation in seasonal worker programs could pose challenges to sustained economic growth.

**Participation in RSE, SWP and PLS Schemes**

(In persons)



Source: Vanuatu authorities.

RSE - Recognised Seasonal Employer (New Zealand).

SWP-Seasonal Worker Programme (Australia); PLS-Pacific Labor Scheme (Australia).

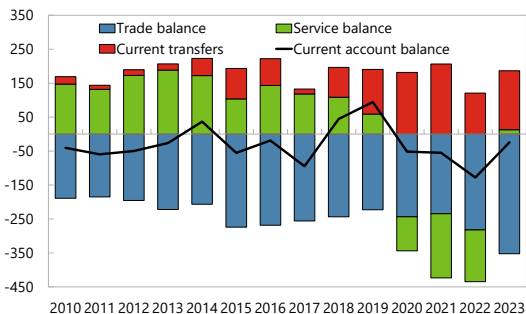


**Figure 2. Vanuatu: External Sector Developments**

*The current account deficit narrowed in 2023 supported by tourism receipts, grants, and remittances*

**Current Account**

(In millions of US dollars)

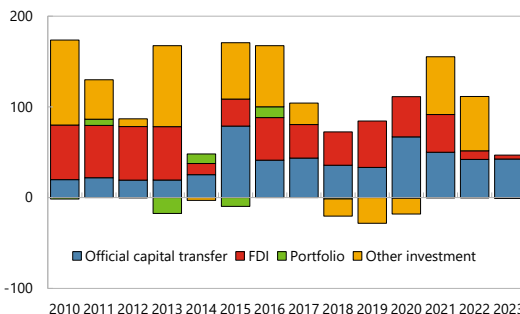


Sources: Vanuatu authorities; and IMF staff calculations.

*Capital transfers and FDI fell in 2023*

**Capital and Financial Accounts**

(In millions of US dollars)

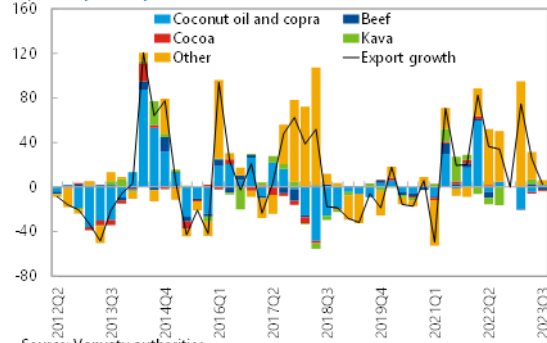


Sources: Vanuatu authorities; and IMF staff calculations.

*Exports have fallen sharply due to the impact of the twin cyclones in early 2023 on agricultural production*

**Export Growth**

(In percent, year-on-year)

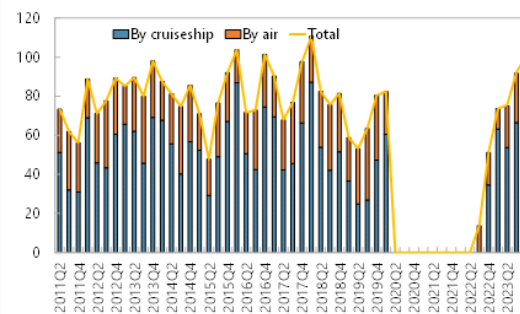


Source: Vanuatu authorities.

*Tourism is recovering since borders reopened, but will stall given the liquidation of Air Vanuatu*

**Tourist Arrivals**

(In thousands of persons)

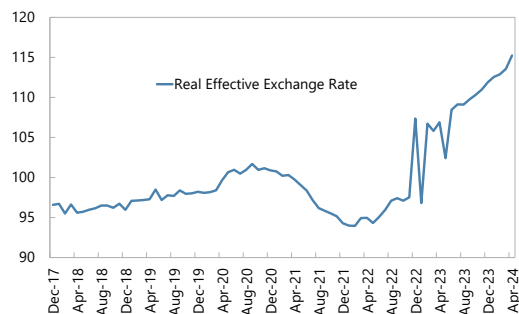


Source: Vanuatu authorities.

*The real effective exchange rate appreciated in 2023 due to nominal exchange rate appreciation*

**Real Effective Exchange Rate**

(Index 2010=100)

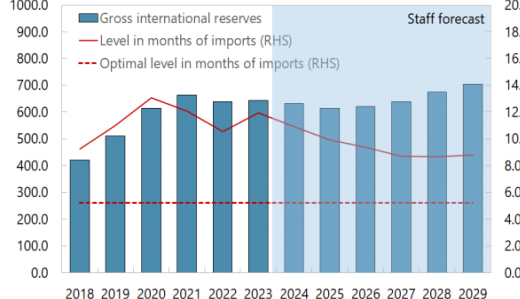


Sources: Vanuatu authorities; and IMF staff calculations.

*Reserves expected to remain adequate driven by gradual recovery of tourism receipts and remittances*

**Official Foreign Exchange Reserves**

(In millions of U.S. dollars)



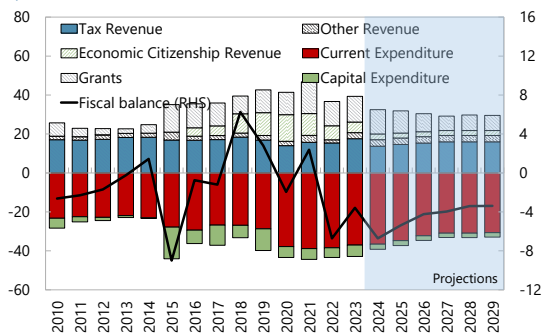
Sources: Vanuatu authorities; and IMF staff estimates.

**Figure 3. Vanuatu: Fiscal and Monetary Sector Developments**

*The fiscal deficit is expected to remain large...*

**Fiscal Revenue and Expenditure**

(In percent of GDP)

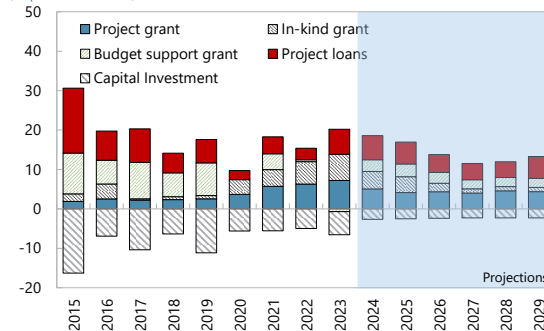


Sources: Vanuatu authorities; and IMF staff calculations.

*...on the back of strong capex spending and lower grants.*

**Capital Spending and External Financing**

(In percent of GDP)

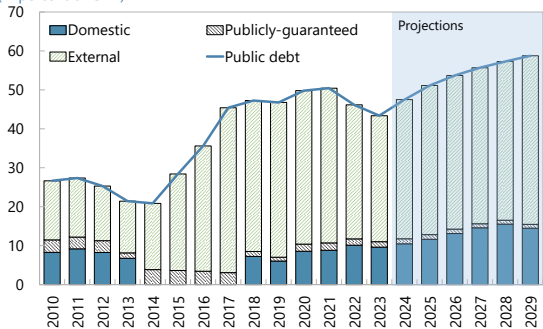


Sources: Vanuatu authorities; and IMF staff estimates.

*Public debt levels are expected to climb, posing risks to debt sustainability.*

**Public and Publicly-guaranteed Debt**

(In percent of GDP)

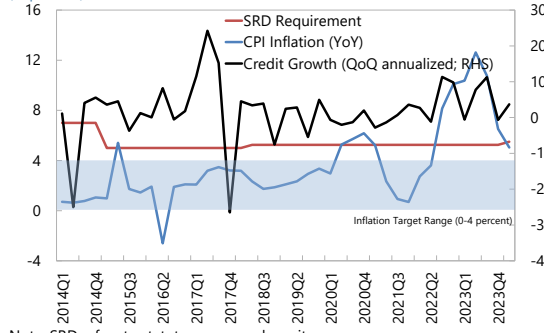


Sources: Vanuatu authorities; and IMF staff estimates.

*The RBV has increased the SRD with the objective of controlling inflation.*

**SRD Requirement, Inflation and Credit Growth**

(In percent)

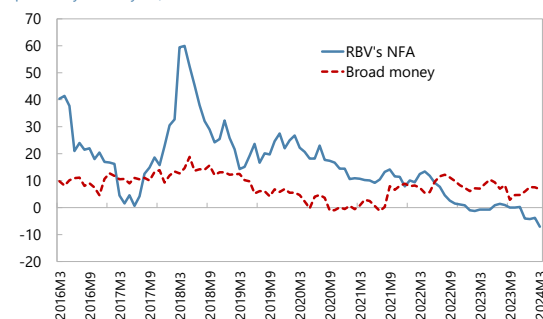


Note: SRD refers to statutory reserve deposit. Source: Vanuatu authorities.

*Money supply has fallen and foreign inflows are also decreasing.*

**RBV's NFA and Money Supply Growth**

(In percent, year-on-year)

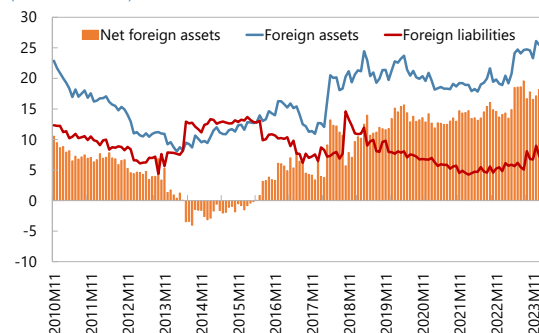


Source: Vanuatu authorities.

*Net foreign assets of commercial banks are stable, through increasing asset positions.*

**Banks' Foreign Assets and Liabilities**

(In billions of vatu)



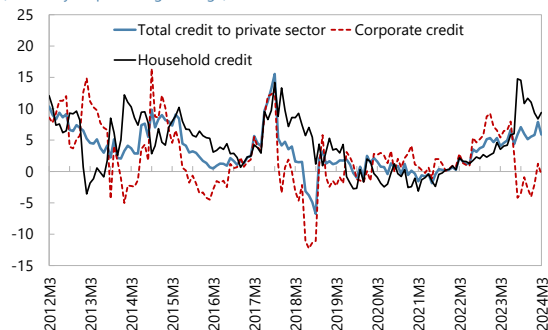
Source: Vanuatu authorities.

**Figure 4. Vanuatu: Financial Sector Developments**

*Private credit growth is decelerating, specially to households...*

**Private Credit Growth**

(Year-on-year percentage change)

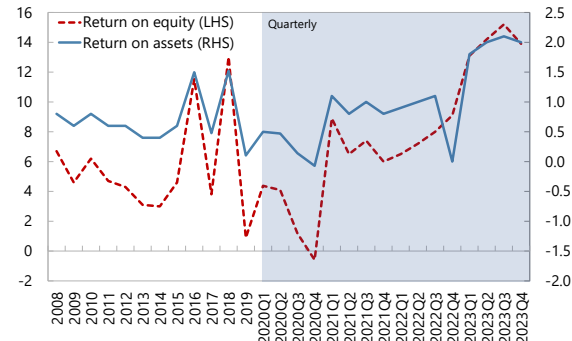


Source: Vanuatu authorities.

*... and banking sector remains profitable.*

**Bank Profitability**

(In percent)

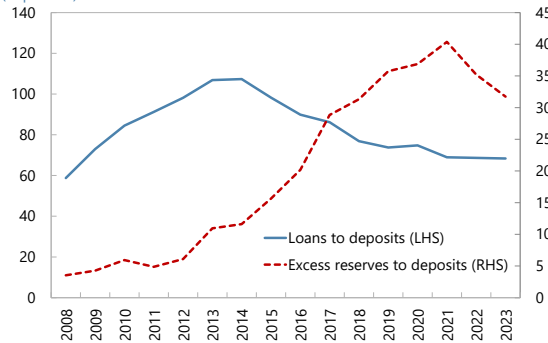


Source: Vanuatu authorities.

*Overall liquid with respect to its funding...*

**Loan-to-Deposit and Excess Reserve Ratio**

(In percent)

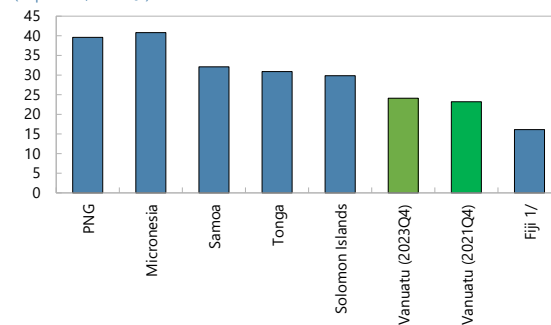


Sources: Vanuatu authorities; and IMF staff calculations.

*... and adequately capitalized.*

**Capital Adequacy Ratio**

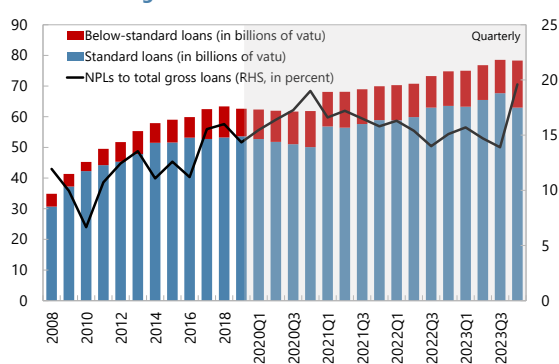
(In percent, 2023Q4)



Sources: Country authorities; and IMF staff calculations.

*Bank asset quality has further deteriorated and NPL's remain high.*

**Non-Performing Loans**

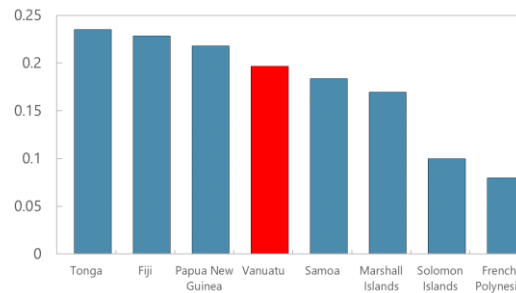


Source: Vanuatu authorities.

*Financial access of households is moderately high compared to its peers.*

**Financial Development Index, 2021**

(Relative ranking of countries on access, depth and efficiency of financial institutions and markets)



Source: IMF Financial Development Index Database.

**Table 1. Vanuatu: Selected Economic Indicators, 2020–29**

Population (2021): 312,039  
 IMF quota: SDR 23.8 million (0.01 percent of total)  
 Main products and exports: Kava, coconut oil, copra, cocoa, beef  
 Key export markets: New Caledonia, Australia, New Zealand

Per Capita GDP (2021): US\$ 2,952  
 Literacy rate (2018): 87.5 percent

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Estimate	Forecast				
<b>Output and prices (annual percent change)</b>										
Real GDP	-5.0	-1.6	1.9	2.2	0.9	1.5	2.1	2.5	2.0	2.0
Consumer prices (period average)	5.3	2.3	6.7	11.2	4.2	2.8	2.1	2.0	2.0	2.0
Consumer prices (end period)	6.6	0.7	11.2	7.0	3.2	2.3	2.0	2.0	2.0	2.0
<b>Government finance (in percent of GDP)</b>										
Total revenue	41.4	46.8	36.7	39.3	32.5	31.9	30.4	29.2	29.8	29.6
Taxes	14.0	15.7	15.4	17.6	13.8	14.6	15.4	16.0	16.0	16.0
Other revenue	15.9	14.8	8.8	8.6	6.2	5.8	5.8	5.8	5.8	5.8
Grants	11.5	16.3	12.5	13.2	12.5	11.4	9.3	7.4	8.0	7.8
Expenditure	43.4	44.4	43.4	42.9	39.2	37.3	34.7	33.2	33.2	32.9
Expense	37.8	38.8	38.4	37.0	36.6	34.8	32.3	30.9	30.9	30.7
Net acquisition of non financial assets	5.6	5.5	5.0	5.9	2.6	2.5	2.4	2.3	2.3	2.3
Net lending (+)/borrowing (-)	-1.9	2.4	-6.7	-3.6	-6.7	-5.4	-4.2	-4.0	-3.4	-3.4
Public and publicly-guaranteed debt (end of period)	48.9	49.5	45.3	42.6	46.7	50.5	53.3	55.4	57.1	58.7
Domestic	8.6	8.8	10.1	9.7	10.5	11.8	13.4	15.0	16.0	15.1
External	40.4	40.7	35.2	33.0	36.3	38.8	39.9	40.4	41.1	43.7
<b>Money and credit (annual percentage change)</b>										
Broad money (M2)	5.3	14.2	5.6	-0.8	3.7	8.0	10.5	9.6	9.3	5.8
Net foreign assets	12.1	7.8	-0.1	0.8	2.3	7.4	10.4	9.0	9.5	7.4
Domestic credit	-11.7	7.0	21.4	11.9	3.6	4.5	5.4	5.8	4.6	0.7
Of which: Credit to private sector	-0.5	0.3	6.1	5.9	0.9	0.9	0.9	1.2	1.3	1.4
<b>Interest rates (in percent, end of period) 1/</b>										
Deposit rate (vatu deposits)	0.7	0.5	0.4	0.4	...	...	...	...	...	...
Lending rate (vatu loans)	9.5	9.4	9.0	8.8	...	...	...	...	...	...
<b>Balance of payments (in percent of GDP)</b>										
Current account	-5.1	-6.0	-12.3	-2.2	-7.4	-6.5	-4.6	-4.2	-4.0	-4.4
Trade balance	-24.2	-25.5	-27.2	-31.4	-25.9	-28.2	-29.3	-30.3	-33.2	-34.3
Exports of goods	5.1	5.7	7.1	5.5	5.2	5.3	5.3	5.4	5.5	5.5
Imports of goods	29.2	31.1	34.3	36.9	31.1	33.6	34.6	35.7	38.7	39.8
Travel receipts	6.2	0.2	3.9	14.2	3.5	5.8	11.1	14.6	18.2	19.6
Gross Remittances	13.3	20.6	18.4	13.5	14.8	15.4	15.2	14.8	14.5	14.2
Capital and financial account	10.9	17.8	11.9	4.6	6.4	4.9	5.3	5.4	6.7	6.5
Of which: Foreign direct investment	4.4	4.5	0.9	0.4	3.4	3.6	3.8	3.8	3.7	3.5
Overall balance	10.1	5.5	-2.5	0.5	-0.9	-1.6	0.7	1.3	2.6	2.1
Gross international reserves (in millions of U.S. dollars)	614	665	639	644	633	613	622	639	675	705
Gross international reserves (in months of prospective G&S imports)	13.1	12.1	10.6	12.0	10.9	9.9	9.4	8.7	8.6	8.8
External debt service (in percent of GNFS exports)	7.7	16.9	40.7	26.7	13.0	10.7	11.4	9.9	8.5	7.3
<b>Exchange rates 2/</b>										
Vatu per U.S. dollar (period average)	104.1	112.9	113.5	114.8	...	...	...	...	...	...
Vatu per U.S. dollar (end of period)	107.7	112.2	114.8	114.8	...	...	...	...	...	...
<b>Memorandum items:</b>										
Nominal GDP (in millions of U.S. dollars)	1,008	921	1,039	1,123	1,169	1,214	1,265	1,323	1,377	1,433
GDP per capita (U.S. dollars)	3,341	2,952	3,219	3,365	3,387	3,401	3,426	3,464	3,486	3,508

Sources: Vanuatu authorities; and IMF staff estimates and projections.

1/ Weighted average rate of interest for total bank deposits and loans.

2/ The vatu is officially pegged to an undisclosed basket of currencies.

**Table 2 Vanuatu: Central Government Budgetary Operations, 2020–29<sup>1/</sup>**  
(In millions of Vatu)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
				Estimate			Forecast			
<b>Total revenue</b>	<b>43,471</b>	<b>48,652</b>	<b>43,260</b>	<b>50,689</b>	<b>43,612</b>	<b>44,430</b>	<b>44,193</b>	<b>44,343</b>	<b>47,062</b>	<b>48,630</b>
Domestic revenue	31,399	31,718	28,561	33,703	26,858	28,528	30,744	33,085	34,455	35,861
Taxes	14,732	16,336	18,201	22,677	18,498	20,405	22,293	24,261	25,251	26,282
Taxes on property	496	468	443	494	980	1,018	1,061	1,109	1,154	1,202
Taxes on goods and services	11,097	11,906	13,862	17,439	14,476	15,925	17,278	18,819	19,587	20,387
VAT	6,496	7,297	9,112	10,504	9,886	10,759	11,748	12,874	13,399	13,946
Excise	2,593	3,073	2,626	4,059	2,602	2,962	3,235	3,545	3,689	3,840
Other	2,008	1,535	2,124	2,876	1,987	2,203	2,295	2,401	2,499	2,601
Taxes on international trade	3,140	3,962	3,896	4,744	3,042	3,462	3,954	4,333	4,510	4,694
Other revenue	16,667	15,382	10,361	11,026	8,360	8,123	8,451	8,824	9,203	9,579
<i>Of which: Economic citizenship programs</i>	14,352	11,647	8,482	7,004	3,936	3,530	3,665	3,819	3,994	4,157
Grants from development partners <sup>2/</sup>	12,072	16,934	14,699	16,986	16,755	15,901	13,449	11,257	12,607	12,769
Infrastructure projects grants	3,874	5,966	7,446	9,330	6,813	5,795	6,337	6,130	7,271	7,215
Budget support and social program	-157	4,180	555	-875	4,000	4,500	4,000	3,500	3,643	3,792
In kind aid	3,928	4,400	6,698	8,532	5,942	5,607	3,112	1,627	1,694	1,763
<b>Expenditure</b>	<b>45,514</b>	<b>46,175</b>	<b>51,175</b>	<b>55,309</b>	<b>52,633</b>	<b>51,934</b>	<b>50,338</b>	<b>50,363</b>	<b>52,450</b>	<b>54,194</b>
Current Expenditure <sup>3/</sup>	39,645	40,411	45,315	47,730	49,106	48,449	46,881	46,921	48,867	50,465
Compensation of employees	15,471	16,796	17,583	17,590	18,314	18,857	19,622	20,443	21,336	22,184
Use of goods and services	9,810	10,574	11,990	12,000	12,494	12,973	13,517	14,136	14,713	15,314
Interest payment	863	1,005	1,033	1,263	1,323	1,620	1,840	2,120	2,470	2,733
Subsidies	1,510	422	330	114	980	1,461	786	426	339	353
Grants by central government	4,646	4,574	4,147	5,228	5,154	4,611	4,746	4,963	5,166	5,376
Social benefits	1,315	500	1,296	1,167	1,799	1,058	997	943	887	480
Other expense <sup>2/</sup>	6,030	6,540	8,936	10,368	9,044	7,869	5,374	3,889	3,956	4,025
Acquisition of nonfinancial assets <sup>3/</sup>	5,869	5,764	5,860	7,579	3,526	3,485	3,457	3,443	3,583	3,729
<b>Gross operating balance <sup>4/</sup></b>	<b>3,826</b>	<b>8,240</b>	<b>-2,055</b>	<b>2,959</b>	<b>-5,494</b>	<b>-4,019</b>	<b>-2,689</b>	<b>-2,578</b>	<b>-1,804</b>	<b>-1,835</b>
<b>Net lending (+)/borrowing (-)</b>	<b>-2,043</b>	<b>2,476</b>	<b>-7,915</b>	<b>-4,620</b>	<b>-9,020</b>	<b>-7,505</b>	<b>-6,146</b>	<b>-6,021</b>	<b>-5,388</b>	<b>-5,564</b>
Net acquisition of financial assets	589	3,640	-5,994	71	-934	66	566	566	566	566
Net incurrence of liabilities	2,646	1,265	1,921	4,691	8,087	7,571	6,712	6,587	5,954	6,130
Domestic	2,448	137	2,743	546	1,656	2,330	3,035	3,277	2,570	-490
Foreign	198	1,128	-822	4,145	6,430	5,241	3,677	3,310	3,384	6,620
<b>Memorandum items:</b>										
Public and publicly-guaranteed debt	51,326	51,473	53,420	54,914	62,742	70,437	77,349	84,136	90,290	96,620
Domestic	8,039	8,176	10,919	11,465	13,122	15,451	18,486	21,764	24,334	23,844
Publicly guaranteed	935	984	1,010	1,010	1,010	1,010	1,010	1,010	1,010	1,010
External	42,352	42,313	41,491	42,503	48,674	54,040	57,917	61,426	65,010	71,830
Debt service	4,529	5,269	6,406	6,429	3,824	4,950	4,724	5,281	5,710	9,532
External debt service	2,734	3,853	4,734	4,550	2,310	2,949	3,447	3,549	3,591	3,211
Primary balance	-1,180	3,481	-6,882	-3,357	-7,698	-5,884	-4,306	-3,901	-2,918	-2,831

Sources: Vanuatu authorities; and IMF staff estimates and projections.

1/ Fiscal year corresponds to the calendar year.

2/ Includes aid in kind; the large decline between 2022 and 2023 reflects the reduction in COVID-related aid in kind.

For 2024 and beyond, this item includes estimated expenses related to the restructuring costs for Air Vanuatu and resuming domestic operations.

3/ Does not include consumption of fixed capital (depreciation).

4/ Gross operating balance is used instead of net, as there is no data on consumption of fixed capital (depreciation).

**Table 3. Vanuatu: Central Government Budgetary Operations, 2020–29<sup>1/</sup>**  
(In percent of GDP)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
				Estimate			Forecast			
<b>Total revenue</b>	<b>41.4</b>	<b>46.8</b>	<b>36.7</b>	<b>39.3</b>	<b>32.5</b>	<b>31.9</b>	<b>30.4</b>	<b>29.2</b>	<b>29.8</b>	<b>29.6</b>
Domestic revenue	29.9	30.5	24.2	26.1	20.0	20.5	21.2	21.8	21.8	21.8
Taxes	14.0	15.7	15.4	17.6	13.8	14.6	15.4	16.0	16.0	16.0
Taxes on property	0.5	0.4	0.4	0.4	0.7	0.7	0.7	0.7	0.7	0.7
Taxes on goods and services	10.6	11.4	11.8	13.5	10.8	11.4	11.9	12.4	12.4	12.4
VAT	6.2	7.0	7.7	8.1	7.4	7.7	8.1	8.5	8.5	8.5
Excise	2.5	3.0	2.2	3.1	1.9	2.1	2.2	2.3	2.3	2.3
Other	1.9	1.5	1.8	2.2	1.5	1.6	1.6	1.6	1.6	1.6
Taxes on international trade	3.0	3.8	3.3	3.7	2.3	2.5	2.7	2.9	2.9	2.9
Other revenue	15.9	14.8	8.8	8.6	6.2	5.8	5.8	5.8	5.8	5.8
Of which: Economic citizenship programs	13.7	11.2	7.2	5.4	2.9	2.5	2.5	2.5	2.5	2.5
Grants from development partners	11.5	16.3	12.5	13.2	12.5	11.4	9.3	7.4	8.0	7.8
Infrastructure projects grants	3.7	5.7	6.3	7.2	5.1	4.2	4.4	4.0	4.6	4.4
Budget support and social program	-0.1	4.0	0.5	-0.7	3.0	3.2	2.8	2.3	2.3	2.3
In kind aid	3.7	4.2	5.7	6.6	4.4	4.0	2.1	1.1	1.1	1.1
<b>Expenditure</b>	<b>43.4</b>	<b>44.4</b>	<b>43.4</b>	<b>42.9</b>	<b>39.2</b>	<b>37.3</b>	<b>34.7</b>	<b>33.2</b>	<b>33.2</b>	<b>32.9</b>
Current Expenditure <sup>3/</sup>	37.8	38.8	38.4	37.0	36.6	34.8	32.3	30.9	30.9	30.7
Compensation of employees	14.7	16.1	14.9	13.6	13.6	13.5	13.5	13.5	13.5	13.5
Use of goods and services	9.3	10.2	10.2	9.3	9.3	9.3	9.3	9.3	9.3	9.3
Interest payment	0.8	1.0	0.9	1.0	1.0	1.2	1.3	1.4	1.6	1.7
Subsidies	1.4	0.4	0.3	0.1	0.7	1.0	0.5	0.3	0.2	0.2
Grants by central government	4.4	4.4	3.5	4.1	3.8	3.3	3.3	3.3	3.3	3.3
Social benefits	1.3	0.5	1.1	0.9	1.3	0.8	0.7	0.6	0.6	0.3
Other expense <sup>2/</sup>	5.7	6.3	7.6	8.0	6.7	5.6	3.7	2.6	2.5	2.4
Acquisition of nonfinancial assets <sup>3/</sup>	5.6	5.5	5.0	5.9	2.6	2.5	2.4	2.3	2.3	2.3
<b>Gross operating balance <sup>4/</sup></b>	<b>3.6</b>	<b>7.9</b>	<b>-1.7</b>	<b>2.3</b>	<b>-4.1</b>	<b>-2.9</b>	<b>-1.9</b>	<b>-1.7</b>	<b>-1.1</b>	<b>-1.1</b>
<b>Net lending (+)/borrowing (-)</b>	<b>-1.9</b>	<b>2.4</b>	<b>-6.7</b>	<b>-3.6</b>	<b>-6.7</b>	<b>-5.4</b>	<b>-4.2</b>	<b>-4.0</b>	<b>-3.4</b>	<b>-3.4</b>
Net acquisition of financial assets	0.6	3.5	-5.1	0.1	-0.7	0.0	0.4	0.4	0.4	0.3
Net incurrence of liabilities	2.5	1.2	1.6	3.6	6.0	5.4	4.6	4.3	3.8	3.7
<b>Memorandum items:</b>										
Public and publicly-guaranteed debt	48.9	49.5	45.3	42.6	46.7	50.5	53.3	55.4	57.1	58.7
Domestic	8.6	8.8	10.1	9.7	10.5	11.8	13.4	15.0	16.0	15.1
External	40.4	40.7	35.2	33.0	36.3	38.8	39.9	40.4	41.1	43.7
Of which: RCF/RFI	0.6	0.5	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Debt service	4.3	5.1	5.4	5.0	2.8	3.6	3.3	3.5	3.6	5.8
Of which: External debt service	2.6	3.7	4.0	3.5	1.7	2.1	2.4	2.3	2.3	2.0
Primary balance	-1.1	3.3	-5.8	-2.6	-5.7	-4.2	-3.0	-2.6	-1.8	-1.7
Nominal GDP (millions of vatu)	104,929	104,023	117,917	128,931	134,236	139,386	145,229	151,883	158,082	164,535

Sources: Vanuatu authorities; and IMF staff estimates and projections.

1/ Fiscal year corresponds to the calendar year.

2/ Includes aid in kind; the large decline between 2022 and 2023 reflects the reduction in COVID-related aid in kind.

For 2024 and beyond, this item includes estimated expenses related to the restructuring costs for Air Vanuatu and resuming domestic operations.

3/ Does not include consumption of fixed capital (depreciation).

4/ Gross operating balance is used instead of net, as there is no data on consumption of fixed capital (depreciation).

Table 4. Vanuatu: Monetary Survey, 2020–25

	2020	2021	2022	2023	2024	2025
					Forecast	
(In millions of vatu; end of period)						
<b>Net foreign assets</b>	81,243	87,579	87,509	88,167	90,192	96,880
Monetary authorities	68,385	73,245	73,830	71,021	69,769	67,507
Commercial banks	12,858	14,334	13,679	17,146	20,423	29,373
<b>Net domestic assets</b>	15,911	23,367	29,679	28,048	30,302	33,235
Domestic credit	43,046	46,064	55,930	62,596	64,850	67,783
Claims on government (net)	-21,116	-18,501	-12,482	-10,036	-8,380	-6,050
Claims on municipalities	34	29	30	33	33	33
Claims on other sectors	64,128	64,535	68,382	72,599	73,197	73,800
Claims on nonfinancial public enterprises	949	1,141	1,148	1,421	1,400	1,378
Claims on private sector	63,179	63,395	67,234	71,177	71,797	66,738
Other items (net)	-27,135	-22,696	-26,251	-34,548	-34,548	-34,548
<b>Total broad money (M2)</b>	97,154	110,946	117,188	116,215	120,494	136,572
Narrow money	51,095	59,205	67,519	73,920	81,692	98,831
Currency outside banks	10,384	11,333	13,553	14,359	11,457	16,009
Demand deposits	40,711	47,872	53,965	59,560	70,234	82,821
Quasi-money	46,059	51,741	49,669	42,295	38,802	31,285
(Annual percentage change, unless otherwise indicated)						
<b>Net foreign assets</b>	12.1	7.8	-0.1	0.8	2.3	7.4
<b>Net domestic assets</b>	12.7	7.1	0.8	-3.8	-1.8	-3.2
Domestic credit	-11.7	7.0	21.4	11.9	3.6	4.5
Credit to the economy	-0.7	0.6	6.0	6.2	0.8	0.8
Private sector credit	-0.5	0.3	6.1	5.9	0.9	-7.0
<b>Total broad money</b>	5.3	14.2	5.6	-0.8	3.7	13.3
<b>Vatu broad money</b>	7.2	10.3	9.7	2.9	15.9	12.9
<b>Memorandum items:</b>						
Vatu broad money multiplier	1.4	1.3	1.3	1.2	1.2	1.2
Total broad money multiplier	1.9	1.9	1.7	1.6	1.5	1.4
Velocity						
Narrow money	2.2	1.9	1.9	1.8	1.7	1.5
Vatu broad money	1.5	1.4	1.4	1.5	1.4	1.3
Total broad money	1.1	1.0	1.0	1.1	1.1	1.1
Reserve money (in millions of vatu)	48,463	55,759	57,101	56,892	56,203	54,675
Reserve money (annual percentage change)	2.9	15.1	2.4	-0.4	-1.2	-2.7
Credit to private sector (in percent of GDP)	60.2	60.9	57.0	55.2	53.5	47.9
Foreign currency deposits (annual percentage change)	5.8	60.9	-14.3	-4.9	43.7	-19.4
Foreign currency deposits/total deposits (percent)	11.3	15.8	13.0	12.6	16.9	13.0
Foreign currency credit/total credit (percent)	28.4	27.5	27.5	27.5	27.5	27.5
Net foreign assets of banks (in millions of U.S. dollars)	119.4	127.8	119.2	149.4	177.9	255.9
Net foreign assets (in percent of GDP)	77.4	84.2	74.2	68.4	67.2	69.5
Nominal GDP (in millions of vatu)	104,929	104,023	117,917	128,931	134,236	139,386

Sources: Vanuatu authorities, and IMF staff estimates and projections.

**Table 5. Vanuatu: Balance of Payments, 2020–29**  
(In percent of GDP, unless otherwise stated)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Est.	Forecast				
<b>Current account balance</b>	<b>-5.1</b>	<b>-6.0</b>	<b>-12.3</b>	<b>-2.2</b>	<b>-7.4</b>	<b>-6.5</b>	<b>-4.6</b>	<b>-4.2</b>	<b>-4.0</b>	<b>-4.4</b>
<b>Goods trade balance</b>	<b>-24.2</b>	<b>-25.5</b>	<b>-27.2</b>	<b>-31.4</b>	<b>-25.9</b>	<b>-28.2</b>	<b>-29.3</b>	<b>-30.3</b>	<b>-33.2</b>	<b>-34.3</b>
Exports of goods (f.o.b.)	5.1	5.7	7.1	5.5	5.2	5.3	5.3	5.4	5.5	5.5
Domestic exports	4.4	5.4	6.8	4.8	4.8	4.9	5.0	5.0	5.1	5.1
Re-exports	0.6	0.3	0.3	0.8	0.4	0.4	0.4	0.4	0.4	0.4
Imports of goods (f.o.b.)	29.2	31.1	34.3	36.9	31.1	33.6	34.6	35.7	38.7	39.8
<b>Services trade balance</b>	<b>-10.0</b>	<b>-20.5</b>	<b>-14.7</b>	<b>1.2</b>	<b>-7.1</b>	<b>-3.8</b>	<b>1.4</b>	<b>4.7</b>	<b>8.1</b>	<b>9.3</b>
Receipts	10.3	3.4	8.0	21.6	10.9	13.2	18.5	22.0	25.6	27.0
<i>Of which: travel</i>	6.2	0.2	3.9	14.2	3.5	5.8	11.1	14.6	18.2	19.6
Payments	20.3	24.0	22.6	20.4	18.0	17.0	17.1	17.2	17.5	17.7
<b>Primary income</b>	<b>11.0</b>	<b>17.6</b>	<b>17.9</b>	<b>12.6</b>	<b>14.0</b>	<b>14.5</b>	<b>14.2</b>	<b>13.7</b>	<b>13.3</b>	<b>12.8</b>
Receipts	14.8	21.9	20.5	15.3	16.7	17.4	17.2	16.8	16.4	16.1
Gross Remittances	13.3	20.6	18.4	13.5	14.8	15.4	15.2	14.8	14.5	14.2
Payments	3.9	4.3	2.6	2.7	2.8	2.9	3.0	3.1	3.2	3.3
<b>Secondary income</b>	<b>18.0</b>	<b>22.4</b>	<b>11.6</b>	<b>15.5</b>	<b>11.6</b>	<b>11.1</b>	<b>9.1</b>	<b>7.7</b>	<b>7.8</b>	<b>7.8</b>
Official	18.9	18.2	10.7	10.5	9.3	8.8	6.7	5.4	5.4	5.4
ECP Revenues	13.7	11.2	7.2	5.4	2.9	2.5	2.5	2.5	2.5	2.5
Private	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
<b>Capital and financial accounts</b>	<b>10.9</b>	<b>17.8</b>	<b>11.9</b>	<b>4.6</b>	<b>6.4</b>	<b>4.9</b>	<b>5.3</b>	<b>5.4</b>	<b>6.7</b>	<b>6.5</b>
<b>Capital account</b>	<b>8.3</b>	<b>6.4</b>	<b>5.2</b>	<b>4.3</b>	<b>5.6</b>	<b>4.7</b>	<b>4.8</b>	<b>4.5</b>	<b>5.0</b>	<b>4.8</b>
<i>Of which: Official capital transfers (net)</i>	6.6	5.4	4.1	3.8	5.1	4.2	4.4	4.0	4.6	4.4
<b>Financial account</b>	<b>2.6</b>	<b>11.4</b>	<b>6.7</b>	<b>0.3</b>	<b>0.8</b>	<b>0.2</b>	<b>0.4</b>	<b>0.9</b>	<b>1.6</b>	<b>1.7</b>
Foreign direct investment	4.4	4.5	0.9	0.4	3.4	3.6	3.8	3.8	3.7	3.5
Portfolio investment	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment	-1.7	6.9	5.8	0.0	-2.5	-3.3	-3.3	-2.9	-2.0	-1.8
<b>Net errors and omissions</b>	<b>4.3</b>	<b>-6.3</b>	<b>-2.1</b>	<b>-2.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Overall balance</b>	<b>10.1</b>	<b>5.5</b>	<b>-2.5</b>	<b>0.5</b>	<b>-0.9</b>	<b>-1.6</b>	<b>0.7</b>	<b>1.3</b>	<b>2.6</b>	<b>2.1</b>
<b>Financing:</b>	<b>-10.5</b>	<b>-5.8</b>	<b>2.3</b>	<b>-0.7</b>	<b>0.7</b>	<b>1.5</b>	<b>-0.7</b>	<b>-1.3</b>	<b>-2.6</b>	<b>-2.1</b>
Change in international reserves (- = increase)	-10.1	-5.5	2.5	-0.5	0.9	1.6	-0.7	-1.3	-2.6	-2.1
IMF RCF/RFI	-0.4	-0.3	-0.2	-0.2	-0.2	-0.1	0.0	0.0	0.0	0.0
<b>Memorandum items:</b>										
Gross international reserves	60.9	72.2	61.5	57.3	54.1	50.5	49.1	48.3	49.0	49.2
In months of prospective imports	13.1	12.1	10.6	12.0	10.9	9.9	9.4	8.7	8.6	8.8
Exports of goods (annual percentage change)	10.3	2.1	41.4	-15.4	-2.2	6.1	4.6	5.8	5.7	4.2
Imports of goods (annual percentage change)	9.5	-2.6	24.2	16.5	-12.4	12.2	7.5	7.9	12.7	7.0
Exchange rate (vatu per U.S. dollar, period average)	104.1	112.9	113.5	114.8	...	...	...	...	...	...
Exchange rate (vatu per U.S. dollar, end of period)	107.7	112.2	114.8	114.8	...	...	...	...	...	...
Public external debt	40.4	40.7	35.2	33.0	36.3	38.8	39.9	40.4	41.1	43.7
Public external debt service (percent of G&S exports)	16.9	40.7	26.7	13.0	10.7	11.4	9.9	8.5	7.3	6.0
Nominal GDP (in millions of U.S. dollars)	1,008	921	1,039	1,123	1,169	1,214	1,265	1,323	1,377	1,433

Sources: Vanuatu authorities; and IMF staff estimates and projections.



Table 6. Vanuatu: Medium-Term Baseline Scenario, 2020–29

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
			Estimates		Forecast					
<b>Output and prices (annual percentage change)</b>										
Real GDP	-5.0	-1.6	1.9	2.2	0.9	1.5	2.1	2.5	2.0	2.0
Consumer prices (period average)	5.3	2.3	6.7	11.2	4.2	2.8	2.1	2.0	2.0	2.0
Consumer prices (end period)	6.6	0.7	11.2	7.0	3.2	2.3	2.0	2.0	2.0	2.0
<b>Government finances (in percent of GDP)</b>										
Total revenue	41.4	46.8	36.7	39.3	32.5	31.9	30.4	29.2	29.8	29.6
Taxes	14.0	15.7	15.4	17.6	13.8	14.6	15.4	16.0	16.0	16.0
Other revenue	15.9	14.8	8.8	8.6	6.2	5.8	5.8	5.8	5.8	5.8
Grants	11.5	16.3	12.5	13.2	12.5	11.4	9.3	7.4	8.0	7.8
Expenditure	43.4	44.4	43.4	42.9	39.2	37.3	34.7	33.2	33.2	32.9
Expense <sup>1/</sup>	37.8	38.8	38.4	37.0	36.6	34.8	32.3	30.9	30.9	30.7
Acquisition of nonfinancial assets <sup>1/</sup>	5.6	5.5	5.0	5.9	2.6	2.5	2.4	2.3	2.3	2.3
Net lending (+)/borrowing (-)	-1.9	2.4	-6.7	-3.6	-6.7	-5.4	-4.2	-4.0	-3.4	-3.4
Public and publicly-guaranteed debt (end of period)	48.9	49.5	45.3	42.6	46.7	50.5	53.3	55.4	57.1	58.7
Domestic	8.6	8.8	10.1	9.7	10.5	11.8	13.4	15.0	16.0	15.1
External	40.4	40.7	35.2	33.0	36.3	38.8	39.9	40.4	41.1	43.7
Of which: RCF/RFI	1.0	0.9	0.5	0.3	0.1	0.0	0.0	0.0	0.0	0.0
<b>Balance of payments (in percent of GDP)</b>										
Current account	-5.1	-6.0	-12.3	-2.2	-7.4	-6.5	-4.6	-4.2	-4.0	-4.4
Trade balance	-24.2	-25.5	-27.2	-31.4	-25.9	-28.2	-29.3	-30.3	-33.2	-34.3
Exports of goods	5.1	5.7	7.1	5.5	5.2	5.3	5.3	5.4	5.5	5.5
Imports of goods	29.2	31.1	34.3	36.9	31.1	33.6	34.6	35.7	38.7	39.8
Travel receipts	6.2	0.2	3.9	14.2	3.5	5.8	11.1	14.6	18.2	19.6
Capital and financial account	10.9	17.8	11.9	4.6	6.4	4.9	5.3	5.4	6.7	6.5
Of which: Foreign direct investment	4.4	4.5	0.9	0.4	3.4	3.6	3.8	3.8	3.7	3.5
Overall balance	10.1	5.5	-2.5	0.5	-0.9	-1.6	0.7	1.3	2.6	2.1
Gross international reserves (in millions of U.S. dollars)	614	665	639	644	633	613	622	639	675	705
(in months of prospective G&S imports)	13.1	12.1	10.6	12.0	10.9	9.9	9.4	8.7	8.6	8.8
External debt service (in percent of GNFS exports)	16.9	40.7	26.7	13.0	10.7	11.4	9.9	8.5	7.3	6.0
<b>Memorandum items:</b>										
Nominal GDP (in billions of vatu)	104.9	104.0	117.9	128.9	134.2	139.4	145.2	151.9	158.1	164.5

Sources: Vanuatu authorities and IMF staff estimates and projections.

<sup>1/</sup> Does not include consumption of fixed capital (depreciation).

Table 7. Vanuatu: Bank Financial Soundness Indicators, 2017–23

	2017	2018	2019	2020	2021	2022	2023
<b>Capital adequacy</b>							
Regulatory capital to risk-weighted assets	18.0	20.1	19.2	20.0	23.2	23.1	24.1
Regulatory Tier 1 capital to risk-weighted assets	15.6	16.3	17.9	18.9	21.0	19.8	19.8
<b>Asset quality</b>							
Nonperforming loans net of provisions to capital	57.1	52.2	42.5	57.5	45.4	42.1	56.6
Nonperforming loans to total gross loans	15.6	16.0	14.4	19.0	15.8	15.1	19.6
<b>Earnings and profitability</b>							
Return on assets	0.5	1.5	0.1	-0.1	0.8	1.1	2.0
Return on equity	3.8	13.0	0.9	-0.6	6.0	9.1	13.9
Interest margin to gross income	63.6	65.3	65.1	68.0	68.8	64.1	60.4
Noninterest expenses to gross income	63.2	63.3	70.4	78.1	72.5	71.1	65.5
<b>Liquidity</b>							
Liquid assets to total assets (liquid asset ratio)	35.5	45.2	43.6	44.0	46.7	45.9	46.3

Source: Reserve Bank of Vanuatu.

Table 8. Vanuatu: Capacity Development Activities

Surveillance Issues	IMF			Asian Development		World Bank	
	Past	2023 <sup>1/</sup>	Planned/ Ongoing	Past	Planned/ Ongoing	Past	Planned/ Ongoing
<u>Fiscal Sector:</u>							
Public financial management	✓	✓	✓			✓	✓
Expenditure framework							
Revenue framework	✓	✓	✓				
Debt management		✓	✓				
<u>Macro-financial Issues:</u>							
Financial Supervision and Regulation	✓	✓	✓	✓	✓		
Financial Market Development				✓	✓		
Correspondent Banking Partnerships					✓		
<u>Macroeconomic Framework:</u>							
Macroeconomic Framework		✓	✓				
Macroeconomic Programming		✓	✓				
<u>Macro-structural Issues:</u>							
Infrastructure				✓	✓	✓	✓
Private sector development				✓	✓		
Governance issues				✓	✓		
Poverty/gender/inequality							
Climate change							
Natural disaster management						✓	✓
Financial inclusion				✓	✓		
<u>Statistics:</u>							
Data enhancement	✓	✓	✓				

1/ IMF Fiscal year.

## Annex I. Authorities' Actions to Previous Fund Policy Advice

Fund Recommendation	Policy Actions
<b>Fiscal Policy</b>	
<p>Formulate a medium-term fiscal strategy; complete the proposed 2017 tax reforms that include the introduction of a personal and corporate income taxes; and stabilize expenditures as a share of GDP. The fiscal strategy should contain new revenue mobilization policies, including a well-designed income tax, and an expenditure rationalization agenda, while protecting productive and climate-critical infrastructure spending.</p>	<ul style="list-style-type: none"> <li>• The authorities have not formulated a medium-term fiscal strategy or adopted the 2017 tax reforms (including the introduction of an income tax).</li> <li>• The authorities established a national revenue governance committee to oversee efforts in expanding its revenue base, but continue to have capacity/staffing issues.</li> <li>• The government introduced a PFM Improvement Roadmap in May 2023, though progress on implementation remains unclear.</li> </ul>
<p>Properly manage fiscal risks by minimizing the contingent the contingent liabilities of Air Vanuatu; establish effective supervision and transparency of SOEs and limit and prioritize their external borrowing.</p> <p>On Air Vanuatu: The 2021 and 2023 Staff Reports called for the restructuring of Air Vanuatu to be completed urgently, and identify a sustainable solution that minimizes contingent liabilities and transfers from the government while preserving the airline's systemic economic role. The reports also recommended bolstering management and transparency of SOEs, particularly with respect to Air Vanuatu, including timely publication of financial statements.</p>	<ul style="list-style-type: none"> <li>• The bill on commercial government business enterprises (CGBE), that will enable the timely preparation and publication of CGBE financial statements, has met with delays and is yet to be tabled in Parliament.</li> </ul>
<b>Monetary Policy</b>	
<p>The RBV should remain data-driven and stand ready to act if there are signs of persistent excess liquidity that leads to rapid credit growth.</p>	<ul style="list-style-type: none"> <li>• The RBV has increased the statutory reserve deposit (SRD) 0.25 pp to address inflationary pressures.</li> <li>• The RBV has carried out OMOs to mop up excess liquidity in the system.</li> <li>• The authorities should stay vigilant of liquidity developments.</li> </ul>
<b>Financial Sector Policy</b>	
<p>Closely monitor the banking sector and establish crisis management frameworks.</p>	<ul style="list-style-type: none"> <li>• The authorities stated that they are closely monitoring the banking system to safeguard financial stability. They requested assistance to the Pacific Financial Technical Assistance Center (PFTAC) to implement changes and develop/review their current prudential standards.</li> </ul>
<p>Strengthen legal frameworks and institutional capacities on AML/CFT.</p>	<ul style="list-style-type: none"> <li>• Legislative frameworks have been developed and amended, notably resulting in re-establishing the Financial Intelligence Unit as an independent institution.</li> </ul>
<p>Strengthen the RBV's autonomy and governance to help ensure the continuation of effective monetary and financial policies</p>	<ul style="list-style-type: none"> <li>• Implementation of 2016 Safeguards Assessment recommendations are still incomplete.</li> <li>• There is a pressing need to repeal the 2022 Reserve Bank Act amendments that allow the government to increase its borrowing from the central bank (from 20% to 40%), to reduce monetary financing and improve the bank's independence.</li> </ul>
<b>Structural Policy</b>	
<p>Diversify the economy to foster stable growth and resilience. Enact reforms to address governance and corruption weaknesses, including the governance of SOEs, the AML/CFT framework, the ECP, tax transparency, and central bank governance and autonomy.</p>	<ul style="list-style-type: none"> <li>• The authorities have ratified the Pacific Agreement on Closer Economic Relations (PACER) Plus in October 2022. The PACER Plus Implementation Unit is working with relevant authorities to implement its trade and development needs.</li> <li>• In January 2023, the Vanuatu Electronic Single Window project, aiming to reduce the cost and time of trading was completed.</li> <li>• The Economic Development Zone (EDZ) legislation is in progress and yet to be approved in Parliament.</li> </ul>

Fund Recommendation	Policy Actions
<b>Natural Disasters and Climate Change</b>	
<p>Integrate financing plans, consistent with a medium-term fiscal strategy, for the adaptation plan and disaster response in a more efficient and effective manner.</p>	<ul style="list-style-type: none"> <li>• The authorities have not integrated climate investment needs or disaster response into medium term fiscal planning.</li> <li>• The authorities amended the Disaster Risk Management Act (2024).</li> <li>• The authorities published a revised NDC, including estimated costs of needed adaptation, mitigation and loss and damage efforts.</li> </ul>

## Annex II. External Sector Assessment

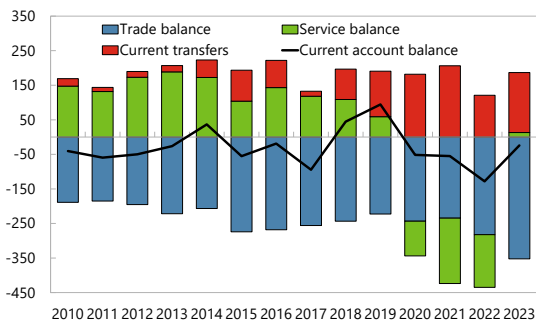
**Overall Assessment:** The external position of Vanuatu in 2023 was moderately stronger than the level implied by fundamentals and desirable policies. The current account deficit is estimated to have narrowed in 2023 on the back of recovering tourism activity, remittances, and donor grants. Foreign reserves increased in 2023 and are expected to remain adequate over the medium-term. However, there is significant uncertainty surrounding this assessment due to data gaps which may not adequately capture the idiosyncratic characteristics of Vanuatu and the large measurement errors associated with the significant periodic revisions of the current account. Furthermore, Air Vanuatu’s voluntary liquidation in May 2024 and the stronger-than-expected decline in foreign revenue from the Economic Citizenship Program (ECP) in early 2024, highlight the significant risks to the external position in 2024 and beyond through weaker exports and lower receipts. The policy implications of a cyclical (tourism) and structural (ECP) deterioration in the external position call to attention the need to safeguard medium-term external balances. Policies should focus on improving export capacity (including through untapped or underutilized resources), enhancing productivity, and rebuilding fiscal buffers.

### Current Account

**Background.** The current account deficit is estimated to have narrowed to 2.2 percent of GDP in 2023, following average deficits of 9.1 percent from 2021 to 2022. The gradual resurgence of tourism, grants from donor partners and resilient remittances supported this outturn. However, the trade deficit widened further driven by the rise in imports (to 36.9 percent of GDP, from 34.3 percent of GDP in 2022) due to large import demand from infrastructure projects and domestic consumption on the back of lower global oil and food prices. In 2024, the current account deficit is projected to deteriorate to 7½ percent of GDP driven by the decline in services exports related to tourism and travel, and lower ECP revenues.

#### Current Account

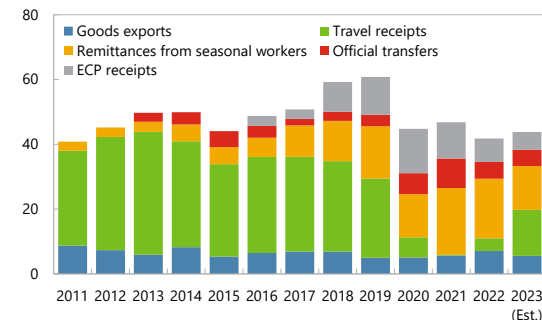
(In millions of US dollars)



Sources: Vanuatu authorities; and IMF staff calculations.

#### Select Credit Items of the Current Account

(In percent of GDP)



Sources: Vanuatu authorities; and IMF staff estimates.

**Assessment.** The EBA-Lite results imply that Vanuatu’s external position was moderately stronger than the level implied by fundamentals and desirable policies. The model yields a current account gap of 2.3 percent of GDP in 2023, estimated as the difference between the cyclically adjusted current account balance of -1.4 percent of GDP and the current account norm of -3.7 percent of GDP. The current account gap is also explained by the policy gaps primarily the fiscal deficit and lower social safety nets (proxied by health spending) relative to the rest of the world. The unexplained residual potentially reflects country-specific features and structural distortions such as export and investment impediments which are not captured in the model.

### Vanuatu: EBA-lite Model Estimates for 2023 (In percent of GDP)

	CA model 1/ (in percent of GDP)	REER model 1/ (in percent of GDP)
<b>CA-Actual</b>	<b>-2.2</b>	
Cyclical contributions (from model)	-0.3	
Natural disasters and conflicts	1.0	
<b>Adjusted CA</b>	<b>-1.4</b>	
<b>CA Norm</b> (from model) 2/	<b>-3.7</b>	
Adjustments to the norm	0.0	
<b>Adjusted CA Norm</b>	<b>-3.7</b>	
<b>CA Gap</b>	<b>2.3</b>	<b>2.3</b>
o/w Relative policy gap	3.0	
Elasticity	-0.3	
<b>REER Gap</b> (in percent)	<b>-8.4</b>	<b>-8.3</b>

1/ Based on the EBA-lite 3.0 methodology

2/ Cyclically adjusted, including multilateral consistency adjustments.

The expected deterioration in tourism and ECP-related receipts in 2024 underscore the need for greater improvements in the export capacity (such as greater utilization of natural resources including fishing and high value agricultural products), and careful preservation of foreign sources of international reserves.

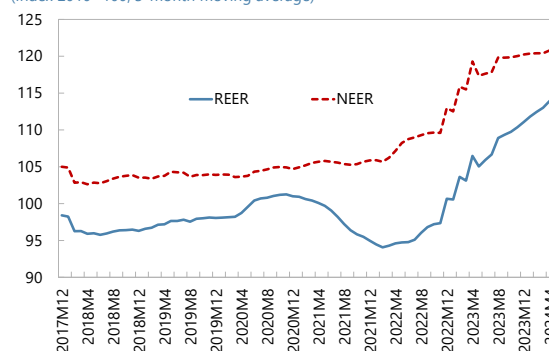
## Real Exchange Rate

**Background.** The real effective exchange rate (REER) appreciated in 2023, mainly due to the appreciation of the nominal bilateral exchange rates against the AUD and USD.

**Assessment.** Applying the estimated trade elasticity (0.3), to the current account gap indicates a REER undervaluation of 8.4 percent. However, it is important to note that the assessment may not automatically warrant an adjustment to the nominal exchange rate as there is significant uncertainty due to large measurement errors reflected in the periodic revisions of the current account data. The REER model results also point to a REER gap of -8.3 percent but are not directly applicable to Vanuatu given significant measurement errors. Policies that continue to address the structural weakness in the export sector, strengthen public finances and boost productivity would help bring the currency in line with fundamentals and desirable policies.

### Nominal and Real Effective Exchange Rates

(Index 2010=100, 3-month moving average)



Sources: Vanuatu authorities; and IMF staff calculations.

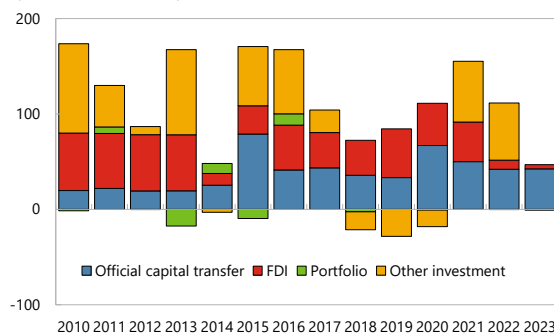
### Capital and Financial Accounts: Flows and Policy Measures

**Background.** Vanuatu’s capital and financial account flows in 2023 were largely driven by project-related capital grants and foreign direct investment (FDI). The capital account balance estimated at 4.3 percent of GDP was mainly driven by project grants. The small positive financial account balance was led by FDI estimated at 0.4 percent of GDP in 2023, but significantly lower than its 10-year average of 4.3 percent of GDP.

**Assessment.** Structural reforms that promote FDI are crucial for Vanuatu’s economic diversification and growth. These include advancing infrastructure development, improving the business environment and streamlining foreign investment application and registration processes (See IMF Country Report No. 21/208 (Annex VII) for more details about FDI in Vanuatu).

**Capital and Financial Accounts**

(In millions of US dollars)



Sources: Vanuatu authorities; and IMF staff calculations.

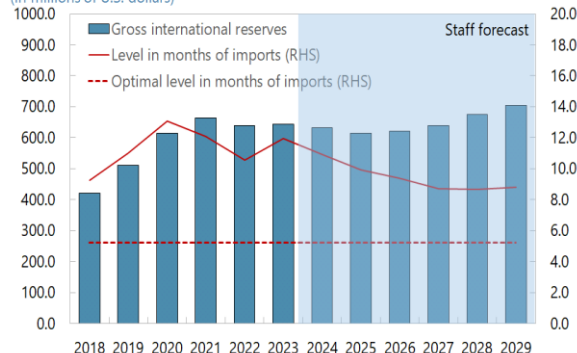
### FX Intervention and Reserves Level

**Background.** Vanuatu’s gross official reserves increased to US\$643 million (12 months of imports cover) in 2023, supported by tourism receipts, remittances, and donor support.

**Assessment.** The reserve adequacy methodology for credit constrained economies estimates the optimal level of reserves by comparing the benefits of reserves in reducing the likelihood and severity of a crisis against the cost of holding reserves.<sup>1</sup> The assessment estimates that Vanuatu’s adequate level of reserves falls within the range of 3.8 to 5.2 months of imports. Reserves are projected to remain adequate over the medium-term supported by the recovery of tourism receipts, remittances, and donor support, despite declining ECP revenues. Maintaining adequate reserves over the medium is important to provide a buffer against natural disasters and external shocks.

**Official Foreign Exchange Reserves**

(In millions of U.S. dollars)



Sources: Vanuatu authorities; and IMF staff estimates.

<sup>1</sup> The assessment is based on the sample average of countries (50 percent) and considers Vanuatu’s vulnerability to natural disasters (75 percent).

## Annex III. Risk Assessment Matrix

Source of Risk	Likelihood	Expected Impact	Policy Recommendations
<p><b>Global. Intensification of regional conflicts.</b> Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows.</p>	<b>High</b>	<p><b>Medium.</b> Vanuatu is sensitive to increase in global prices and supply chain disruptions as its heavily dependent on imports.</p>	<p>Monitor inflation developments closely and act swiftly in case price pressures increase sharply.</p>
<p><b>Global. Abrupt global slowdown.</b> Global and idiosyncratic risk factors cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and market fragmentation triggering sudden stops in EMDEs <b>China:</b> Sharper-than-expected contraction in the property sector weighs on private demand, further amplifies local government fiscal strains, and results in disinflationary pressures and adverse macro-financial feedback loops.</p>	<b>Medium</b>	<p><b>Medium.</b> Global economic slowdown particularly in main trading partners like Australia, New Zealand or China could negatively affect the growth prospect in Vanuatu particularly via the tourism and remittances channels.</p>	<p>New stimulus package would also be needed to support the economy, but inflationary pressures should also be considered in this scenario.</p>
<p><b>Global. Extreme climate events.</b> Extreme climate events driven by rising temperatures cause loss of human lives, severe damage to infrastructure, supply disruptions, lower growth, and financial instability.</p>	<b>Medium</b>	<p><b>High.</b> Vanuatu faces high natural disaster risk, including tropical cyclone, earthquakes, floods, and volcanic activity. Climate change is likely to alter weather and precipitation patterns, raise sea levels and increase the intensity and frequency of some types of natural disasters.</p>	<p>Build climate-resilient infrastructure. Integrate financing plans that are consistent with the medium-term fiscal strategy, for the adaptation plan and disaster response to support resilient building.</p>
<p><b>Domestic. Political instability</b> can lead to delays in major infrastructure projects by affecting the execution of major infrastructure projects given weak domestic capacity.</p>	<b>High</b>	<p><b>High.</b> Delays in the execution of major infrastructure projects could negatively affect GDP growth and jeopardize the fragile recovery.</p>	<p>Continue building internal capacity. Plan with technical and financial partners about the modalities for the execution of major infrastructure project. The May 29, 2024, referendum to implement reforms in the political system with the objective of increase its stability should be implemented.</p>



Source of Risk	Likelihood	Expected Impact	Policy Recommendations
<b>Domestic. Further drop in ECP revenues.</b> ECP revenues could further fall sharply amid growing concerns regarding AML/CFT risks, amplified by the loss of key correspondent banking relationships. AML/CFT deficiencies could lead to lessening Vanuatu's passport attractiveness. The UK and Ireland already fully suspended the visa agreement with Vanuatu (EU full suspension exemption until August 2024).	<b>High</b>	<b>High.</b> ECP revenue accounted for 33 percent of total revenue (including grants) in 2020. Further ECP revenue declines may jeopardize medium-term fiscal sustainability. The cash reserve buffer can mitigate the shock if the decline is temporary.	Formulate a medium-term fiscal consolidation plan. Strengthen AML/CFT controls in line with international standards. Improve tax revenue mobilization by introducing income tax and strengthening the tax administration to improve VAT collection. Rationalize some spending such as wages and salaries.
<b>Domestic. Deteriorating nonperforming loans (NPLs).</b> Financial institutions' assets quality could further deteriorate with a spike in ratios given the end of forbearance measures or if the recovery is jeopardized.	<b>High</b>	<b>High.</b> Banks could deleverage to rebuild capital buffers and subsequently tighten credit conditions. Structurally high NPL ratios could hinder the financial inclusion.	Guide banks to accumulate further general provisioning early. Establish crisis management and resolution frameworks.
<b>Domestic. Weak governance.</b> Lack of transparency and supervising framework for state-owned enterprises (SOEs) could deteriorate their financial performance and induce large fiscal costs.	<b>High</b>	<b>High.</b> Promoting FDI is key for Vanuatu's economic growth. Weak FDI could lead to slow economic growth and deterioration of external fiscal sustainability.	Establish the governance structure of the SOEs.
<b>Domestic. Weak financial integrity and financial sector oversight.</b> Weaknesses in the AML/CFT framework and its implementation and EU blacklisting related to tax transparency could undermine business appetite of foreign companies in a de-risking context, leading to further loss of CBRs and hindering promotion of foreign direct investment (FDI). Lack of autonomy of the RBV could also affect their business appetite and the appropriate conduct of monetary policy.	<b>High</b>	<b>High.</b> Promoting FDI is key for Vanuatu's economic growth. Weak FDI could lead to slow economic growth and deterioration of external fiscal sustainability.	Strengthen the AML/CFT regime. Make the tax bill consistent with the international standard of tax transparency. Implement the 2016 safeguard assessment.
<b>Domestic. Delays and potential complications with the resolution of the voluntary liquidation of Air Vanuatu.</b>	<b>High</b>	<b>High.</b> Air Vanuatu is vitally important in the economy given the role it plays for tourism, connectivity and commerce.	Restore operations after restructuring and enable market-based operating principles.

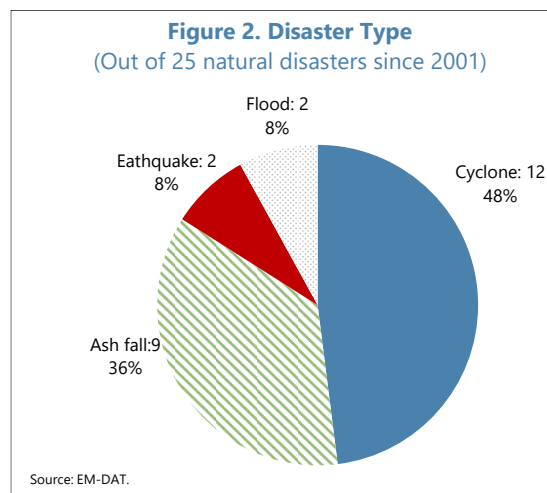
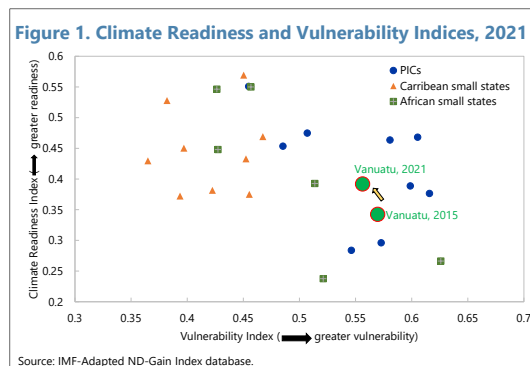
## Annex IV. Vanuatu’s Climate Adaptation Needs

Vanuatu is highly susceptible to climate disaster risks. In response, the country is taking steps to adapt and build its resilience against present and future climate disruptions. However, current adaptation efforts and resources are insufficient to meet its enormous adaptation needs. This annex briefly explains the impacts of climate change and constraints to adaptation actions. It also outlines possible solutions to effectively address the climate adaptation shortcomings.

**1. Vanuatu is extremely vulnerable to climate change and disaster risks.** The archipelago nation is exposed and frequently affected by various natural disasters given its geographical location in the ring of fire and the cyclone belt (Figure 1).<sup>1</sup> Since 2001, Vanuatu has experienced 25 natural disasters, including tropical cyclones, floods, ash fall (volcanic eruptions), and earthquakes (see text table & Figure 2). Nearly 81 percent of its landmass and 76 percent of its population is exposed to two or more potential natural hazards (Vanuatu Government, 2022). In 2023 alone, the two back-to-back category 4 Tropical Cyclones, Judy and Kevin (in March), and category 5 Tropical Cyclone Lola (in October) wreaked havoc and significant damages in Vanuatu demonstrating the urgency to enhance resilience and adaptation to withstand present and future climate disruptions.<sup>2</sup>

Natural Disasters in Vanuatu				
Year	Disaster Type	Total Affected (percent of population)	Total Deaths	Total Damage (USD million)
2001	Tropical cyclone	800 (0.3%)	1	-
2001	Tropical cyclone	-	1	-
2001	Ash fall	4500 (2.3%)	-	-
2002	Earthquake	503 (0.3%)	-	-
2002	Flood	3001 (1.5%)	-	-
2002	Earthquake	500 (0.3%)	-	-
2004	Tropical cyclone	54008 (25.8%)	2	-
2005	Ash fall	5000 (2.3%)	-	-
2006	Ash fall	-	-	-
2008	Ash fall	9000 (3.9%)	-	-
2009	Flood	950 (0.4%)	-	-
2009	Ash fall	400 (0.2%)	-	-
2011	Tropical cyclone	-	-	-
2011	Tropical cyclone	32000 (13.0%)	-	-
2014	Tropical cyclone	20006 (7.6%)	12	2000
2015	Tropical cyclone	188000 (70.0%)	11	449400
2017	Ash fall	11000 (3.9%)	-	-
2017	Tropical cyclone	2564 (0.9%)	-	-
2018	Ash fall	6300 (2.2%)	-	-
2018	Ash fall	7286 (2.6%)	-	-
2020	Tropical cyclone	130120 (43.1%)	3	-
2021	Ash fall	3383 (1.1%)	-	-
2023	Tropical cyclone	197,388 (66%)	-	-

Sources: The International Disasters Database (EM-DAT), Post Disaster Needs Assessment Report (2023); and IMF staff estimates



<sup>1</sup> The IMF-Adapted ND-GAIN Index is an adaptation of the original index, adjusted by IMF staff to replace the Doing Business Index, used as source data in the original ND-GAIN. The index is composed of a Readiness score and a Vulnerability score, which calculates a country’s vulnerability to climate disruptions and other global challenges and their readiness to improve resilience. The more ready a country is to improve its resilience the higher its score, and the more vulnerable a country is the higher its score.

<sup>2</sup> Tropical Cyclone Lola was the earliest category 5 tropical cyclone on record to form in Vanuatu before the official November-April cyclone season.

**2. Vanuatu is already experiencing the severe impact of climate change and is expected to worsen.** This has led to the destruction of homes and infrastructure, loss of life and livelihoods, and impacted economic sectors such as tourism and agriculture that are pertinent for national growth and development. In early 2020, Category 5 Tropical Cyclone Harold affected 43 percent of the population with loss and damages estimated at over 60 percent of GDP (Vanuatu Government, 2022). The exposure of Vanuatu's diverse ecosystem to climate hazards also puts food and water security at risk. Natural disasters (droughts, floods) with associated pests and diseases destroy livestock and crops, and imperil agricultural production. Sea-surface warming, ocean acidification and tropical storms degrade the oceans' resources and harm marine life. This in turn creates hardship for many households who depend on natural resources for their livelihood and sustenance and who have limited capacity to cope and adapt to climate impacts.<sup>3</sup> Health problems are also likely to increase due to incidence of climate-related food and water-borne diseases and heat-related illness. Climate change have also triggered the internal displacement of people in Vanuatu. For instance, Tropical Cyclone Pam in 2015 affected an estimated 188,000 people (more than half of the population) and displaced more than 65,000 people (Vanuatu National Disaster Management Office, 2018). The volcanic activity on Ambae Island in 2018 also led to the displacement of around 11,700 people (McDonnell, 2021).

**3. In the long term, Vanuatu will likely face even greater risks given the expected increase in climate hazards.** Sea-level rise combined with tectonic activity and storm surges continue to threaten low-lying coastal communities, potentially requiring permanent relocation. Although these issues have been observed in Vanuatu, they are likely to be exacerbated by climate change. For instance, a portion of Efate where the capital city, Port Villa, is located, is slowly sinking due to seismic activity which worsens the real rate of sea level rise. Additionally, 6 villages on 4 of Vanuatu's islands have been relocated inland due to rising sea levels while other at-risk settlements have been identified to move in future (Sengupta, 2023). Climate-induced relocation combined with increasing urbanization could lead to problems such as rising informal settlements, overcrowding, socio-economic tensions and overwhelm limited natural and financial resources. Climate relocation also threatens the survival of Vanuatu's unique cultural knowledge and connection to ancestral land.

**4. In response to the climate emergency, Vanuatu updated and enhanced its Nationally Determined Contribution (NDC) in 2022, which reflects the country's highest commitments on adaptation, mitigation and loss and damage over the next decade.** The NDC contains 20 mitigation, 116 adaptation, and 12 loss and damage commitments which are linked to the National Sustainable Development Plan, Sustainable Development Goals, and the sectoral action plans for each vulnerable sector.<sup>4</sup> The NDC requires significant financing estimated at 108 percent of 2023

<sup>3</sup> An estimated 75 percent of households are engaged in subsistence agriculture.

<sup>4</sup> Vanuatu has an institutional structure for the implementation of the enhanced NDC. The National Advisory Board on Climate Change & Disaster Risk Reduction is the supreme policy making and advisory body that coordinates closely with all relevant government ministries and stakeholders to implement climate change and disaster risk reduction in the country.

GDP, which is beyond any reasonable investment capacity that the country can afford.<sup>5</sup> The achievement of the NDC targets is conditional upon international support in the form of increased access to funding, capacity development and technology transfer.

**5. Vanuatu is also prioritizing transformative adaptation action for resilient development.** Climate adaptation initiatives include enhancing local capacity and climate literacy through community education and awareness, strengthening coastal defenses, and building resilient infrastructure. Several adaptation projects have also been approved by the National Advisory Board on Climate Change and Disaster Risk Reduction and are under implementation (see text table). Additionally, the implementation of mitigation projects is expected to provide resilience and adaptation co-benefits. Work in this Article IV consultation (see SIP) complements some of these estimates and offers an alternative lens through which adaptation investment can be viewed.

Select Current Environmental Projects			
Project Name	Objectives	Project Timeline	Total Project Cost
Vanuatu Coastal Adaptation Project Phase 2 (VCAP2)	Focus on supporting environmental resource protection and biodiversity.	2022-2028	US\$12.5 million (1.1% of GDP) funded by the Global Environment Facility and the Least Developed Country Fund
Vanuatu Climate Change Resilience Project (VCRRP)	Seeks to increase community access to climate information and early warning systems, enhance food, water security, and build climate resilient livelihoods.	2022-2028	US\$32.7 million (2.9% of GDP) \$26.2m funded by the Green Climate Fund and \$6.5m co-financed from the Vanuatu and Australia Governments and Save the Children
Climate Information Services for Resilient Development in Vanuatu (Van-KIRAP)	Supports the development, communication, and application of climate information services for agriculture, fishery, infrastructure, water sectors and communities.	2016-2024	US\$26.6 million (2.4% of GDP) \$23m funded by the Green Climate Fund and \$3.6m co-financing
Enhancing Adaptation and Community Resilience by Improving Water Security in Vanuatu	Create safe, climate-resilient, and sustainable water utilization and improve water security in local communities.	2022-2028	US\$28.3 million (2.5% of GDP) \$23.3m funded by the Green Climate Fund and \$5m co-financing.

Sources: Department of Climate Change and Green Climate Fund. Note: Figures in brackets refers to project cost as a share of 2023 GDP.

<sup>5</sup> The total estimated NDC financing is made up of adaptation (64% of GDP), mitigation (28% of GDP) and loss & damages (16% of GDP).

**6. Despite progress, current adaptation efforts and resources falls short of the enormous adaptation needs.** This reflects various constraints in financial, institutional, and human resources, and lack of effective systems of governance and financial management. Additionally, adaptation efforts that are feasible and effective today are likely to be constrained and become less effective given increasing climate hazards (IPCC, 2023). To address these shortcomings, climate adaptation requires a multi-faceted approach. These encompass strong and inclusive collaboration, and coordination between stakeholders (government, civil society, business, development agencies, donors), strengthening institutional capacity and frameworks, laws, and policies. Scaling up access to climate finance, technology, and international support are critical enablers to enhance climate action. Effective governance is also crucial for accountable and transparent decision-making, responsible use of resources, and ensures that adaptation initiatives are delivered in a coordinated and complementary manner. Climate resilient development in Vanuatu will also benefit from the integration of indigenous knowledge and cultural values together with scientific knowledge.<sup>6</sup>

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<sup>6</sup> In 2023, a Traditional Knowledge Climate and Weather Indicator [Booklet](#) was compiled, which documents traditional knowledge indicators of weather and climate in Vanuatu.

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## Annex V. Financial Sector Sensitivity Analysis

*Vanuatu's banking system is relatively large compared to the size of the economy and is dominated by a large state-owned bank and three mid-sized subsidiaries of foreign banks. On average, the banking system appears profitable and well-capitalized. However, there are some pockets of vulnerabilities that require closer scrutiny. In particular, nonperforming loans have been high for a long period (at least since 2016), with an industry average of around 19.4 percent, the highest among regional peers. This has been accompanied by relatively mixed loan loss provisioning across banks and a relatively large FX loan portfolio in at least one lender. A bank-by-bank sensitivity analysis reveals that the banking system remains relatively well capitalized under a mild downside scenario, but some institutions appear increasingly vulnerable under the severely adverse scenario. In particular, a severely adverse credit shock would have the largest impact on the asset quality at banks, with capital levels at some banks falling below the regulatory minimum.*

### Key Features of Vanuatu's Banking System

- 1. Vanuatu's banking system has VT171 billion in total assets, equivalent to around 1.5 times the size of the economy.** There are five banks in the sector, including a large state-owned bank and three subsidiaries of foreign banks.<sup>1</sup> Total credit to the economy from the banking sector amounts to around VT78 billion, with the household (54 percent), tourism (10 percent) and professional (10 percent) and wholesale and retail (10 percent) sectors comprising the largest borrowers.
- 2. The banking system appears reasonably profitable with a wide variation across banks.** The average return on assets (ROA) for the sector is around 2 percent, though there is wide dispersion among the five banks. The ROA ranges between 1–3 percent for some banks (2023 provisional data), while net income has been weak or even negative at other banks.
- 3. While banks appear relatively well capitalized,<sup>2</sup> asset quality and loan loss provisioning reveal signs of vulnerabilities.** As of 2023Q4, the average capital adequacy ratio (CAR) for the banking system is around 24.1 percent, though there is wide dispersion (14–42 percent) among the banks. Similarly, while the non-performing loan (NPL) ratio averages around 19 percent for the industry, there is a wide variation among the five banks. Moreover, the loan loss provisions held against NPLs appear relatively low for some banks, suggesting that some of the lenders might potentially have relatively optimistic assumptions regarding the asset quality in their NPL portfolios. Additionally, the concentration of some banks' largest exposures also necessitates closer scrutiny.
- 4. Impaired loans to households comprise the largest portion of NPLs, which necessitates further analysis on the recovery of these loans and capacity of households to repay the banks**

<sup>1</sup> The smaller domestic bank, Wanfuteng Bank, went into administration by the Reserve Bank (the financial regulator) in June 2023.

<sup>2</sup> Based on the 10 percent minimum capital adequacy ratio.

**in the event of future downturns.** Other loans (including households) comprise 86 percent of total NPLs, while loans to the construction 4 percent and trade 3.9 percent sectors are the next two biggest contributors. The out-sized proportion of household loans in NPLs requires closer evaluation, to determine if these loans should be recategorized to allow bank balance sheets room to facilitate new credit to the household sector. Additionally, the capacity of households to repay existing loans must also be assessed, to estimate the potential downside risks to the banking sector in the event of a severe downturn.

### Sensitivity Analysis on the Banking System

**5. The sensitivity analysis assumes a mild and a severe downside scenario.** The table below presents the shock assumption of the stress test exercise:

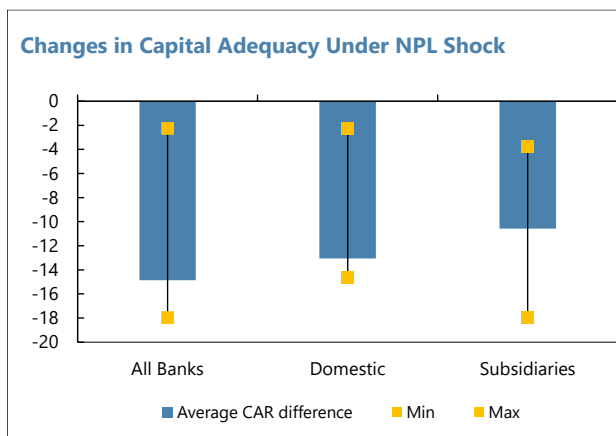
<b>Mild Downside Scenario</b>	<b>Assumptions</b>
Credit Risk	NPLs increase to double the current maximum NPL among banks. This is equivalent to an increase of about 60 percent. Level of provisioning needed is assumed to be 40 percent for NPLs.
Interest Rate Risk	Interest rate decreases by 0.65 percentage points, mirroring the RBV's rate cut in response to the COVID-19 pandemic.
FX Risk	The vatu depreciates by 7 percent against the US dollar. This corresponds to the average depreciation of the vatu over the past two decades (excluding the pandemic period).
<b>Severe Downside Scenario</b>	<b>Assumptions</b>
Credit Risk	NPLs increase to three-times the current maximum NPL among banks. This corresponds to an increase of 87 percent in NPLs. Level of provisioning needed assumed to be 80 percent for NPLs.
Interest Rate Risk	Interest rates decline by 2.25 percentage points, which corresponds to the actual fall in interest rates following the pandemic. <sup>1</sup>
FX Risk	The vatu depreciates by 16 percent which corresponds to the largest depreciation of the currency over the past two decades (excluding the pandemic period).
<sup>1</sup> The historical average, calculated using data from 1999 to 2019, indicates a required adjustment of 4.75 percentage points. However, implementing this adjustment would result in a negative policy rate. Consequently, the rate cut was adjusted to set the policy rate at 0.	

**6. Vanuatu's banking system appears relatively well capitalized under a mild downside scenario.** Under a mild downside scenario covering credit risk, interest rate risk and FX risk, the average CAR for banks averages 24.2 percent. For domestic banks, the CAR declines by 9.8 percentage points after an NPL shock, by 1.4 percentage points under the interest risk shock and increased by 0.03 percentage points under an FX shock. Given the current high level of capitalization in the banking system, none of the banks falls below the minimum regulatory CAR set by the Reserve Bank.

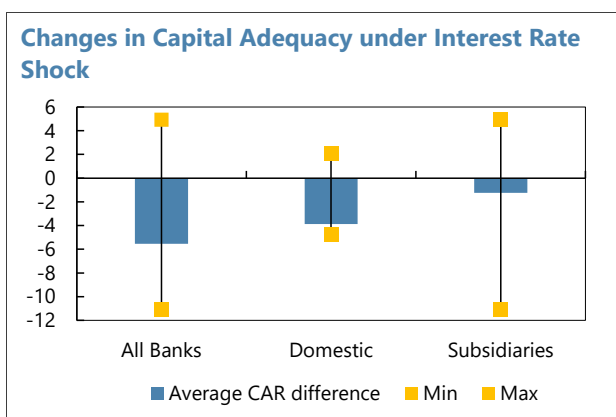


**7. However, under a severe downside scenario, the banking system looks vulnerable and could pose financial stability risks for the economy.**

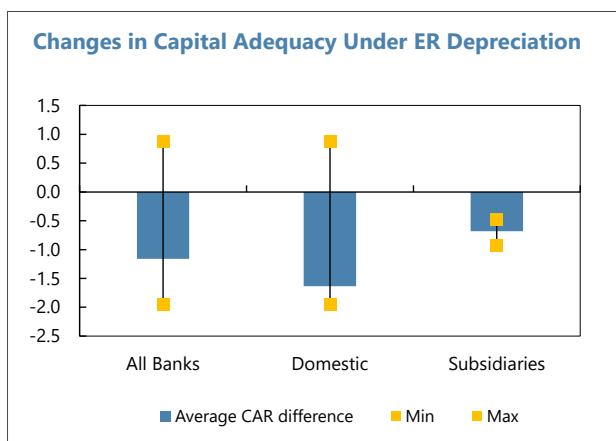
- **Under the credit risk shock**, the shock assesses the asset quality and the provisioning held against the non-performing loans. All banks are impacted adversely under this scenario, and the foreign banks appear more vulnerable to an increase in their NPLs. The CARs decrease by 14.9 percentage points on average for the banks. For some banks, the CAR falls below the minimum regulatory requirement of 10 percent.



- **Under the interest rate shock**, the shock assesses how changes in rate-sensitive assets and liabilities affect the capital position. Assets and liabilities are sorted into three time-to-repricing buckets (3 months, 3-6 months, and 6-12 months). The buckets are used to calculate the net impact of the interest shock on banks' net income. The simulations show that policy rate cuts of 225 basis points induce a decrease in the average CAR of about 5 percentage points relative to the baseline, with a lot of heterogeneity across banks.



- **Under the FX shock in this scenario**, the shock assesses the sensitivity of banks to depreciation of the vatu. Given the strong peg, episodes of large volatility of the vatu have so far been limited. The simulations assume a worst-case scenario in which the exchange rate depreciates by 16 percent, the largest depreciation of the vatu with respect to the USD in the last two decades. Such a large depreciation in the case of Vanuatu would benefit the banks with a positive net open position and negatively hurts banks with negative net open position. Vanuatu's banking system has around 35 percent of its loans in FX, on average. The bank with the largest FX exposure has FX loans at around 50 percent of total loans. Following the depreciation shock, the CAR for the banks decreases on average by 1.2 percentage point, mostly on the back of the rising NPLs on FX loans.



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## Annex VI. External Economic Shocks and Their Impact on Vanuatu

*After the pandemic, the global economic landscape has seen a significant increase in risks and uncertainty that might affect future growth prospects. How sensitive is Vanuatu to these risks? Based on historical data, this annex aims to examine the impact of external shocks on Vanuatu's economy, focusing on its magnitude and timing.*

**1. Vanuatu is highly exposed to external shocks.** The global economic environment is currently facing significant challenges, including supply chain bottlenecks, deepening geoeconomic fragmentation, increased commodity price volatility, escalating regional conflicts or climate change. These factors pose major threats that can affect economies worldwide. Despite their remote location from international markets, the Pacific Islands are highly susceptible to global economic and environmental shocks.<sup>1</sup> Their economies rely heavily on tourism, remittances, and grants and they are highly dependent on imports. External factors are crucial in driving their economic conditions, as disruptions in trade or shifts in global demand can significantly impact their primary sources of income. The objective of this annex is to shed light on Vanuatu's economy response to different external shocks.

**2. This annex uses multiple data sources to construct the shocks, as shown in Table 1.** Macroeconomic data for Vanuatu is sourced from the IMF World Economic Outlook data, over the period 1980 to 2021, and data post-2022 are excluded as they are still estimates.

**3. Model selection.** Since there is a need to understand both the contemporaneous and dynamic effects of these shocks, the selected methodology is the local projection by Jorda (2005):

$$y_{t+k} - y_{t-1} = \beta_j^k \text{shock}_t + \theta_j^k \text{shock}_{t-1} + \Gamma_j^k \Delta y_{t-1} + \varepsilon_t^k$$

where the dependent variable  $y_{t+k}$  is the log change in GDP, CPI, and change in investment (as a percent of GDP) for year  $t$  over  $k$  years and  $\text{shock}_t$  is the shock (one of: climate, World Uncertainty Index, GDP growth,<sup>2</sup> CPI, trade restrictions and high inflation episodes in trade partners) at year  $t$ . The coefficient  $\beta$  is the effect of the  $\text{shock}_t$  in  $y_t$  at horizon  $k$ . Controls include 1 lag of the shock and 1 lag of the dependent variable.

**4. Vanuatu is susceptible to many shocks.** Figure 1 presents the outcomes of local projection regressions on Vanuatu's GDP growth in response to several shocks. Panel (a) illustrates the economic contraction following a climate shock, with output declining by approximately 3 percentage points the year of the shock and peaking at 4 percentage points one-year post-shock. Over the last few years, current global events have increased economic uncertainty. Uncertainty can harm growth by disrupting trade and financial linkages between countries and by modifying

<sup>1</sup> See Colmer (2016).

<sup>2</sup> The results for GDP growth in trade partners have been inverted to present a fall in trade partners GDP growth.

investment patterns.<sup>3</sup> Furthermore, previous research also shows that countries with low institutional quality tend to suffer larger and more persistent effects from uncertainty.<sup>4</sup>

**Table 1. Vanuatu: Data Sources and Explanation of Shocks**

<b>Shocks</b>	<b>Source</b>	<b>Calculations</b>
Climate	EM-DAT: The international disaster database	EM-DAT covers different types of climate shocks (flooding, landslide, and storms). The climate shocks used in this annex is a dummy that is equal to 1 when any of these climate events happened in a certain year.
World Uncertainty Index (Asia-Pacific)	Ahir, Bloom and Furceri (2022)	Computed by counting the percent of word "uncertain" (or its variant) in the Economist Intelligence Unit country reports. Asia-Pacific region index is weighted by GDP. Used as log difference.
GDP growth in trading partner	GEE (Global Economic Conditions database. IMF)	GDP in trade partner, export weighted. Used as log difference.
CPI in trade partner	GEE	CPI in trade partner, export weighted.
Trade restrictions (Measure of Aggregate Trade Restrictions)	Estefania-Flores et. al. (2022)	Trade restrictions in trade partners. Weighted by top 5 trade partners each year. <sup>1/</sup> Used in changes.
High inflation episodes	World Economic Outlook	Dummy equal to 1 when inflation (y/y) in trade partner increases >2SD in any quarter of a given year. Weighted by top 5 trade partners each year.
<p>Note: The coverage period for all data is 1980-2021 (annual data).</p> <p>1/ Weights are calculated as follows <math>weight_i = \frac{exports_{i,j,t} + imports_{i,j,t}}{total\ top\ 5\ exports_{j,t} + total\ top\ 5\ imports_{j,t}}</math>. The final weighted shocks are:  <math>Weighted\ shock_{j,t} = \sum_{i=1}^5 shock_{i,t} \times weight_{i,t}</math>, where: <math>j</math>: country of interest (Vanuatu); <math>i</math>: trade partner (top 5 trade partners); <math>t</math>: year; <math>shock_{i,t}</math>: shock in trade partner in year <math>t</math>; <math>weight_i</math>: weight of <math>i</math> in country <math>c</math> in year <math>t</math>.</p>		

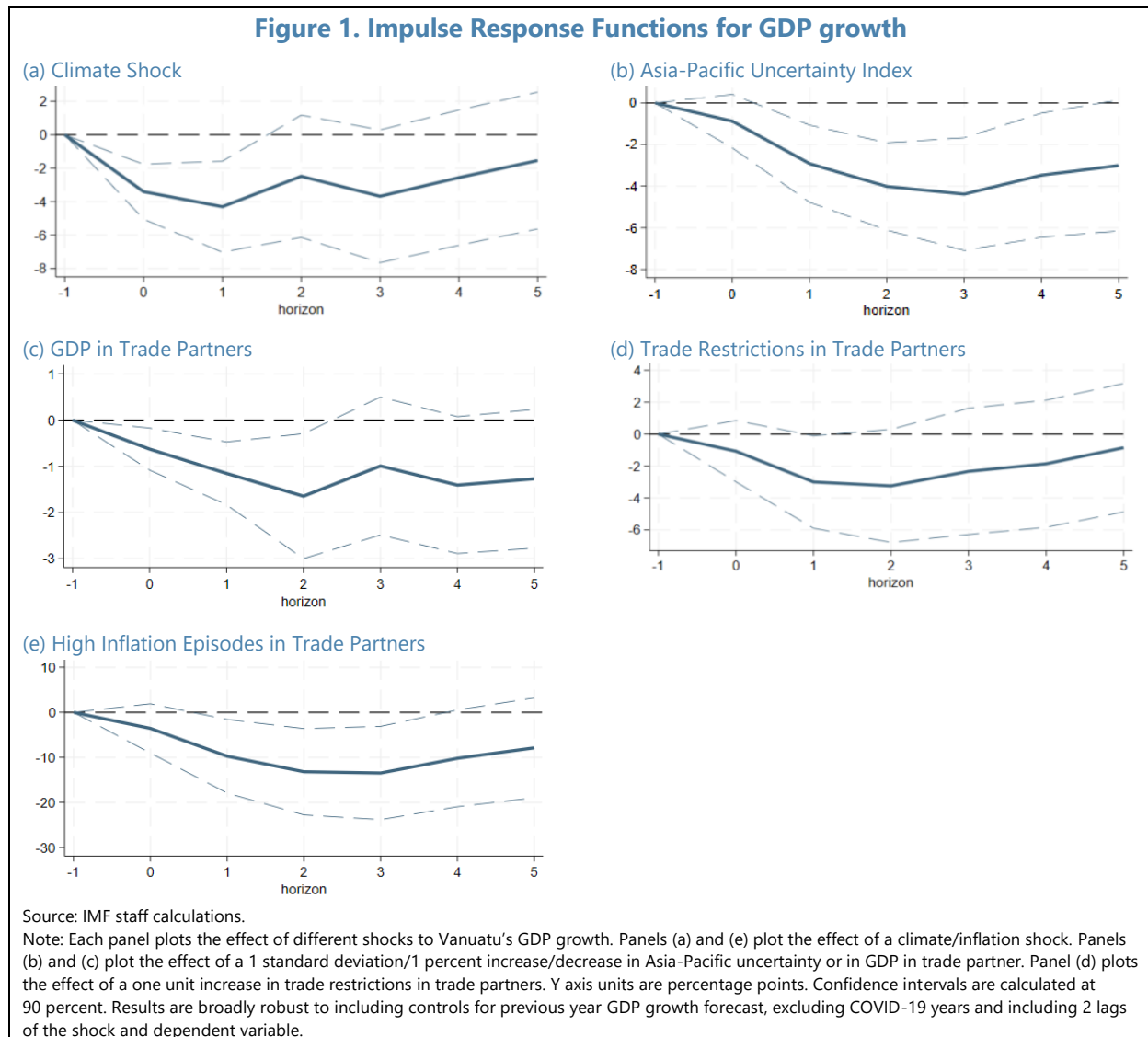
**5. Regional developments can affect growth as well.** Panel (b) examines the impact of increased regional uncertainty on Vanuatu's GDP growth. It shows that a one standard deviation increase leads to a GDP decrease of about 4 percentage points over three years.<sup>5</sup> Growth dynamics in trade partners can also influence Vanuatu's output by diminishing export demand. Panel (c) details the impact of a 1 percent drop in trade partner growth, which lowers Vanuatu's GDP growth by 2 percentage points, with the effect peaking after two years. The ongoing geoeconomic fragmentation has caused a rise in trade barriers globally. These barriers can reshape international trade dynamics and harm GDP growth by reducing trade flows, increasing costs, disrupting supply

<sup>3</sup> See Ahir and others (2022) and Baker and others (2016).

<sup>4</sup> See Ahir and others (2022).

<sup>5</sup> One standard deviation increase in the index corresponds to a level increase of about 46 percent. For context, in 2019-20, the index increased by around 61 percent, following the warnings of the emergence of the SARS-CoV-2 virus in China. In 2022 early, it increased by 55 percent following the start of Russia's invasion of Ukraine.

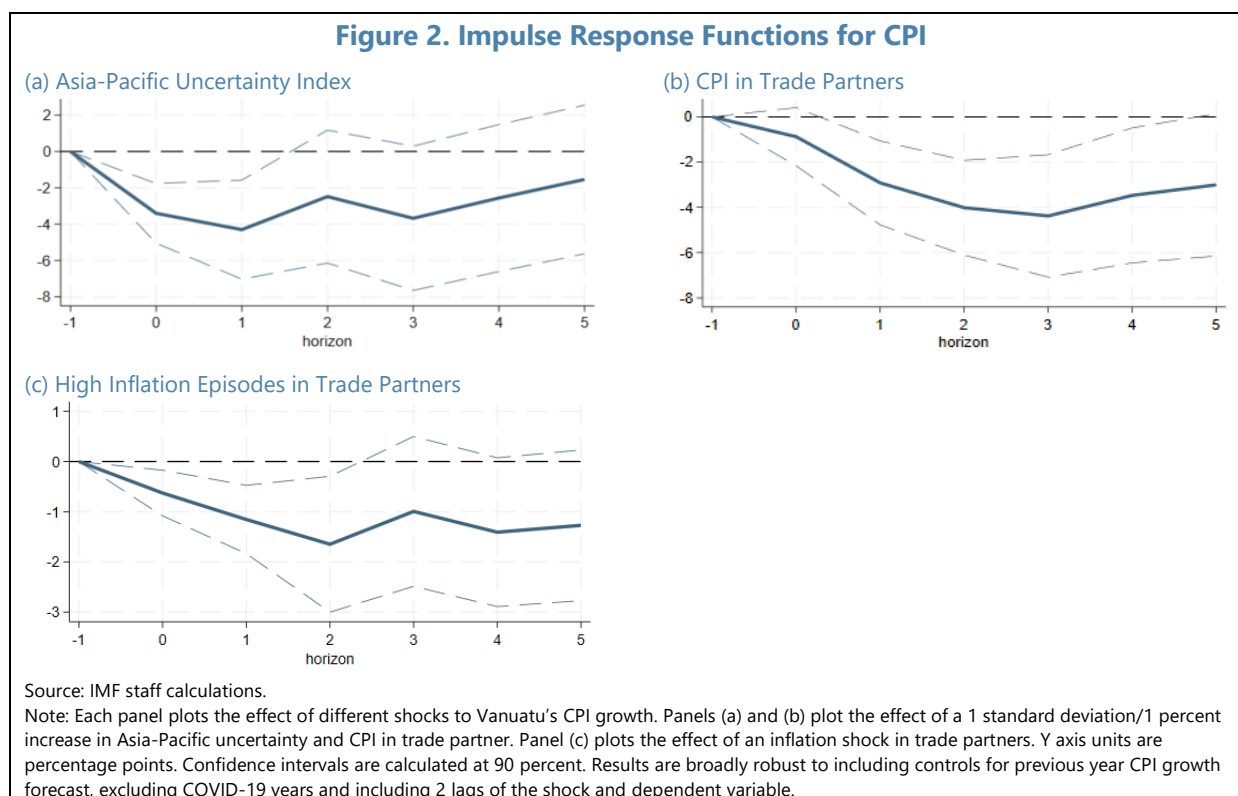
chains, and harming productivity and investment.<sup>6</sup> Panel (d) explores the effect of an increase trade barriers in Vanuatu's top five trade partners, showing a GDP reduction in Vanuatu of 3 percentage points, on average, within a year of the shock.



**6. Finally, inflation can also play a role on growth.** A substantial shock, such as the one seen in Australia in 2023Q2 with CPI increases of above 6 percentage points year on year, could lead to a sharp decline of Vanuatu's output about 10 percentage points. The impact of inflationary shocks is especially relevant as it can escalate import prices, crucial for Vanuatu's investment projects and supplies within the hospitality sector. These results also underline that the effects of these shocks

<sup>6</sup> See Estefania-Flores and others (2019), Asia-Pacific Department Regional Economic Outlook Chapter 3 (2021 and 2022) and Campos and others (2023).

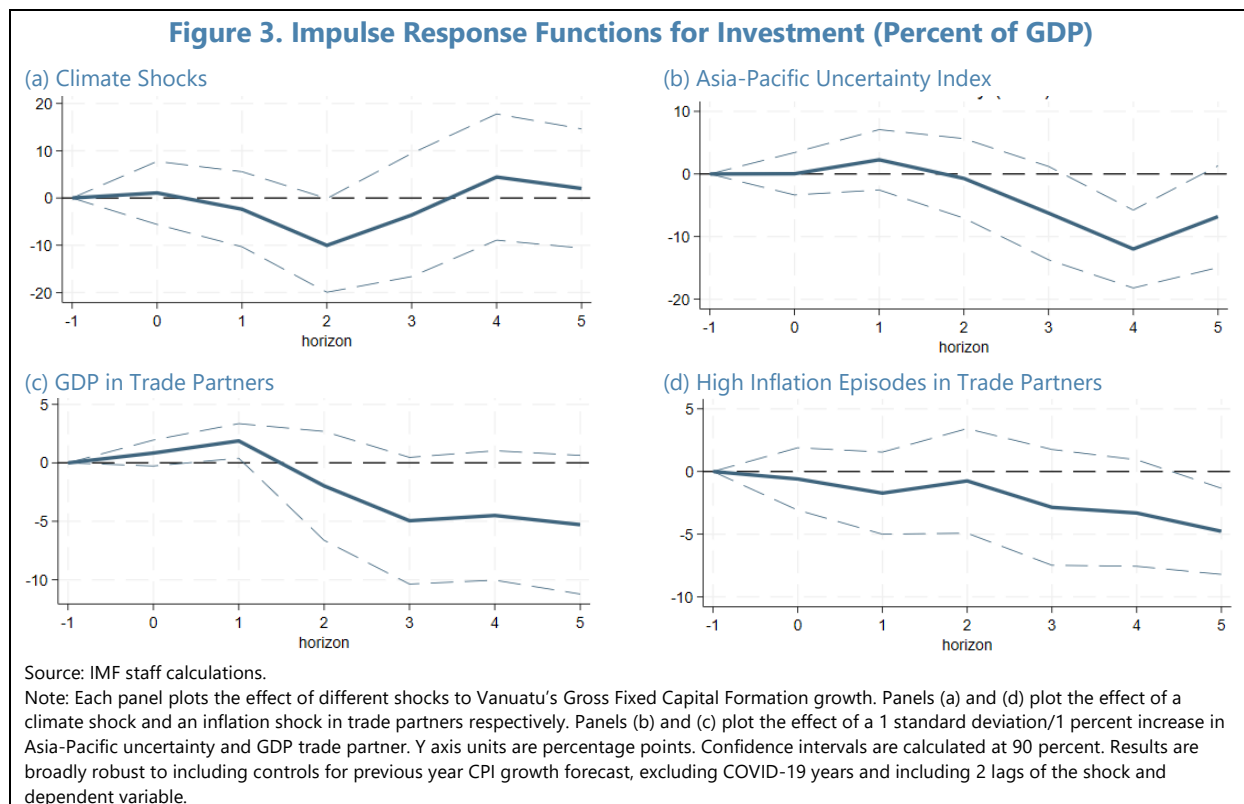
are long-lasting, persistently influencing Vanuatu's growth patterns for up to 5 years after their occurrence.



**7. The effect on domestic inflation is relatively more muted, but still important.** Figure 2 shows the results of local projection regressions on Vanuatu's CPI growth. Uncertainty can influence inflation, specifically through production and trade disruptions that can lead to supply shortages, exerting upward pressure on prices. Panel (a) indicates that uncertainty increases inflation in Vanuatu by approximately 1 percentage point two years following the shock. Inflation can also be transmitted from trade partners, via import prices. Panel (b) shows that a 1 percent increase in trade partners' inflation results in nearly a 2-percentage point rise in Vanuatu's inflation. Panel (c) further highlights that substantial inflation spikes in trade partners can amplify this effect to around 15 percentage points 2 years post-shock. Notably, the inflationary impact from trade partners is persistent, continuing to escalate up to five years after the initial shock. These findings underscore the need for the central bank to closely monitor these shocks and proactively manage monetary policy to mitigate their long-term effects.

**8. Finally, a similar analysis on the impact of shocks on Vanuatu's investment patterns has meaningful messages.** Climate shocks can undermine investment by causing physical damage to infrastructure, disrupting supply chains, and elevating prices due to shortages and increased demand for reconstruction materials. Additionally, these events can also decrease investor confidence, particularly deterring foreign investment, as resources shift from productive investments to recovery efforts. Figure 3 presents similar analysis for investment reported in the national

accounts. Panel (a) shows that 2 years after a climate shock, investment falls by 10 percentage points of GDP.



### 9. A significant portion of investment in Vanuatu occurs through donors and loans.

Uncertainty can undermine investment by eroding investor confidence and weakening the financial capabilities of investment partners.<sup>7</sup> Panel (b) illustrates that, although the impact is delayed, uncertainty negatively affects investment growth over the medium term in Vanuatu. Panels (c) and (d) highlight the significant role of economic conditions in trade partners for investment within the country. Adverse economic conditions in partners can suppress investment growth up to 5 percentage points of GDP. To navigate these challenges, Vanuatu needs to implement a robust investment program that enhances resilience and enables the country to sustain its economic development despite potential shocks that could hinder investment over the medium term.

**10. The recent increased frequency of shocks in the global economy and broad economic uncertainty, pose significant challenges to stability.** The analysis confirms that Vanuatu is highly susceptible to external shocks, which can substantially affect the nation's medium-term growth prospects, inflation trajectories and investment patterns. These shocks call for the implementation of targeted measures to address vulnerabilities and mitigate their impact. Measures include reducing or diversifying external dependence, refining monetary policy frameworks to manage inflationary pressures effectively, and improving the institutional quality to develop robust investment programs

<sup>7</sup> See Ahir and others (2022) and Baker and others (2016).

than can support sustained economic growth. Finally, improving the ability to monitor and react to economic indicators swiftly, can help ensure the country's growth trajectory amid rising global economic uncertainty.



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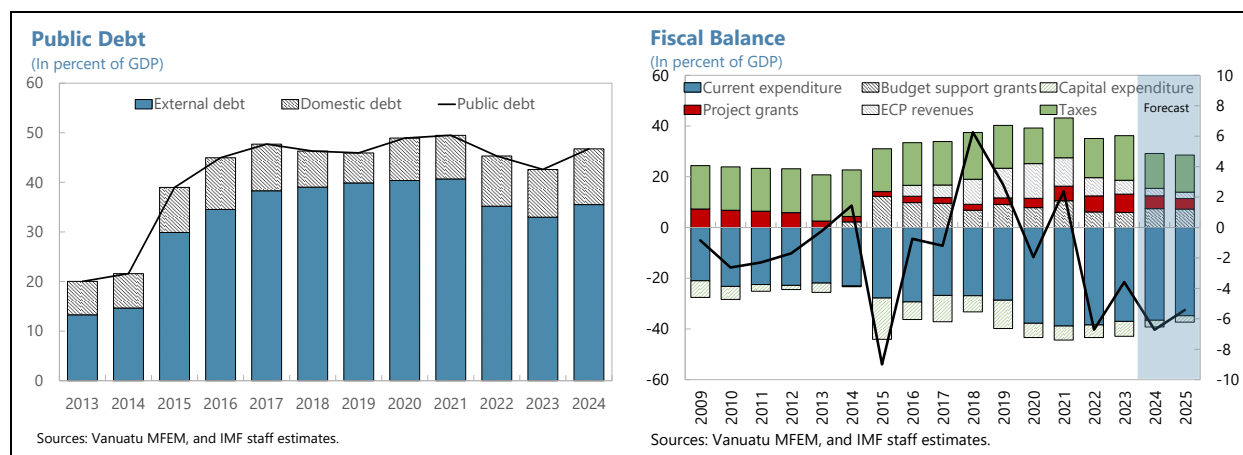
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## Annex VII. Vanuatu's Fiscal Framework

*Fiscal deficits have widened in recent years in the wake of the pandemic, multiple tropical cyclones, and the government's ambitious infrastructure development plans. Increased discretionary spending has been accompanied by sharp structural declines in the revenues from the Economic Citizenship Program (ECP), posing growing challenges for fiscal sustainability. This annex briefly explores the fiscal framework in Vanuatu and its effectiveness in maintaining medium-term fiscal sustainability.*

**1. In the wake of the COVID-19 pandemic and the subsequent tropical cyclones that hit Vanuatu between 2020 and 2024, the government maintained an expansionary fiscal policy to support the vulnerable segments and the economic recovery.** The services sector (mainly tourism), which was the most impacted through these shocks, received significant fiscal support, either via tax subsidies or moratoriums. In the Budget 2024, the government laid out ambitious plans to boost capital expenditure spending for infrastructure development, even while revenue from the Economic Citizenship Program (ECP) were projected to remain on a downward trend. Following the Air Vanuatu voluntary liquidation in May 2024, the government stepped in to assume the liabilities of the airline, including paying down arrears to lessors, compensating airline staff that were made redundant and absorbing entitlement costs.

**2. Public debt levels remain relatively steady, but the fiscal performance has worsened in recent years.** Public and publicly guaranteed (PPG) debt stood at an estimated VT55 billion (43 percent of GDP) as of end-2023, with external debt (33 percent of GDP) comprising three-fourths of total debt. Public debt reached a high of around 50 percent of GDP in 2021 but has edged lower in the past two years as the government made early repayments to external creditors (text figure). Meanwhile fiscal deficits have widened in recent years, on the back of a structural decline in ECP revenues combined with increased spending on discretionary items including wages, allowances, vehicles, and other items. Current expenditures have grown sharply since 2018, with the increased spending primarily funded through ECP revenues between 2018-2022 (text figure). Given little growth in tax revenue, combined with a sharp decline in ECP revenues, current expenditures look unsustainable.



**3. The fiscal rules framework for Vanuatu is guided by the Public Economic and Financial Management Act (PFEM), which stipulates the fiscal and budget responsibilities for the various agencies of government.** According to the principles of fiscal responsibilities detailed in the PFEM Act, contingent on prudent debt levels, “total overall expenditures of the State in each financial year should be less than its total overall receipts in the same financial year”, essentially stipulating a balanced budget. The principles also allow for deviations from this rule, stipulating that such deviations should be “temporary”, and, accompanied by adequate reasons for the deviation as well as a strategy and timeline to return to the principle. The PFEM Act requires agencies to publish an annual Budget Policy statement, assessing the consistency of the annual Budget with the PFEM principles. Additionally, the PFEM Act also necessitates a Fiscal Strategy report at the time of the introduction of the Appropriations Bill, assessing the consistency between the economic and financial assumptions and the Budget Policy statement. The Budget Policy statement also proposes indicative debt threshold levels as guidelines,<sup>1</sup> similar to the Medium-Term Debt Management Strategy (MTDS) document, including 60 percent of GDP for total public debt, 40 percent of GDP for external debt and 70 percent of total debt for FX debt (see table excerpt from the MTDS).

	<b>Current</b>	<b>Target</b>
Domestic debt ATM (years)	6.7	Above 10 years
Debt refixing in one year (%)	8.7	Below 6 percent
FX debt as a percentage of total debt	79.4	Below 70 percent
Total debt as a percentage of Nominal GDP	43.8	Below 60 percent
External Debt as a percentage of Nominal GDP	36.5	Below 40 percent
Domestic Debt as a Percentage of Nominal GDP	7.3	Below 20 percent

Sources: IMF; and Ministry of Finance and Economic Management calculations.

**4. The interpretation of the fiscal rule appears subjective and its implementation is inconsistent.** Discussions with the relevant stakeholders indicate a mixed picture on the interpretation of the fiscal rule as stipulated by the PFEM Act. One interpretation by the authorities is that the rule applies to the “recurrent items” only and “over the medium-term”, despite the fact that the PFEM Act clearly states that it applies to “total overall expenditures” and “in the same financial year.”<sup>2</sup> Moreover, the authorities’ definition of “recurrent items” is unclear, as it seems to include

<sup>1</sup> These indicative targets are not stipulated in the PFEM Act and do not constitute an official debt rule.

<sup>2</sup> For instance, the 2024 Budget Policy statement states that the long-term fiscal policy objective is that “recurrent balance is positive over the medium-term”.

capital expenditures, several one-off “New Policy Proposals,” loan repayments and miscellaneous expense items. In the budget document, these “recurrent” expenditure items are offset against “recurrent” revenue items that include budget support grants, domestic bond issuance and access to cash reserves.<sup>3</sup>

**5. Vanuatu is deemed to have a weak link between its fiscal rules framework and the annual budget process.**<sup>4</sup> There is no formal enforcement of the fiscal rule and no monitoring of the budget implementation outside the government and scant evidence of auditing. Moreover, while the balanced budget rule has legal basis, the exception clause in the PFEM Act allows ample leeway to deviate from the rule. Additionally, the debt rule (see MTDS Table above) is merely a political commitment and not enshrined in law. Combined with overly optimistic macroeconomic and revenue forecasts, the current processes engender fiscal slippage and widening budget deficits. The government has run deficits in three of the past five years, and is looking very likely to realize a large deficit in 2024 and in subsequent years given the impact of Air Vanuatu’s liquidation and the structural decline in ECP revenues.

**6. Re-establishing a fiscal anchor and improving enforcement of the fiscal rule are essential to secure medium-term fiscal sustainability.** As highlighted in the forthcoming IMF paper, MTFs are effective only when they are closely tied to the annual budget process and provide strategic guidance during budget preparations. Moreover, a clear assessment of downside risks can help formulate more realistic macroeconomic projections and design a better medium-term fiscal strategy. Improvements in public financial management (PFM) capacity, especially for strengthening budget planning and monitoring, expenditure management and accountability, will go a long way in achieving medium term fiscal sustainability.

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<sup>3</sup> See “Budget Overview” section of the Budget 2024 document for further details on the balancing of the budget.

<sup>4</sup> Forthcoming IMF paper on Fiscal Frameworks in Asia.

## Annex VIII. Data Issues

### 1. Vanuatu: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating 1/							
C							
Questionnaire Results 2/							
Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	B	B	C	C	B	C	C
Detailed Questionnaire Results							
Data Quality Characteristics							
Coverage	B	B	C	B	B		
Granularity 3/	B		B	C	B		
Consistency			C	C		C	
Frequency and Timeliness	D	B	C	C	A		
<p>Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.</p> <p>1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.</p> <p>2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF <i>Review of the Framework for Data Adequacy Assessment for Surveillance</i>, January 2024, Appendix I).</p> <p>3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.</p>							
A	The data provided to the Fund is adequate for surveillance.						
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.						
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.						
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.						
<p><b>Rationale for staff assessment.</b></p> <p>National accounts and balance of payments data are typically delayed at most by 1 to 3 years. National accounts data to calculate GDP from the production side is solid but official estimates from the expenditure side could be improved, as there are large statistical discrepancies. Prices data frequency is quarterly, which is broadly adequate for surveillance, but the data shows some consistency issues, more specifically, with the CPI weights. There has been a recent revision of the weights that might help resolve this issue. Balance of payments data is also typically subject to large revisions. While fiscal data is published at a higher frequency, certain elements such as ECP revenues, donor grants, SOE data, bilateral debt, etc. are not comprehensively and consistently reported. A variety of Government data systems were compromised in 2022 leading to difficulties in reconstructing sources which impacted a range of statistics. The external statistics were impacted leading to delays and possibly consistency issues for the 2022</p>							
<p><b>Changes since the last Article IV consultation.</b></p> <p>Recent revisions to the CPI weights may help resolve consistency issues. Authorities have implemented new software for calculating CPI and the use of scale, which will enhance accuracy. Additionally, they are working to improve GDP official estimates from the expenditure side and are developing methods to calculate GDP from the revenue side.</p>							
<p><b>Corrective actions and capacity development priorities.</b> Ongoing TA programs by STA/ICD/PFTAC are already addressing some of the issues mentioned above. Staffing, systems and funding generally for the statistics function are a key issue – similar constraints across the PIC region. Some data issues may be remedied through the use of memoranda of understanding and service level agreements between the primary party responsible and the source entities (this is likely more applicable to the DoFT/MEMF and the GFS (e.g., sourcing SOE data) and RBV. A security breach of government systems in 2022 led to serious data sourcing issues - resourcing for cybersecurity across government would help avoiding such disruptions.</p>							
<p><b>Use of data and/or estimates different from official statistics in the Article IV consultation.</b> The country team has needed to replace official data with its own estimates at places to ensure consistency across sectors and accounts. Also, for certain series (e.g. donor grant information, credit from MDBs etc.), information is sometimes obtained from alternate sources to cross-check with authorities data and sometimes is used to replace official information.</p>							
<p><b>Other data gaps.</b> Multiple data series pertaining to the population census, households, corporates, infrastructure projects, SOEs, labor related statistics and would be very helpful for a more comprehensive assessment.</p>							

### 2. Vanuatu: Data Standards Initiatives

Vanuatu participates in the Enhanced General Data Dissemination System (e-GDDS) and publishes the data on its National Summary Data Page since April 2019.

### 3. Vanuatu: Table of Common Indicators Required for Surveillance

As of June 30, 2024

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data <sup>6</sup>	Frequency of Reporting <sup>6</sup>	Expected Frequency <sup>6,7</sup>	Vanuatu <sup>8</sup>	Expected Timeliness <sup>6,7</sup>	Vanuatu <sup>8</sup>
Exchange Rates	Mar-24	Mar-24	M	M	D	M	...	1M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	Mar-24	Mar-24	M	M	M	M	1M	8W
Reserve/Base Money	Mar-24	Mar-24	M	M	M	M	2M	3M
Broad Money	Mar-24	Mar-24	M	M	M	M	1Q	3M
Central Bank Balance Sheet	Mar-24	Mar-24	M	M	M	M	2M	3M
Consolidated Balance Sheet of the Banking System	Mar-24	Mar-24	M	M	M	M	1Q	3M
Interest Rates <sup>2</sup>	Mar-24	Mar-24	M	M	M	M	...	1M
Consumer Price Index	Mar-24	Jun-24	Q	Q	M	Q	2M	6W
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> —General Government <sup>4</sup>	Dec-21	–	A	–	A	...	3Q	...
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> —Central Government	Feb-24	May-24	M	Q	Q	Q	1Q	2M
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>	Dec-23	Mar-24	Q	Q	Q	A	2Q	1M
External Current Account Balance	Dec-23	Jun-24	Q	Q	Q	...	1Q	...
Exports and Imports of Goods and Services	Dec-23	Jun-24	Q	Q	M	M	12W	1M
GDP/GNP	2021	Oct-23	A	A	Q	A	1Q	12M
Gross External Debt	Dec-23	Mar-24	Q	Q	Q	...	2Q	...
International Investment Position	Dec-23	Jun-24	Q	Q	A	...	3Q	...

<sup>1</sup> Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.

<sup>2</sup> Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

<sup>3</sup> Foreign, domestic bank, and domestic nonbank financing.

<sup>4</sup> The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

<sup>5</sup> Including currency and maturity composition.

<sup>6</sup> Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than.

<sup>7</sup> Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.

<sup>8</sup> Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (<https://dsbb.imf.org/>). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "...".



# VANUATU

## STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION— INFORMATIONAL ANNEX

July 23, 2024

Prepared By

The Asia and Pacific Department  
(In consultation with other departments)

### CONTENTS

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## FUND RELATIONS

(As of June 30, 2024)

**Membership Status:** joined September 28, 1981; Article VIII

### General Resources Account:

	SDR Million	Percent Quota
Quota	23.80	100.00
Fund holdings of currency	19.61	82.38
Reserves tranche position	4.20	17.63

### SDR Department:

	SDR Million	Percent Quota
Net cumulative allocations	39.08	100.00
Holdings	18.72	47.90

### Outstanding Purchases and Loans:

	SDR Million	Percent Quota
RCF Loans	1.70	7.14

### Latest Financial Arrangements:

#### Outright Loans:

Type	Date of Commitment	Date Drawn/Expired	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
RCF	Jun 05, 2015	Jun 15, 2015	8.50	8.50
RFI	Jun 05, 2015	Jun 08, 2015	8.50	8.50

### Projected Payments to the Fund <sup>1/</sup>

(SDR Million; based on existing use of resources and presenting holdings of SDRs)

	2024	2025	Forthcoming		
			2026	2027	2028
Principal	0.85	0.85			
Charges/Interest	0.41	0.82	0.82	0.82	0.82
Total	1.26	1.67	0.82	0.82	0.82

<sup>1/</sup> When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

**Implementation of HIPC Initiative:** Not applicable.

**Implementation of Multilateral Debt Relief Initiative:** Not applicable

**Implementation of Catastrophe Containment and Relief:** Not applicable



### **Exchange Rate Arrangements**

Vanuatu's de jure exchange rate arrangement is an adjustable peg. Currently, the exchange rate of the vatu is linked to a transactions-weighted (trade and tourism receipts) basket of currencies. The weights and composition of the basket, which are not publicly disclosed, are adjusted periodically. The Reserve Bank of Vanuatu (RBV) quotes daily buying and selling rates for the vatu against the U.S., Australian, and New Zealand dollars; the euro; the U.K. pound; and the Japanese yen. The rate in terms of the U.S. dollar as of June 30, 2024 was VT 118.83 per U.S. dollar. The de facto exchange rate arrangement is classified as "other managed," as the composite weights are not disclosed and cannot be confirmed. Vanuatu has accepted the obligations of Article VIII, Sections 2(a), 3, and 4 of the IMF's Articles of Agreement, and maintains an exchange system that is free of restrictions on making of payments and transfers for current international transactions and multiple currency practices.

### **Article IV Consultation**

Vanuatu is on a 12-month consultation cycle. The previous Article IV consultation mission took place over January 11 – January 25, 2023, and the consultation was concluded on March 20, 2023 (Country Report No. 23/115).

### **OFC Assessments**

The most recent Offshore Financial Center Module II Assessment, conducted by MFD, was concluded in May 2006.

### **Safeguards Assessment**

The first safeguards assessment of the RBV was completed in October 2016 in connection with emergency financing received in 2015. The assessment found that the RBV has a recognized accounting framework and publishes annual financial statements, albeit with some delay. It also identified several weaknesses in its governance arrangements, autonomy, transparency, and audit mechanisms. Recommendations included: (i) drafting amendments to the Reserve Bank of Vanuatu Act to align it with leading practices for central banks; (ii) establishing an Audit Committee; (iii) outsourcing internal audit services to an independent international audit firm; and (iv) formulating a recapitalization plan. The RBV received technical assistance on the recapitalization framework and appointed a Chief Risk Officer. That said, the absence of an audit committee and an internal audit function continue to present risks to the RBV's control environment. Furthermore, the RBV's plans to draft relevant amendments to the RBV Act in line with the 2016 safeguards recommendations have not materialized. Instead, the Parliament enacted, in June 2022, amendments to the RBV Act that further deteriorate the RBV's autonomy and governance arrangements. The authorities committed to repeal the 2022 amendments to the RBV Act in 2023 and continue their efforts.

### **Technical Assistance**

Technical assistance on macroeconomic analysis and framework, banking regulation and financial sector supervision, and government finance statistics has been provided mainly through PFTAC.

### **Resident Representative**

The resident representative office for the Pacific Islands, including Vanuatu, was opened in September 2010 in Suva, Fiji. Mr. Neil Saker is the current Resident Representative.

## RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

Relations with other IFIs:

- World Bank Group:

[http://projects.worldbank.org/search?lang=en&searchTerm=&countrycode\\_exact=VU](http://projects.worldbank.org/search?lang=en&searchTerm=&countrycode_exact=VU)

- Asian Development Bank:

<https://www.adb.org/countries/vanuatu/main>

- Pacific Financial Technical Assistance Center:

<https://www.pftac.org/content/dam/PFTAC/Documents/Workplans/fy23/Vanuatu.pdf>



# VANUATU

## STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION— DEBT SUSTAINABILITY ANALYSIS<sup>1</sup>

July 23, 2024

Approved By  
**Maria Gonzalez (IMF), Fabian  
Bornhorst (IMF) and  
Manuela Francisco (IDA)**

Prepared by the staff of the International Monetary  
Fund and the International Development Association

<b>Risk of external debt distress:</b>	High
<b>Overall risk of debt distress:</b>	High
<b>Granularity in the risk rating:</b>	Sustainable
<b>Application of judgement:</b>	No

*The voluntary liquidation of the national carrier Air Vanuatu has significantly increased uncertainty around the outlook and fiscal outcomes. The immediate fallout from this development will be on tourism and growth prospects, while the longer term fiscal implications could likely be protracted, accompanied by higher public debt. In addition to lower revenue from tourism receipts and duty fees, staff envisage a mixed picture on capital spending and other expenditures related to the Air Vanuatu liquidation. Under the baseline, the Debt Sustainability Analysis (DSA) concludes that the risk of overall debt distress remains high, similar to the June 2023 DSA, and the PV of public-debt-to-GDP ratio breaches the threshold level of 55 percent from 2033 onwards, a year later than in the previous DSA. The sharp reduction in revenues from the Economic Citizenship Program (ECP) is expected to create a structural fiscal deficit into the medium term, having a significant impact on future fiscal outcomes. Under an alternate scenario with zero ECP revenues, the PV of public-debt-to-GDP breaches the threshold level from 2027 onward.*

*The risk of external debt distress for Vanuatu has deteriorated to high (from moderate in the previous DSA), as the airline stoppage threatens service exports in the near term. The PV of external debt-to-exports ratio breaches the indicative threshold under the baseline scenario in 2024 and 2025. With the envisaged increase in external debt over the medium term, the PV of external debt-to-GDP breaches the threshold level of 40 in the later years (2033-34).*

*Public debt is deemed sustainable given the breaches are marginal and in the later years for external debt indicators. The sustainability of public debt hinges to a large extent on the success of the Air Vanuatu restructuring, to restore its commercial viability for domestic operations, the government's sustained ability to access highly concessional external loans,*

<sup>1</sup> The Composite Indicator (CI) for Vanuatu is estimated at 3.05, based on the April 2024 WEO and 2022 World Bank CPIA; given the CI score in this and previous vintages the debt carrying capacity for Vanuatu is assessed as medium.

*and it is anchored in the assumption of a gradually declining deficit. The deteriorating debt profile, and the high risk ratings in particular, highlights the urgent need for continued fiscal consolidation beyond what is assumed in the baseline scenario, strengthening debt management strategies and enhancing resilience against future shocks to ensure fiscal sustainability.*

## PUBLIC DEBT COVERAGE

### 1. The coverage of public sector debt for this debt sustainability analysis has changed from the DSA update in June 2023, in light of the liquidation of Air Vanuatu on May 10, 2024.

The debt stock covers the central government, central government guaranteed debt and central bank debt borrowed on behalf of the government. Given the high likelihood that the government will take over Air Vanuatu's liabilities, a significant portion of the debt owed by Air Vanuatu to creditors has now been accounted for within public debt (see details in the Box below). Because of data limitations, non-guaranteed SOE debt and private external debt are not included in the analysis.<sup>2</sup> However, a contingent liability scenario for the SOEs is considered (see below). The DSA uses a residency-based definition of external debt.

Subsectors of the public sector	Sub-sectors covered
1 Central government	X
2 State and local government	
3 Other elements in the general government	
4 o/w: Social security fund	
5 o/w: Extra budgetary funds (EBFs)	
6 Guarantees (to other entities in the public and private sector, including to SOEs)	X
7 Central bank (borrowed on behalf of the government)	X
8 Non-guaranteed SOE debt	

2. The DSA includes a combined contingent liabilities stress test, similar to that in the June 2023 (most recent) DSA update.<sup>3</sup> Given that a significant portion of Air Vanuatu's debt is now included as part of public debt for 2024, contingent liabilities now only include the estimated debt of other non-financial SOEs. Total debt of non-financial SOEs is estimated at around 1.6 percent of GDP, so the magnitude of the shock of SOE debt has been kept at the default value of 2 percent of GDP.<sup>4</sup> Contingent liabilities from financial markets are set at the default value of 5 percent of GDP, which represents the average cost to the government of a financial crisis in a low-income country.

<sup>2</sup> Given the limited capacity of Vanuatu's state and local governments, other SOEs (outside Air Vanuatu), and the private sector to borrow externally, other data deficiencies are not expected to affect the external assessment. PFTAC continues to provide technical assistance to help the authorities expand the coverage of government financial statistics (GFS) from budgetary central government to general government and SOEs.

<sup>3</sup> The June 2023 standalone IMF-World Bank Joint DSA for Vanuatu was performed at the request of the authorities following tropical cyclones Kevin and Judy in March 2023. It updated the information in the DSA included with the 2023 Article IV Consultation (published in late March 2023), and incorporated the most up-to-date information at the time of the effect of the natural disaster and the cost reconstruction efforts.

<sup>4</sup> The four SOEs included in the analysis are Port Vila Airport, Vanuatu Agricultural Development Bank, Vanuatu Broadcasting TV Company and Vanuatu Post Ltd. Financial reporting is poor and data for these entities is outdated. As a result, the default level of 2 percent of GDP is used for the contingent liability test. There is a likelihood that the 2 percent underestimates the true contingent liabilities of the SOEs to the government, but the lack of information precludes use of an alternate figure at this stage.

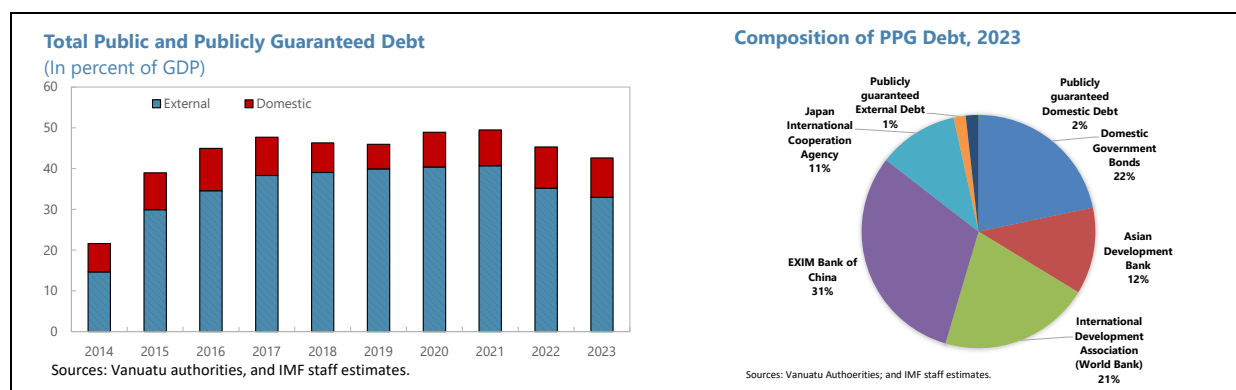
## BACKGROUND ON DEBT

**3. Public and publicly guaranteed (PPG) debt is estimated at approximately 43 percent of GDP at end-2023.** The end-2023 PPG debt stock in nominal terms is estimated at around VT54 billion (Table aside), compared to VT53 billion in 2022, while the composition is broadly unchanged from figures reported in the June 2023 DSA. External debt comprises over  $\frac{3}{4}$  of total public debt, with bilateral lender debt making up 44 percent of total debt and multilateral creditors holding the remaining (33 percent of total debt). The Export-Import Bank of China is the largest single creditor (31 percent of total debt), and Japan International Cooperation Agency (JICA) with 11 percent of total is the other main bilateral

	In Millions of Vatu	In Millions of US dollars	As % of total debt
<b>Total Stock of Debt</b>	54065	471.0	100.0
<b>External Debt</b>	41383	360.5	76.5
Multilateral	17827	155.3	33.0
Asian Development Bank	6497	56.6	12.0
International Development Association (World Bank)	11270	98.2	20.8
Multilateral Government Guarantees	60	0.5	0.1
Bilateral	23556	205.2	43.6
EXIM Bank of China	16718	145.6	30.9
Japan International Cooperation Agency	5993	52.2	11.1
Bilateral Government Guarantees	845	7.4	1.6
<b>Domestic Debt</b>	12682	110.5	23.5
Domestic Government Bonds	11736	102.2	21.7
Domestic Government Guarantees	946	8.2	1.7

Sources: Ministry of Finance and Economic Management; and IMF staff estimates

lender to the country. World Bank (21 percent) and ADB (12 percent) are the largest multilateral lenders to Vanuatu. The currency composition of the external debt portfolio is reportedly 46 percent in Chinese yuan, 21 percent in Japanese yen, 17 percent in US dollars, 13 percent in Euros and 3 percent in British pounds. Domestic debt comprises around 23.5 percent of total debt, primarily composed of domestic bonds held by domestic banks and the Vanuatu National Provident Fund (VNPF), the public pension fund.



**4. Preliminary estimates indicate external debt levels in 2023 have declined on the back of early repayments and reduced drawdowns on external loans.** Discussion with the authorities reveal that external debt owed to multilateral and bilateral creditors declined in 2022-23, primarily due to early repayments. Outstanding debt owed to JICA is estimated to have declined by around

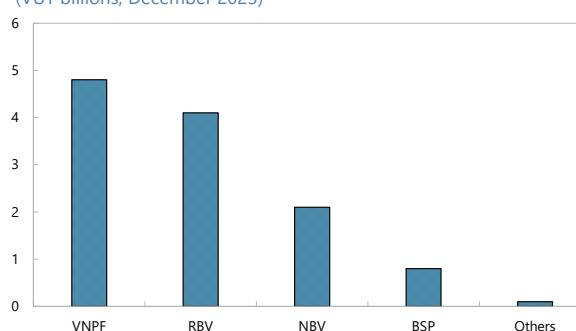
15 percent to around VT6 billion at end-2023. Among multilateral lenders, debt owed to IDA and ADB is estimated to have remained relatively unchanged or marginally declined in 2023, partly due to early repayments and slower-than-expected drawdown on loans due to delayed project execution. Downward revisions to the actual debt levels and external loan drawdowns, based on recent data from authorities and donors, have contributed to a declining external debt profile since 2020.

### 5. Domestic debt continues to grow and the government's issuance forecast in 2024-25 suggests that the domestic capacity for absorbing the bonds might be tested in the near-term.

The government's domestic debt is primarily held by four domestic entities, namely, the Reserve Bank of Vanuatu (RBV; that is, the central bank), the VNPF, the state-owned National Bank of Vanuatu and PNG-based BSP bank (text figure). As of 2023Q3, VNPF and RBV held a combined 69 percent of domestic government debt, while NBV (20 percent) and BSP (8 percent) held most of the remaining debt. The government's issuance forecasts for 2024 suggest that nearly VT5 billion in government bonds could potentially come to the market, the largest annual issuance to-date. Domestic debt is projected to rise from 10 percent of GDP in 2023 to around 15 percent of GDP by 2030, and to 20 percent of GDP by 2040. Given the relatively shallow depth of the domestic debt market, absorbing the bulk of the issuance in the near-term could prove difficult for the domestic creditors and may test the boundaries of borrowing from the RBV. Currently, RBV's holdings government debt already exceeds the threshold of 20 percent of the government's annual revenues.<sup>5</sup> Increased issuance in the domestic market could likely add to the growing reliance on monetary financing.

**Holders of Domestic Government Bonds**

(VUT billions, December 2023)



Sources: Ministry of Finance and Economic Management; and IMF Staff Estimates.

**6. The government had developed a medium-term debt management strategy (MTDS) for 2023-26, with the overarching objective of minimizing the long-term costs to the government and supporting the functioning of the domestic government debt market.**<sup>6</sup> The scope of the strategy includes debt of the central government and its guarantees issued to the SOEs. According to the MTDS, the average maturity of the external debt portfolio currently stands at 10.1 years, while that for the domestic portfolio is at 6.7 years. The debt redemption profile indicates

<sup>5</sup> While the original RBV Act had stipulated a limit on government bond holdings to 20 percent of average government revenue, an amendment to the Act in 2021-2022 raised this threshold to 40 percent. The government is considering reverting to the previous threshold, in line with IMF recommendations.

<sup>6</sup> Vanuatu is required to prepare and implement Performance and Policy Actions (PPAs) under the Sustainable Development Finance Policy (SDFP) to address key debt vulnerabilities in the country. Since FY21, Vanuatu has implemented PPAs in areas of debt management and debt transparency. Over the past four years, to mitigate risks from non-concessional sources of financing, Vanuatu has also adhered to a zero-Non-Concessional Borrowing Ceiling under the SDFP. With regards to debt transparency, Vanuatu has implemented reforms to improve the timeliness and coverage of debt data through publication of quarterly debt reports.

that around 8-10 percent of total external debt is maturing in each of the next four years, while between 5-10 percent of the total domestic debt is expected to mature in each of the next four years. The government has indicated plans to implement the Vanuatu Central Securities Depository System (VCSDS) to improve the government bond issuance process, and develop an Investor Relations strategy including the development and publication of an Annual borrowing Plan and Issuance calendar. The RBV's introduction of a fully automated registry for dematerialized securities, and the upcoming automated payment system, will also help improve transparency and efficiency and the development of the nascent domestic government debt market. In light of the Air Vanuatu liquidation, the government needs to urgently reassess its MTDS over 2024-27 and evaluate the likelihood and safeguards pertaining to breaching internal debt limits.<sup>7</sup>

## BACKGROUND ON MACROECONOMIC FORECASTS

### 7. **Growth had gradually been recovering up until Air Vanuatu's voluntary liquidation.**

The economy likely grew by 2.2 percent y/y in 2023 and was continuing to expand in 2024 until Air Vanuatu's voluntary liquidation in early May. The adverse impacts of sequential natural disasters in 2023—notably the three cyclones—significantly impeded recovery efforts, particularly in the agricultural sector. Nonetheless, the resurgence in tourism, recovering growth in trade partners, sustained inflows of remittances and the authorities' timely emergency response and recovery programs buffered the negative impact of the cyclones.

**8. Inflation increased sharply during 2022H2 and through most of 2023 in contrast to global price trends.** Inflation increased from 3.7 percent y/y in the second quarter of 2022 to 14.4 percent y/y in the second quarter of 2023. This spike was driven largely by food prices, which were significantly affected by the cyclones' impact on the agricultural sector. The consumer price index (CPI) decelerated in the second half of 2023, led by declines in electricity and gas prices, and it fell to 7 percent y/y in 2023Q4. Despite the recent downtrend, inflation continues to exceed the 0-4 percent inflation target range of the Reserve Bank of Vanuatu (RBV), with food prices being the primary driver.

**9. The government has been running deficits over the past two years and revenue outturns indicate that deficits will likely persist into the medium term under current policies.** Fiscal slippage has worsened in recent years, on the back of increased discretionary spending (e.g., public wage increases, housing allowances, acquisition of vehicles, etc.) driving deficits sharply wider in 2022 and 2023.<sup>8</sup> Budget 2024 (pre-Air Vanuatu's liquidation) was centered around a push for

<sup>7</sup> The authorities have set a threshold level of 60 percent of GDP for Total Debt and 40 percent of GDP for External debt in their MTDS and use primarily as strategic targets for their internal monitoring purposes. However, there is currently no enforcement procedure in place to prevent breaching these thresholds.

<sup>8</sup> According to the principles of fiscal responsibilities detailed in the Public Economic and Financial Management Act (PFEM), contingent on prudent debt levels, "total overall expenditures of the State in each financial year should be less than its total overall receipts in the same financial year", essentially stipulating a balanced budget. While the balanced budget rule has legal basis, the exception clause in the PFEM Act allows ample leeway to deviate from the



higher capital expenditure for infrastructure development and increased project execution of around VT17.5 billion (14 percent of GDP) in New Policy Proposals (NPPs), targeting infrastructure and capital improvements, adding to previous outlays.<sup>9</sup> Budget execution was already delayed by supply and execution capacity constraints, and the realism of the budget was already under question with unrealistic assumptions and forecasts.<sup>10</sup> The authorities passed a Supplementary Budget in May 2024, which included large spending items on allowances and legal expenses. Moreover, year-to-date outturns reveal that revenues from the Economic Citizenship Program (ECP) have collapsed and appear unlikely to recover, potentially leaving a structural deficit into the medium term. The government has not yet disclosed details of expenditure rationalization needed in light of the significant expenses materializing from Air Vanuatu's liquidation process (e.g. payments of arrears to creditors and lessors, the cost of restructuring and legal fees, and miscellaneous short-term spending needs). The recent liquidation event and loss of ECP revenues will almost certainly derail the 2024 Budget plans, although it will also offer opportunities for reprioritization and for adapting the overall spending envelope to available resources.

**10. Macroeconomic assumptions have been revised significantly in the wake of the Air Vanuatu liquidation and the collapse in ECP revenues.** Further assumptions pertaining to the Air Vanuatu impact are collated in a box later in this document.

- **Real GDP growth:** Under the baseline scenario, assuming rapid positive outcomes with respect to the services resumption of the airlines domestic operations, real GDP growth is still expected to decelerate markedly in 2024 to 0.9 percent and recover very gradually to around 1.5 percent in 2025.
- **Inflation:** Adverse effects from the airline situation are expected to be somewhat mitigated by the consistently strong demand for Vanuatu's exports of goods and services to its trading partners. As both internal (supply chain disruptions due to natural disasters) and external (import prices) price pressures ease, and as the fall in the tourism sector further reduces demand, staff estimate inflation to continue declining, to around 3.2 percent y/y by end-2024, and 2.3 percent y/y by end-2025 (inside the RBV's inflation target). Average inflation over 2024–2034 is predicted to be 2.1 percent, compared to the previous projection of 3.3 percent. This inflation profile is consistent with the averages in the previous DSA, declining in 2024 and 2025 before stabilizing over the medium-term within the RBV's target range of 0 to 4 percent.

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rule. For details on Fiscal Framework in Vanuatu, refer to Annex VII of the Staff Report for the 2024 Article IV Consultation.

<sup>9</sup> Key projects under the NPPs included: new airports and airport runway extension and facilities upgrades; building and upgrading of roadways; purchasing/leasing of new aircraft for the domestic carrier; and a water rehabilitation project.

<sup>10</sup> For instance, the government forecast real GDP growth of 5.2 percent y/y for 2024 and 6.5 percent y/y for 2025, relative to staff's 0.9 percent y/y and 1½ percent y/y forecasts respectively. Government revenues for 2024 assumed the strongest revenue outturns over the past three decades.

- **Revenue forecasts** are lower than the assumptions in the previous DSA, reflecting the immediate impact of the Air Vanuatu bankruptcy, ongoing recovery from three tropical cyclones in 2023 and the persistent decline in non-tax revenues associated with the ECP over the longer-term. ECP revenues were around 14 percent of GDP in 2020, but have declined to 5.4 percent of GDP in 2023. The baseline assumes ECP revenues will continue to decline, averaging around 2.5 percent of GDP in the medium-term. Further details on the fiscal assumptions are in the box below.

	Previous DSA				Current DSA				(current vs previous)			
	2024	2025	2024-29	2024-34	2024	2025	2024-29	2024-34	2024	2025	2024-29	2024-34
Real GDP growth, percent	2.6	3.5	2.8	2.7	0.9	1.5	1.8	1.9	-1.8	-2.0	-1.0	-0.7
Inflation (GDP deflator), percent	5.6	3.8	3.6	3.3	3.2	2.3	2.3	2.1	-2.4	-1.5	-1.3	-1.1
Nominal GDP (USD mn)	1263	1357	1483.0	1719.3	1169	1214	1297	1443	-94	-142	-186	-276
Revenue and grants	35.3	33.0	33.0	32.7	32.5	31.9	30.6	30.1	-2.8	-1.1	-2.4	-2.6
Primary expenditure	41.4	38.5	38.1	37.6	38.2	36.1	33.7	32.5	-3.1	-2.4	-4.4	-5.1
Primary balance	-6.0	-5.5	-5.2	-5.0	-5.7	-4.2	-3.2	-2.4	0.3	1.3	2.0	2.5
Exports of goods and services	26.8	32.6	31.3	31.4	16.1	18.5	24.9	29.2	-10.7	-14.0	-6.3	-2.2
Imports of goods and services	60.9	60.7	60.1	60.6	49.1	50.6	53.0	55.2	-11.8	-10.1	-7.1	-5.4
Current account balance	-3.8	1.5	0.7	0.5	-7.4	-6.5	-5.2	-4.7	-3.6	-8.1	-5.9	-5.2

- **External borrowing and grants** was expected to moderate from the highs seen in recent years, as COVID- and cyclone-related recovery and reconstruction assistance from development partners tapers, and earmarked financing for delayed large-scale infrastructure projects is slowly absorbed depending on the project completion rates. However, the fallout from the Air Vanuatu liquidation is expected to alter this trajectory (see box below). The forecast envisages an increase in budget support grants from development partners, partially helping offset the broader declining trend in grants post-COVID and post-cyclone. Budget support grants from development partners is estimated to increase in 2024-25, while that for infrastructure projects is expected to decline as the government scales back capital expenditure spending.
- **The current account deficit** is projected to widen substantially on the back of a sharp drop in tourism receipts in 2024 and 2025 due to the airline liquidation, with exports of goods and services expected to drop to 16.1 percent of GDP in 2024 before marginally recovering to 18.5 percent in 2025 (compared to 26.8 percent and 32.6 percent respectively in the previous DSA). The average deficit is estimated to be 4.7 percent of GDP over 2024–34 compared to a marginal surplus of 0.5 percent over the same period in the previous DSA.
- **Foreign direct investment inflows** are expected to average 3.6 percent of GDP over 2024–29, in line with the historical average of 3.5 percent. FDI remains key for Vanuatu’s growth and economic diversification.<sup>11</sup>

**11. The effects of natural disasters and climate change over the longer term are incorporated into the baseline scenario.** The scenario assumed there are no major costly disasters

<sup>11</sup> A detailed breakdown FDI data is currently not available for Vanuatu.

in 2024–28 (beyond those already materialized), to simplify the policy discussion of the near-term outlook—a standard practice in DSAs for other small states with a similar risk profile. After 2028 the baseline incorporates the average long-term effects of natural disasters and climate change. Based on empirical evidence on the impact of natural disasters, real GDP growth is lowered by 0.5 percentage points annually, the current account balance is lowered by 1.3 percent of GDP and the fiscal deficit is increased by 0.35 percent of GDP relative to disaster-free projections.

**12. Realism tools do not flag substantial risks around the forecast (Figure 4).** The projected total three-year fiscal adjustment (between 2023 and 2025) indicates a large increase in the deficit, on the back of the government’s voluntary liquidation plans for Vanuatu and the loss of ECP revenues. The realism tool suggests that the pace of current consolidation is relatively weak based on the distribution and could be bolstered. The real growth forecasts for 2024 and 2025 are below the projected growth paths under the different fiscal multipliers. This likely reflects the idiosyncratic nature of the Air Vanuatu shock and the growth effects from the potential scaling back of capex plans. The realism of projections for public and private investment rates and their contribution to real GDP cannot be assessed due to data availability constraints.

**13. Similar to the previous DSA, the fiscal balance continues to be the main driver for public sector debt.** The current account deficit is expected to widen sharply in the near-term on the back of the developments around Air Vanuatu, but subsequently normalize in the medium-term as the trade balance stabilizes. Meanwhile, the primary deficit is expected to remain high in the near-term—on the back of the Air Vanuatu grounding and weaker ECP revenues—driving public debt higher in the medium term.

## COUNTRY CLASSIFICATION

**14. Vanuatu’s debt carrying capacity is assessed as medium, as in the previous DSA.** The debt carrying capacity determines the applicable thresholds for the PPG external and total public debt sustainability indicators used in the assessment. The composite index (CI) is 3.05 based on April 2024 World Economic Outlook (WEO) data. The composite index (CI) captures: (i) information from

Applicable Thresholds	
<b>APPLICABLE</b>	
<b>EXTERNAL debt burden thresholds</b>	
PV of debt in % of	
Exports	180
GDP	40
Debt service in % of	
Exports	15
Revenue	18
<b>APPLICABLE</b>	
<b>TOTAL public debt benchmark</b>	
PV of total public debt in percent of GDP	55

the 2022 World Bank Country Policy and Institutional Assessment (CPIA) score; (ii) external conditions as captured by world economic growth; and (iii) country-specific factors including import coverage of reserves. Vanuatu's CI score of 3.05 compared to 3.02 in the previous DSA vintage (which was based on April 2023 WEO data). There is no change to Vanuatu's classification from the June 2023 DSA.

### Box 1. Implications of Air Vanuatu's Liquidation for the DSA

**Air Vanuatu's voluntary liquidation creates a highly uncertain outlook with prolonged and deep risks.**

Given ongoing developments and significant uncertainty on resolutions outcomes, staff's preliminary estimate for economic outcomes carries higher-than-usual confidence bands. Air Vanuatu entered voluntary liquidation in May 2024, a development expected to significantly impact the tourism sector and the execution of infrastructure projects. The tourism industry is anticipated to face substantial challenges due to the increased difficulty for tourists to visit and move around the nation, which will have spillovers to other related sectors like retail trade or transportation. Furthermore, disruptions in transportation are likely to affect the availability of labor for infrastructure investments, potentially compromising its implementation. The recent transition of Air Vanuatu into liquidation poses additional risks if a timely resolution is not achieved. While multiple airlines in the region have expressed interest in expanding capacity on international routes into Vanuatu, the future of domestic connectivity remains in doubt.

**Macroeconomic Assumptions.** Given the airline's liquidation, while economic growth is projected to see a marginal improvement in 2025, the forecast reflects a downward revision of 2 percentage points compared to the projections made in the previous DSA. Growth over 2024-29 is projected to average 1.8 percent, 1.0 percentage point lower than in the June 2023 DSA. The growth projections in 2024-2034 (Table above) have also been revised down to an average of 1.9 percent (from 2.7 earlier) for the reasons cited above. The decline in tourism due to the airline disruption is expected to weigh heavily on travel receipts in the second half of 2024, driving the current account deficit sharply wider, to around 7½ percent in 2024, before marginally recovering to a deficit of around 6½ percent in 2025.

**Debt.** Based on preliminary discussion with relevant stakeholders, staff estimate that contingent liabilities for the government related to Air Vanuatu could likely be around 2 percent of GDP, linked to the debt owed to secured creditors. In the DSA, it is assumed the government will honor the airline's secured debt obligations to ensure financial stability, and assume the secured debt will be realized as part of the public debt in 2024. Further, the DSA projects that costs to restructure the airline could total around VT3 bn (2.3 percent of GDP) in 2024, and a recurring annual expense is incurred in the years ahead if the airline continues to operate. Given the government's intentions to sustain the airline's domestic operations, the government is assumed to likely bear some of the annual operating costs moving forward particularly those toward community service obligations of the airline, reflecting the subsidy the government will likely need to provide to encourage any potential airline partners.

**External borrowing.** In order to finance costs related to Air Vanuatu's liquidation, the DSA assumes the government will raise concessional external debt and rely on grant financing over the next few years from multilateral and bilateral creditors, who have been proactive in supporting the government during past crisis. The external debt profile is contingent on the specifics of the external loan the government assumes, especially the repayment schedule. In the medium-to-long-term, the baseline assumes that external borrowing will continue to rely on grants and concessional lending, with development partners providing budget support but gradually reducing their contributions into the medium term.

**Fiscal.** The suspended operations of the national carrier are estimated to have a notable impact on tourism and the related VAT and excise duty receipts in 2024 and subsequent years. On expenditure, the liquidation of Air Vanuatu is estimated to have immediate implications on current expenses, especially with regard to

### Box 1. Implications of Air Vanuatu’s Liquidation for the DSA (Concluded)

payments that need to be made to the airline’s creditors. The expenses related to the restructuring and continuing operations of the airline are projected to lead to an increase in current expenditure in 2024 and a recurring expense into the medium term. This assumption implies that the fiscal deficit widens to around 6.7 percent of GDP in 2024, before easing to 5.4 percent in 2025. Moreover, the expected downsizing of Air Vanuatu’s international operations would likely lead to scaling back capital expenditure plans related to airport infrastructure and adversely impact the associated positive externalities. Overall, this implies a deteriorating deficit path in the baseline. While the expenditures linked to infrastructure development projects are expected to decline from their current highs, the decline and persistent weakness in ECP revenues, combined with a slowdown in grants, is expected to create deficits into the medium-term. The overall deficit is expected to average around 4.0 percent of GDP between 2024–2034.

## SCENARIO STRESS TESTS

**15. Similar to the earlier DSAs, staff conducted a contingent liability test for SOEs as well as a tailored stress test for a natural disaster shock given Vanuatu’s vulnerability to natural disasters.** For the combined contingent liability shock, since Air Vanuatu’s debt is now included in public debt, the staff set the default level for SOE debt at 2 percent of GDP to reflect the government’s financial support to the remaining commercially viable SOEs in Vanuatu. Staff continued using the default decrease in GDP of 5 percent from financial market turbulence. For Vanuatu, the default 5 percent of GDP value of the contingent liability can be interpreted as including a capital injection to an undercapitalized domestic bank. Vanuatu, which is classified as a small developing natural-disaster-prone state in the IMF (2016) policy paper on small states, is automatically subject to the LIC-DSF standard natural disaster shock. This is a one-off shock of 10 percentage points in the debt-to-GDP ratio in the second year of the projection period (2025 for this case). Staff adjusted the default parameters by assuming a reduction of real GDP and export growth by 4 and 10 percentage points respectively.<sup>12</sup>

### Combined Contingent Liability Shock

1 The country’s coverage of public debt	The central government, central bank, government-guaranteed debt		
	Default	Used for the analysis	Reasons for deviations from the default settings
2 Other elements of the general government not captured in 1.	0 percent of GDP	0.0	
3 SoE’s debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	2.0	
4 PPP	35 percent of PPP stock	0.0	
5 Financial market (the default value of 5 percent of GDP is the minimum value)	5 percent of GDP	5.0	
<b>Total (2+3+4+5) (in percent of GDP)</b>		<b>7.0</b>	

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country’s public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE’s debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

<sup>12</sup> See the details in IMF, 2016, “Small States’ Resilience to Natural Disasters and Climate Change: Role for the IMF,” *IMF Policy Paper December 2016* (<https://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/Small-States-Resilience-to-Natural-Disasters-and-Climate-Change-Role-for-the-IMF-PP5079>).

## DEBT SUSTAINABILITY

### A. External Debt Sustainability Analysis

**16. The PV of external debt-to-GDP and debt-to-exports ratio breach their indicative thresholds under the baseline scenario, unlike the previous DSA** (Figure 1 and Table 1). The PV of external debt-to-GDP ratio breaches the threshold of 40 between 2032-2034. The PV of external debt-to-exports ratio breaches the threshold in 2024 and 2025, reflecting the sharp drop in exports expected from the fallout of Air Vanuatu's voluntary liquidation. The external-debt-service-to-exports ratio and the external-debt-service-to-revenue ratio remain within their respective thresholds. The external debt service-to-exports and debt service-to-revenue ratios are on a declining trend until 2030, but increase thereafter based on the assumptions on the debt repayment schedule.

**17. The stress tests indicate that an export shock has the largest impact on the external debt profile.** Among the stress test scenarios, the export shock has the most severe impact, causing a breach to the threshold for multiple external debt metrics. The PV of external debt-to-GDP, PV of external debt-to-exports, and debt service-to-exports ratios all breach their respective thresholds at various periods of the forecast horizon. In the previous DSA, under the exports shock, the PV of debt-to-GDP had breached the threshold in 2030, while PV of debt-to-exports ratio breached the threshold from 2025 onwards.

- **Under the contingent liabilities scenario, which captures the government's exposure to SOEs (excluding Air Vanuatu), the PV of external debt-to-GDP and PV of external debt-to-exports ratios breach their indicative thresholds.** The PV of debt-to-GDP ratio breaches the threshold between 2029-2034, likely reflecting the backloaded external debt service schedule. The PV of external debt-to-exports breaches the threshold (180 percent) in 2024 and 2025, reflecting the sharp decline in exports expected due to the fallout from the Air Vanuatu bankruptcy. In the previous DSA, none of the indicators breached thresholds under this scenario.
- **Under the natural disaster scenario, the PV of external debt to-GDP and PV of external debt-to-exports ratios breach their thresholds.** The PV of debt-to-GDP ratio breaches its threshold from 2025 onwards, while the PV of external debt-to-exports ratio breaches its threshold (180) between 2024-2026, while the other indicators remain within the threshold. In the previous DSA, under this scenario the debt service-to-exports ratio breached its threshold and only temporarily for 2023.

**18. An alternate shock scenario, assuming zero ECP revenues, reveals significant deterioration of the external debt profile.** Under the assumption of zero ECP revenues, identical to the scenario used in the previous DSA, three quarters of lost ECP revenues are projected to be replaced by non-concessional external financing, with the remaining quarter by local debt issuance. Under this scenario, the PV of external debt-to-GDP ratio would breach the threshold starting 2026 and through the remainder of the forecast horizon. The PV of external debt-to-exports ratio breaches its threshold (180 percent) between 2024-2027 and then again between 2030-2034. This

scenario highlights the need for Vanuatu to diversify its revenue sources, consider broadening its tax base, and introducing income tax. In the previous DSA, under this scenario the PV of debt-to-GDP ratio breached its threshold from 2027 onward.

## B. Public Sector Debt Sustainability Analysis

**19. The PV of public-debt-to-GDP ratio breaches the threshold under the baseline scenario** (Figure 2 and Table 2). The PV of public-debt-to-GDP ratio breaches the 55 threshold between 2033-2034. This is a year later than the breach in the June 2023 DSA, reflecting similar deterioration in fiscal dynamics in the medium-term.

**20. Under the stress test scenarios, the PV of public debt-to-GDP metric breaches the threshold under multiple scenarios, with the growth shock having the largest impact** (Figure 2 and Table 4).

- **Under the growth, exports and primary balance shock scenarios, the PV of debt-to-GDP ratio breaches the threshold.** The PV of debt-to-GDP ratio breaches the threshold (55) starting in 2026 and remains above the threshold for the remainder of the forecast horizon. The other public debt indicators, namely the PV of debt to revenue and the PV of debt service-to-revenue ratios, remain within their thresholds. Under the natural disaster, the threshold is breached a year earlier, in 2025, and the PV of debt-to-GDP remains above the threshold for the remainder of the forecast horizon. In the previous DSA, the PV of debt-to-GDP ratio breached the threshold under the growth shock (2027 onward), primary balance shock (2030 onward) and exports shock (2028 onward) scenarios.
- **For the contingent liabilities shock, which captures the government's exposure to SOEs (excluding Air Vanuatu), and the alternate scenario of zero ECP revenues, the PV of debt-to-GDP ratio breaches the threshold.** Under both these scenarios, the threshold is breached starting in 2027 and the PV of debt-to-GDP remains above the threshold for the remainder of the forecast horizon. The other public debt indicators remain within their thresholds under both these scenarios. In the previous DSA, under this scenario the PV of debt-to-GDP ratio breached the threshold from 2029 onward.

**21. The scenarios highlight the urgent need for rebuilding fiscal buffers to enhance resilience against escalating fiscal risks and vulnerability to shocks.** The threshold breach in the baseline scenario highlights the growing fiscal risks linked to declining revenues and rising expenditures including capex spending. Effective revenue and expenditure management are essential to ensure medium-term fiscal sustainability. In particular, in addition to diversifying the revenue sources and letting cyclone-related VAT exemptions expire, the government should consider introducing a tax on personal income, to bolster the medium-term revenue prospects. On the expenditure side, continued fiscal slippage has to be avoided, especially discretionary government spending on items such as wages, allowances, travel, and vehicles, and government had to adopt strong fiscal consolidation measures. Given the sizeable capex spending proposals for the medium-term, enhancing public investment management and governance as well as bolstering



capacity to effectively oversee infrastructure projects would also help maintain public debt at sustainable levels in the medium-term.

## RISK RATING AND VULNERABILITIES

**22. Vanuatu's risk of external debt distress has deteriorated to high, from moderate in the previous DSA.** The Air Vanuatu liquidation is expected to worsen the external debt dynamics and leave no room for absorbing future shocks. The external debt-to-exports ratio breaches the threshold under the baseline scenario, albeit only in later years, while the stress tests indicate that the multiple shocks would result in breaches of the thresholds for three of the four external debt ratios. Under the baseline the external debt-to-GDP ratio is expected to overshoot the authorities' own ceiling of 40 in 2027. The debt trajectory highlights that external debt sustainability is at high risk and necessitates urgent fiscal consolidation measures as well as safeguards against contracting new external non-concessional debt. The sensitivity to export-related shocks suggest that Vanuatu should consider broadening its export base through diversification and build external buffers against shocks. Additionally, the ECP revenue shock also highlights the sensitivity of the debt profile to revenues, and the need to implement new revenue mobilization measures. Importantly, the contingent liabilities shock highlights the risks to the debt sustainability from SOEs that could potentially have much broader implications on the fiscal situation in the months and possibly years ahead.

**23. Vanuatu's overall risk of debt distress remains high, but the public debt trajectory remains sustainable.** The sustainability of public debt partially hinges on the success of the Air Vanuatu restructuring, to restore its commercial viability for domestic operations, and, the government's sustained ability to access highly concessional external loans. The benchmark for the PV of external-debt-to-GDP ratio is breached under the baseline scenario, albeit in later years, and there are breaches across multiple stress test scenarios. Additionally, the public-debt-to-GDP ratio would breach the authorities' ceiling of 60 percent by 2030. The rapidly deteriorating debt trajectory underlines the urgent need for prudent fiscal management for rebuilding fiscal buffers to address future shocks. In addition to strict safeguards against accumulating non-concessional external debt, this necessitates bolstering revenue mobilization measures, including by implementing the earlier decision to remove exemptions measures on VAT, widening the tax base and introducing income tax. Similarly, expenditure rationalization in the medium term has a crucial role to play. Importantly, the authorities should ensure a prudent approach to managing the potential liquidation of the national carrier, including limiting any future guarantees to SOEs, to safeguard debt sustainability. The Air Vanuatu situation has increased uncertainty around the fiscal outcomes, especially in the outer years of the forecast horizon. Given that the breaches of benchmark indicators are marginal and only in the later years, both external debt as well as public debt are deemed sustainable.

## AUTHORITIES' VIEWS

**24. While negotiations around Air Vanuatu's liquidation are still ongoing, the authorities have expressed a strong preference in sustaining the domestic operations of the airline.** This



may involve a joint venture with another airline and some form of government support, including, but not restricted to, subsidies for the community service obligations. In the event that the airline is revived with government support, the authorities have indicated that the government will allow the new airline to be operated by external management, with the government as a minority or majority stakeholder. They indicated that the government is not likely to assume the liabilities of the existing airline, but is open to considering capital injections in a new entity.

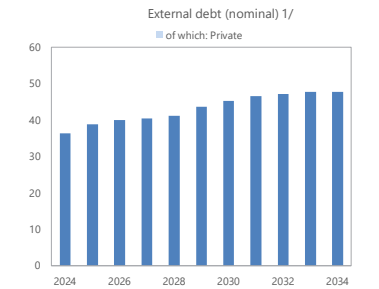
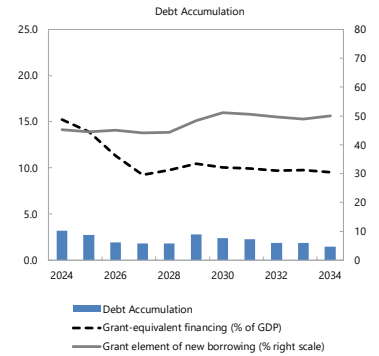
**25. The authorities agreed with staff on the urgent need to secure medium term fiscal sustainability.** The authorities attributed the decline of ECP revenue to AML/CFT-related delays and the re-activation of a cheaper program, but they are considering a revamp to allow them to keep a higher proportion of the fees. In the face of a structural decline in ECP revenue, they are evaluating the introduction of a capital gains tax. They acknowledged staff's recommendation for an income tax, but pointed to political considerations. Given that tax reforms would take time to implement, they acknowledged the urgent need for expenditure rationalization. Authorities concurred with staff on the fiscal slippage in the recent past, especially due to discretionary government spending on items such as wages, allowances, travel, and vehicles, and are keen to pursue a "reset budget" in 2025 around fiscal consolidation. The authorities acknowledged repeated delays in passing the GBE Act, and aim to pass it this year to strengthen the management and monitoring of Vanuatu's state owned enterprises.

**26. Given the sharp decline in ECP revenues and the higher costs pertaining to Air Vanuatu this year, the authorities have also indicated that they will need to raise VT5 billion from domestic bond markets in 2024, the highest annual domestic issuance on record.** This will likely involve significant purchases by the RBV, whose holdings of government debt already exceed 20 percent of average government revenues. While the authorities do not expect to take on any additional concessional external debt this year, they are open to discuss this option with development partners if the need arises. They indicated that development partners have come forward for providing additional budget support loans and grants this year, but concurred with staff's assessment that project grants will likely recede from last year's levels. On debt sustainability, the authorities acknowledge that urgent fiscal consolidation would be essential to secure medium term debt sustainability.

**Table 1. Vanuatu: External Debt Sustainability Framework, Baseline Scenario, 2021–44**  
(In percent of GDP, unless otherwise indicated)

	Actual			Projections											Average 8/		
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2044	Historical	Projections
External debt (nominal) 1/	40.7	35.2	33.0	36.3	38.8	39.9	40.4	41.1	43.7	45.2	46.5	47.1	47.7	47.7	43.0	34.6	43.1
of which: public and publicly guaranteed (PPG)	40.7	35.2	33.0	36.3	38.8	39.9	40.4	41.1	43.7	45.2	46.5	47.1	47.7	47.7	43.0	34.6	43.1
Change in external debt	0.3	-5.5	-2.2	3.3	2.5	1.1	0.6	0.7	2.5	1.6	1.3	0.6	0.6	0.0	-0.7		
Identified net debt-creating flows	5.3	6.8	-0.9	3.7	2.4	0.1	-0.6	-0.4	0.1	-0.4	-0.3	0.3	0.6	0.3	1.7	-2.3	0.5
Non-interest current account deficit	5.5	11.9	1.8	7.0	6.1	4.1	3.6	3.5	3.8	3.2	3.3	3.7	3.9	3.5	4.0	2.3	4.2
Deficit in balance of goods and services	46.0	41.8	30.2	33.0	32.1	27.9	25.6	25.1	25.0	24.0	23.7	23.8	23.6	22.9	21.8	24.3	26.0
Exports	9.1	15.0	27.1	16.1	18.5	23.9	27.4	31.1	32.5	32.9	33.6	34.3	35.0	35.6	41.6		
Imports	55.1	56.9	57.3	49.1	50.6	51.7	53.0	56.2	57.5	56.9	57.3	58.1	58.6	58.5	63.4		
Net current transfers (negative = inflow)	-22.4	-11.6	-15.5	-11.6	-11.1	-9.1	-7.7	-7.8	-7.8	-7.8	-7.8	-7.8	-7.8	-7.8	-9.4	-12.2	-8.5
of which: official	-18.2	-10.7	-10.5	-9.3	-8.8	-6.7	-5.4	-5.4	-5.4	-5.4	-5.4	-5.4	-5.4	-5.4	-7.1		
Other current account flows (negative = net inflow)	-18.1	-18.3	-13.0	-14.4	-14.9	-14.7	-14.2	-13.8	-13.4	-13.0	-12.6	-12.3	-11.9	-11.6	-8.4	-9.9	-13.3
Net FDI (negative = inflow)	-4.5	-0.9	-0.4	-3.4	-3.6	-3.8	-3.8	-3.7	-3.5	-3.4	-3.3	-3.1	-3.0	-2.9	-2.0	-3.5	-3.4
Endogenous debt dynamics 2/	4.3	-4.2	-2.3	0.1	-0.1	-0.3	-0.4	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.2		
Contribution from nominal interest rate	0.5	0.4	0.4	0.4	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6		
Contribution from real GDP growth	0.7	-0.7	-0.7	-0.3	-0.5	-0.8	-1.0	-0.8	-0.8	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9		
Contribution from price and exchange rate changes	3.1	-3.9	-1.9	...	...	...	...	...	...	...	...	...	...	...	...		
Residual 3/	-5.0	-12.3	-1.4	-0.4	0.1	1.0	1.2	1.1	2.5	2.0	1.5	0.3	0.1	-0.4	-2.3	4.2	0.8
of which: exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1		
<b>Sustainability indicators</b>																	
PV of PPG external debt-to-GDP ratio	...	...	33.4	35.1	36.4	36.8	36.9	37.2	38.4	39.2	39.8	40.1	40.3	40.1	34.1		
PV of PPG external debt-to-exports ratio	...	...	123.0	217.6	196.7	154.2	134.8	119.6	118.3	119.0	118.5	116.7	115.1	112.5	81.9		
PPG debt service-to-exports ratio	43.4	13.5	13.8	11.9	11.7	9.9	8.5	7.3	6.0	5.3	5.4	6.2	6.4	6.4	6.4		
PPG debt service-to-revenue ratio	13.0	8.4	14.3	9.6	10.6	11.2	10.7	10.4	9.0	7.9	8.3	9.8	10.3	10.5	12.3		
Gross external financing need (Million of U.S. dollars)	45.5	135.5	57.5	64.6	56.3	34.4	28.5	28.7	32.6	23.3	28.7	44.0	52.9	51.7	119.7		
<b>Key macroeconomic assumptions</b>																	
Real GDP growth (in percent)	-1.6	1.9	2.2	0.9	1.5	2.1	2.5	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	1.8	1.9
GDP deflator in US dollar terms (change in percent)	-7.2	10.7	5.8	3.2	2.3	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.4	2.1
Effective interest rate (percent) 4/	1.1	1.1	1.2	1.2	1.3	1.4	1.4	1.4	1.4	1.4	1.3	1.3	1.3	1.3	1.4	1.3	1.3
Growth of exports of G&S (US dollar terms, in percent)	-46.0	86.6	94.8	-38.1	19.1	34.4	20.0	18.2	8.7	5.5	6.3	6.2	6.1	6.0	5.5	7.4	8.4
Growth of imports of G&S (US dollar terms, in percent)	1.7	16.5	8.9	-10.8	7.0	6.5	7.1	10.3	6.5	3.1	4.8	5.5	5.0	4.0	4.7	5.0	4.4
Grant element of new public sector borrowing (in percent)	...	...	...	45.2	44.5	45.0	44.2	44.3	48.3	51.1	50.6	49.7	48.9	50.0	48.7	...	47.4
Government revenues (excluding grants, in percent of GDP)	30.5	24.2	26.1	20.0	20.5	21.2	21.8	21.8	21.8	21.8	21.8	21.8	21.8	21.8	21.8	26.1	21.5
Aid flows (in Million of US dollars) 5/	149.9	129.5	148.0	208.8	197.0	162.6	137.2	150.3	175.7	166.8	170.4	171.9	182.0	179.2	257.1		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	15.3	13.9	11.3	9.2	9.7	10.4	10.0	9.9	9.7	9.8	9.5	9.3	...	10.8
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	82.0	81.8	81.9	80.1	81.5	78.5	82.2	82.5	83.1	82.3	84.3	85.3	...	81.8
Nominal GDP (Million of US dollars)	921	1,039	1,123	1,169	1,214	1,265	1,323	1,377	1,433	1,492	1,553	1,616	1,682	1,751	2,612		
Nominal dollar GDP growth	-8.6	12.8	8.1	4.1	3.8	4.2	4.6	4.1	4.1	4.1	4.1	4.1	4.1	4.1	4.1	4.3	4.1
<b>Memorandum items:</b>																	
PV of external debt 7/	...	...	33.4	35.1	36.4	36.8	36.9	37.2	38.4	39.2	39.8	40.1	40.3	40.1	34.1		
In percent of exports	...	...	123.0	217.6	196.7	154.2	134.8	119.6	118.3	119.0	118.5	116.7	115.1	112.5	81.9		
Total external debt service-to-exports ratio	43.4	13.5	13.8	11.9	11.7	9.9	8.5	7.3	6.0	5.3	5.4	6.2	6.4	6.4	6.4		
PV of PPG external debt (in Million of US dollars)	...	...	374.8	410.4	442.0	465.6	488.3	512.0	550.7	584.9	618.7	647.3	677.4	702.0	889.5		
(PV-PVt-1)/GDPt-1 (in percent)	...	...	3.2	2.7	1.9	1.8	1.8	2.8	2.8	2.4	2.3	1.8	1.9	1.5	0.6		
Non-interest current account deficit that stabilizes debt ratio	5.2	17.4	4.0	3.7	3.5	3.0	3.1	2.8	1.3	1.6	2.0	3.1	3.3	3.6	4.6		

Definition of external/domestic debt	Residency-based
Is there a material difference between the two criteria?	No



Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as  $[r - g - p(1+g) + \epsilon\alpha(1+r)] / (1+g+p+g)$  times previous period debt ratio, with  $r$  = nominal interest rate;  $g$  = real GDP growth rate;  $p$  = growth rate of GDP deflator in U.S. dollar terms;  $\epsilon$  = nominal appreciation of the local currency, and  $\alpha$  = share of local currency-denominated external debt in total external debt.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Current-year interest payments divided by previous period debt stock.

5/ Defined as grants, concessional loans, and debt relief.

6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

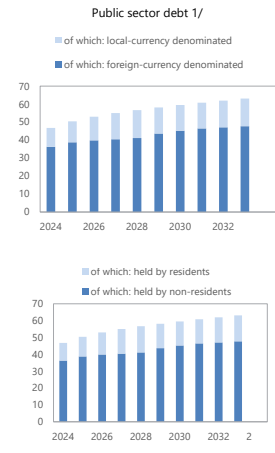
7/ Assumes that PV of private sector debt is equivalent to its face value.

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

**Table 2. Vanuatu: Public Sector Debt Sustainability Framework, Baseline Scenario, 2021–44**  
(In percent of GDP, unless otherwise indicated)

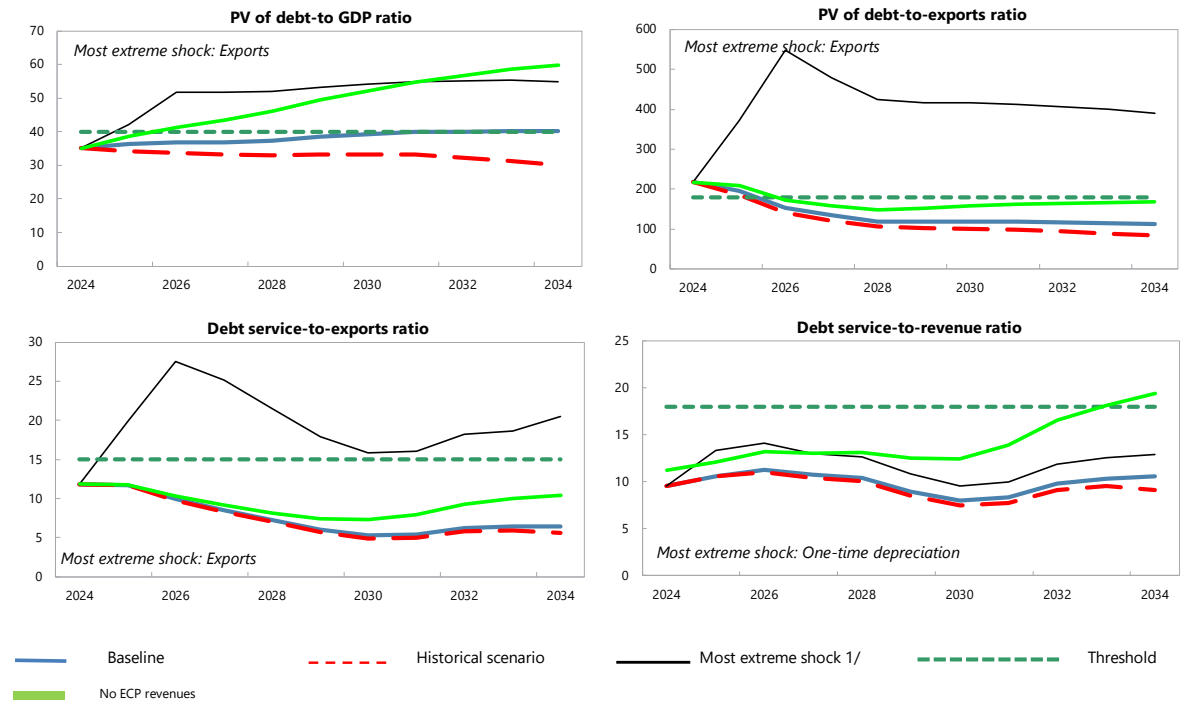
	Actual			Projections											Average 6/		
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2044	Historical	Projections
Public sector debt 1/ of which: external debt	49.5	45.3	42.6	46.7	50.4	53.0	55.0	56.6	58.1	59.5	60.8	61.9	63.1	64.2	75.8	43.2	57.2
Change in public sector debt	0.6	-4.2	-2.7	4.2	3.7	2.6	2.0	1.6	1.5	1.4	1.3	1.2	1.1	1.1	1.3	-0.9	1.8
Identified debt-creating flows	-0.2	1.7	-0.3	5.4	3.8	2.2	1.6	1.2	1.1	1.0	0.9	0.9	0.8	0.8	1.2	0.2	2.4
Primary deficit	-3.3	5.8	2.6	5.7	4.2	3.0	2.6	1.8	1.7	1.7	1.6	1.6	1.5	1.5	0.9	37.8	30.1
Revenue and grants	46.8	36.7	39.3	32.5	31.9	30.4	29.2	29.8	29.6	29.6	29.6	29.6	29.6	29.6	29.6	37.9	32.5
of which: grants	16.3	12.5	13.2	12.5	11.4	9.3	7.4	8.0	7.8	7.8	7.8	7.8	7.8	7.8	7.8		
Primary (noninterest) expenditure	43.4	42.5	41.9	38.2	36.1	33.4	31.8	31.6	31.3	31.2	31.2	31.1	31.1	31.0	30.5		
Automatic debt dynamics	3.1	-4.1	-2.9	-0.3	-0.5	-0.7	-0.9	-0.6	-0.6	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	0.0	0.0
Contribution from interest rate/growth differential	1.2	-1.6	-1.3	-0.3	-0.5	-0.7	-0.9	-0.6	-0.6	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	0.0	0.0
of which: contribution from average real interest rate	0.4	-0.7	-0.3	0.0	0.2	0.3	0.4	0.5	0.6	0.5	0.5	0.5	0.5	0.6	0.6	0.0	0.0
of which: contribution from real GDP growth	0.8	-0.9	-1.0	-0.4	-0.7	-1.1	-1.3	-1.1	-1.1	-1.2	-1.2	-1.2	-1.2	-1.3	-1.5	0.0	0.0
Contribution from real exchange rate depreciation	2.0	-2.5	-1.6	...	...	...	...	...	...	...	...	...	...	...	...	0.0	0.0
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual	0.9	-5.9	-2.4	-1.2	-0.1	0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.0	3.2	0.2
<b>Sustainability indicators</b>																	
PV of public debt-to-GDP ratio 2/	...	...	43.0	45.6	48.0	49.9	51.5	52.7	52.9	53.5	54.1	54.9	55.7	56.6	66.8		
PV of public debt-to-revenue and grants ratio	...	...	109.4	140.3	150.7	164.0	176.3	177.0	179.0	180.9	183.1	185.8	188.3	191.6	226.2		
Debt service-to-revenue and grants ratio 3/	11.5	9.4	13.1	9.4	11.3	10.7	11.9	12.1	19.6	10.7	14.3	13.9	15.7	17.7	27.7		
Gross financing need 4/	2.0	9.3	7.7	8.8	7.8	6.2	6.0	5.5	7.5	4.8	5.8	5.7	6.2	6.7	9.1		
<b>Key macroeconomic and fiscal assumptions</b>																	
Real GDP growth (in percent)	-1.6	1.9	2.2	0.9	1.5	2.1	2.5	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	1.8	1.9
Average nominal interest rate on external debt (in percent)	1.1	1.1	1.2	1.2	1.3	1.4	1.4	1.4	1.4	1.4	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Average real interest rate on domestic debt (in percent)	5.5	-4.5	-0.5	3.1	4.5	4.7	4.8	5.1	5.3	5.6	5.7	5.9	6.0	6.2	6.8	1.9	5.2
Real exchange rate depreciation (in percent, + indicates depreciation)	4.8	-6.3	-4.8	...	...	...	...	...	...	...	...	...	...	...	...	-1.0	...
Inflation rate (GDP deflator, in percent)	0.7	11.2	7.0	3.2	2.3	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	4.2	2.1
Growth of real primary spending (deflated by GDP deflator, in percent)	0.5	-0.2	0.8	-8.0	-4.1	-5.5	-2.5	1.6	0.9	1.9	1.9	1.9	1.9	1.9	1.3	11.3	-0.8
Primary deficit that stabilizes the debt-to-GDP ratio 5/	-3.9	10.0	5.3	1.6	0.6	0.4	0.5	0.2	0.2	0.3	0.4	0.4	0.4	0.4	-0.4	3.8	0.5
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Definition of external/domestic debt	Residence base
Is there a material difference between the two criteria?	No



Sources: Country authorities; and staff estimates and projections.  
 1/ Coverage of debt: The central government, central bank, government-guaranteed debt. Definition of external debt is Residence-based.  
 2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.  
 3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.  
 4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.  
 5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio (i.e., a primary surplus), which would stabilize the debt ratio only in the year in question.  
 6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

**Figure 1. Vanuatu: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2024–34 1/**



Customization of Default Settings		
	Size	Interactions
<b>Standardized Tests</b>	Yes	
<b>Tailored Stress</b>		
Combined CL	No	
Natural disaster	No	Yes
Commodity price	n.a.	n.a.
Market financing	n.a.	n.a.

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing assumptions on additional financing needs resulting from the stress tests*		
	Default	User defined
<b>Shares of marginal debt</b>		
External PPG MLT debt	100%	
<b>Terms of marginal debt</b>		
Avg. nominal interest rate on new borrowing in USD	1.2%	1.2%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	30	30
Avg. grace period	8	8

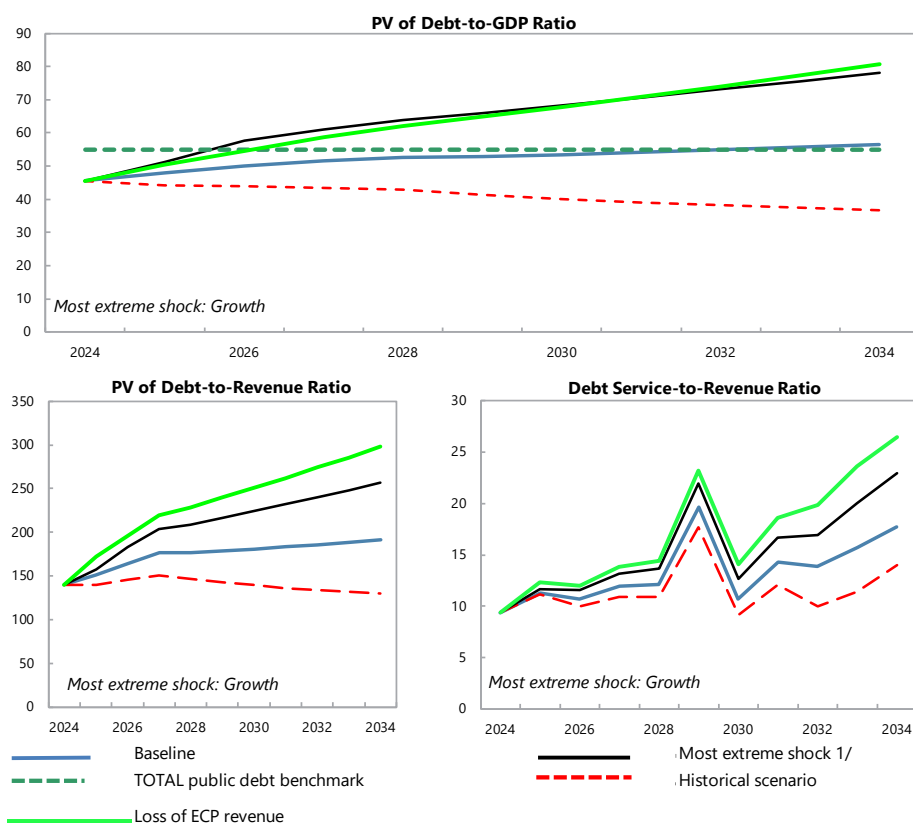
\* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2034. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

**Figure 2. Vanuatu: Indicators of Public Debt Under Alternative Scenarios, 2024–34 1/**



Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
<b>Shares of marginal debt</b>		
External PPG medium and long-term	69%	69%
Domestic medium and long-term	31%	31%
Domestic short-term	0%	0%
<b>Terms of marginal debt</b>		
<b>External MLT debt</b>		
Avg. nominal interest rate on new borrowing in USD	1.2%	1.2%
Avg. maturity (incl. grace period)	30	30
Avg. grace period	8	8
<b>Domestic MLT debt</b>		
Avg. real interest rate on new borrowing	5.8%	5.8%
Avg. maturity (incl. grace period)	8	8
Avg. grace period	6	6
<b>Domestic short-term debt</b>		
Avg. real interest rate	2.2%	2.2%

\* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2034. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

**Table 3. Vanuatu: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2024–34**  
(In percent)

	Projections 1/										
	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
<b>PV of debt-to GDP ratio</b>											
<b>Baseline</b>	35	36	37	37	37	38	39	40	40	40	40
<b>A. Alternative Scenarios</b>											
A1. Key variables at their historical averages in 2024-2034 2/	35	34	34	33	33	33	33	33	32	31	30
A2. Alternative Scenario: [Loss of ECP revenues]	35	39	41	44	46	49	52	55	57	58	60
<b>B. Bound Tests</b>											
B1. Real GDP growth	35	38	41	41	41	43	43	44	44	45	44
B2. Primary balance	35	38	40	40	41	42	43	44	44	45	45
B3. Exports	35	42	52	52	52	53	54	55	55	55	55
B4. Other flows 3/	35	41	45	45	46	47	48	48	49	49	48
B5. Depreciation	35	46	41	41	41	43	44	45	45	45	45
B6. Combination of B1-B5	35	44	46	46	46	48	49	49	50	50	49
<b>C. Tailored Tests</b>											
C1. Combined contingent liabilities	35	39	39	40	40	41	42	43	43	44	44
C2. Natural disaster	35	42	43	43	44	46	47	48	49	50	51
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Threshold</b>	40	40	40	40	40	40	40	40	40	40	40
<b>PV of debt-to-exports ratio</b>											
<b>Baseline</b>	218	197	154	135	120	118	119	118	117	115	113
<b>A. Alternative Scenarios</b>											
A1. Key variables at their historical averages in 2024-2034 2/	218	185	141	122	106	102	101	99	94	89	84
A2. Alternative Scenario: [Loss of ECP revenues]	218	209	173	159	148	152	158	163	165	167	168
<b>B. Bound Tests</b>											
B1. Real GDP growth	218	197	154	135	120	118	119	118	117	115	113
B2. Primary balance	218	206	169	148	131	130	130	130	129	128	126
B3. Exports	218	372	549	479	424	416	417	413	406	400	390
B4. Other flows 3/	218	220	190	166	147	144	145	144	142	139	136
B5. Depreciation	218	197	136	119	106	105	106	106	104	103	100
B6. Combination of B1-B5	218	279	175	236	209	206	207	205	202	199	194
<b>C. Tailored Tests</b>											
C1. Combined contingent liabilities	218	211	165	145	128	127	128	127	126	125	123
C2. Natural disaster	218	238	188	166	148	147	149	150	150	151	149
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Threshold</b>	180	180	180	180	180	180	180	180	180	180	180
<b>Debt service-to-exports ratio</b>											
<b>Baseline</b>	12	12	10	9	7	6	5	5	6	6	6
<b>A. Alternative Scenarios</b>											
A1. Key variables at their historical averages in 2024-2034 2/	12	12	10	8	7	6	5	5	6	6	6
A2. Alternative Scenario: [Loss of ECP revenues]	12	12	10	9	8	7	7	8	9	10	10
<b>B. Bound Tests</b>											
B1. Real GDP growth	12	12	10	9	7	6	5	5	6	6	6
B2. Primary balance	12	12	10	9	8	6	5	6	6	7	7
B3. Exports	12	20	28	25	22	18	16	16	18	19	21
B4. Other flows 3/	12	12	10	9	8	7	6	6	7	7	8
B5. Depreciation	12	12	10	8	7	6	5	5	6	6	6
B6. Combination of B1-B5	12	15	16	14	12	10	9	9	10	10	11
<b>C. Tailored Tests</b>											
C1. Combined contingent liabilities	12	12	10	9	7	6	5	6	6	7	7
C2. Natural disaster	12	13	11	10	8	7	6	6	7	7	7
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Threshold</b>	15	15	15	15	15	15	15	15	15	15	15
<b>Debt service-to-revenue ratio</b>											
<b>Baseline</b>	10	11	11	11	10	9	8	8	10	10	11
<b>A. Alternative Scenarios</b>											
A1. Key variables at their historical averages in 2024-2034 2/	10	11	11	10	10	9	7	8	9	10	9
A2. Alternative Scenario: [Loss of ECP revenues]	11	12	13	13	13	13	12	14	17	18	19
<b>B. Bound Tests</b>											
B1. Real GDP growth	10	11	12	12	12	10	9	9	11	11	12
B2. Primary balance	10	11	11	11	11	9	8	9	10	11	11
B3. Exports	10	11	12	12	12	11	9	10	11	12	13
B4. Other flows 3/	10	11	12	12	11	10	9	9	10	11	12
B5. Depreciation	10	13	14	13	13	11	10	10	12	13	13
B6. Combination of B1-B5	10	11	13	12	12	10	9	10	11	12	13
<b>C. Tailored Tests</b>											
C1. Combined contingent liabilities	10	11	11	11	11	9	8	9	10	11	11
C2. Natural disaster	10	11	12	11	11	9	8	9	10	11	11
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Threshold</b>	18	18	18	18	18	18	18	18	18	18	18

Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the threshold.

2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

3/ Includes official and private transfers and FDI.

Table 4. Vanuatu: Sensitivity Analysis for Key Indicators of Public Debt 2024–34

	Projections 1/										
	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
<b>PV of Debt-to-GDP Ratio</b>											
<b>Baseline</b>	46	48	50	51	53	53	53	54	55	56	57
<b>A. Alternative Scenarios</b>											
A1. Key variables at their historical averages in 2024-2034 2/	46	44	44	43	43	41	40	39	38	37	37
A2. Alternative Scenario: [Loss of ECP revenue]	46	50	55	59	62	65	68	71	74	77	81
<b>B. Bound Tests</b>											
B1. Real GDP growth	46	51	58	61	64	66	68	71	73	75	78
B2. Primary balance	46	51	56	58	59	59	60	61	61	62	63
B3. Exports	46	52	62	64	65	65	66	66	67	68	69
B4. Other flows 3/	46	52	58	60	61	61	62	63	63	64	65
B5. Depreciation	46	56	56	56	55	54	53	52	51	50	50
B6. Combination of B1-B5	46	49	52	51	53	53	53	54	55	55	56
<b>C. Tailored Tests</b>											
C1. Combined contingent liabilities	46	53	55	56	58	58	58	59	60	60	61
C2. Natural disaster	46	57	60	62	64	65	66	68	69	70	72
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>TOTAL public debt benchmark</b>	55	55	55	55	55	55	55	55	55	55	55
<b>PV of Debt-to-Revenue Ratio</b>											
<b>Baseline</b>	140	151	164	176	177	179	181	183	186	188	192
<b>A. Alternative Scenarios</b>											
A1. Key variables at their historical averages in 2024-2034 2/	140	140	146	151	147	143	139	136	134	132	130
A2. Alternative Scenario: [Loss of ECP revenue]	9	12	12	14	14	23	14	19	20	24	26
<b>B. Bound Tests</b>											
B1. Real GDP growth	140	158	183	203	209	217	224	232	240	248	257
B2. Primary balance	140	161	185	198	199	201	203	205	208	209	212
B3. Exports	140	164	204	218	218	220	222	224	227	230	232
B4. Other flows 3/	140	164	192	205	206	208	210	212	215	217	220
B5. Depreciation	140	182	189	195	190	186	182	179	177	174	173
B6. Combination of B1-B5	140	156	170	177	177	179	181	183	186	188	190
<b>C. Tailored Tests</b>											
C1. Combined contingent liabilities	140	166	180	193	194	196	198	200	202	204	207
C2. Natural disaster	140	178	195	211	213	218	222	227	231	234	239
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Debt Service-to-Revenue Ratio</b>											
<b>Baseline</b>	9	11	11	12	12	20	11	14	14	16	18
<b>A. Alternative Scenarios</b>											
A1. Key variables at their historical averages in 2024-2034 2/	9	11	10	11	11	18	9	12	10	11	14
A2. Alternative Scenario: [Loss of ECP revenue]	9	12	12	14	14	23	14	19	20	24	26
<b>B. Bound Tests</b>											
B1. Real GDP growth	9	12	12	13	14	22	13	17	17	20	23
B2. Primary balance	9	11	11	13	13	21	12	15	17	20	21
B3. Exports	9	11	11	13	13	20	11	15	15	16	19
B4. Other flows 3/	9	11	11	12	13	20	11	15	14	16	19
B5. Depreciation	9	12	13	14	14	21	12	16	16	17	19
B6. Combination of B1-B5	9	11	11	12	12	20	11	14	14	17	19
<b>C. Tailored Tests</b>											
C1. Combined contingent liabilities	9	11	11	13	13	20	11	15	17	19	18
C2. Natural disaster	9	12	12	13	14	22	13	16	20	22	21
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

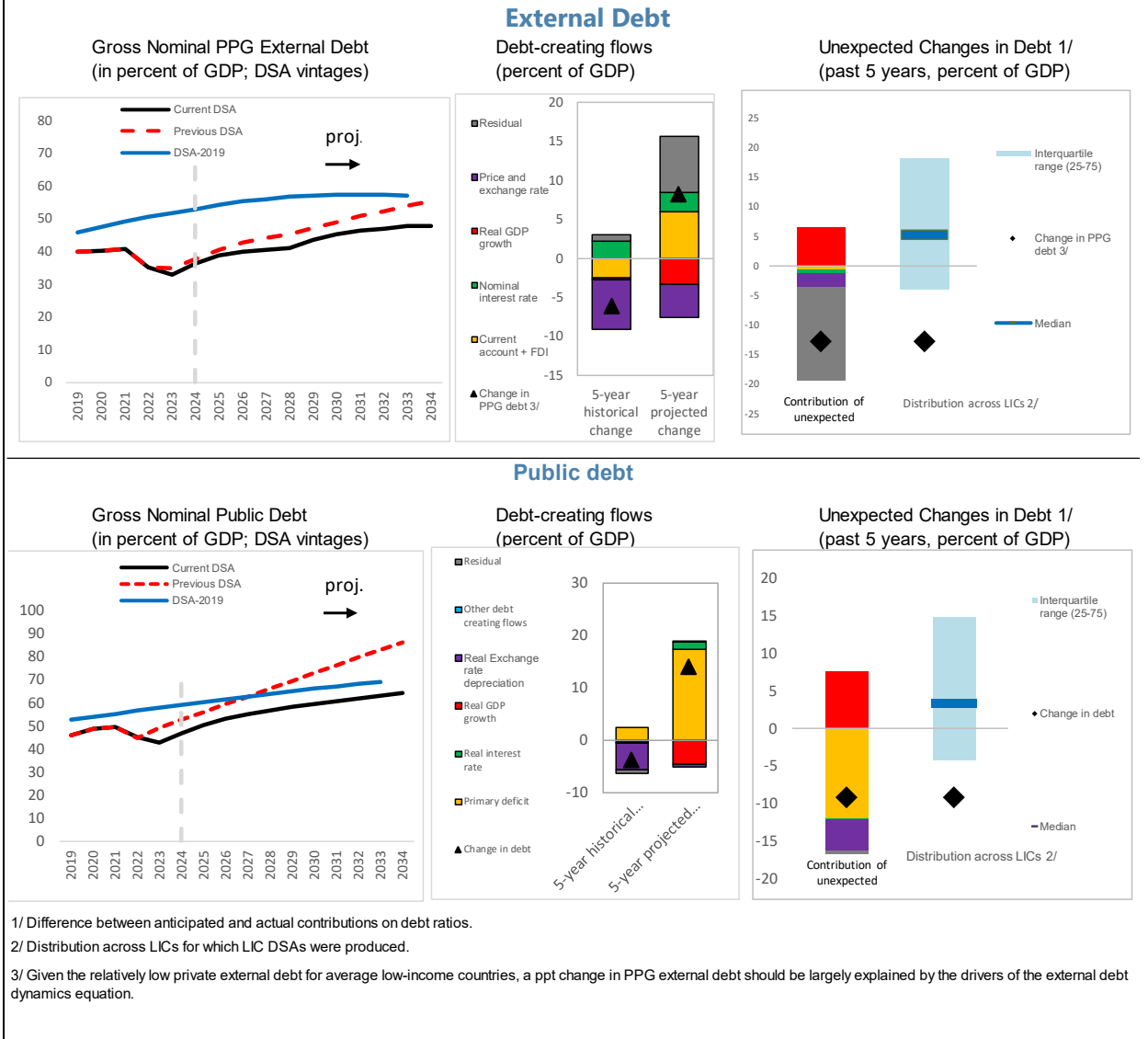
Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the benchmark.

2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.

3/ Includes official and private transfers and FDI.

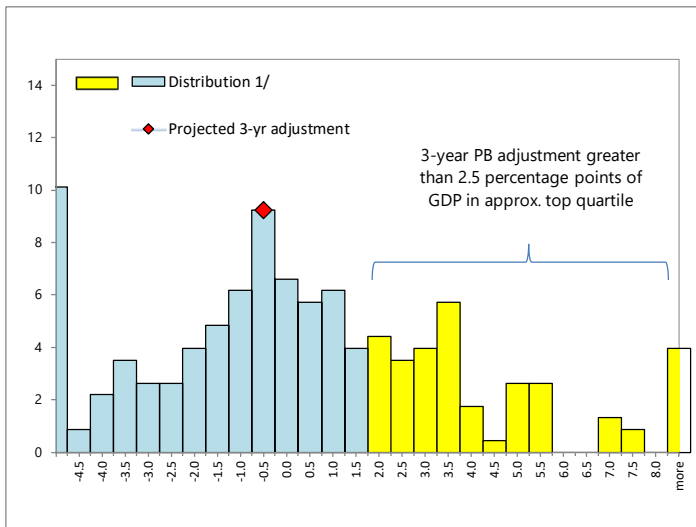
**Figure 3. Vanuatu: Drivers of Debt Dynamics – Baseline Scenario**





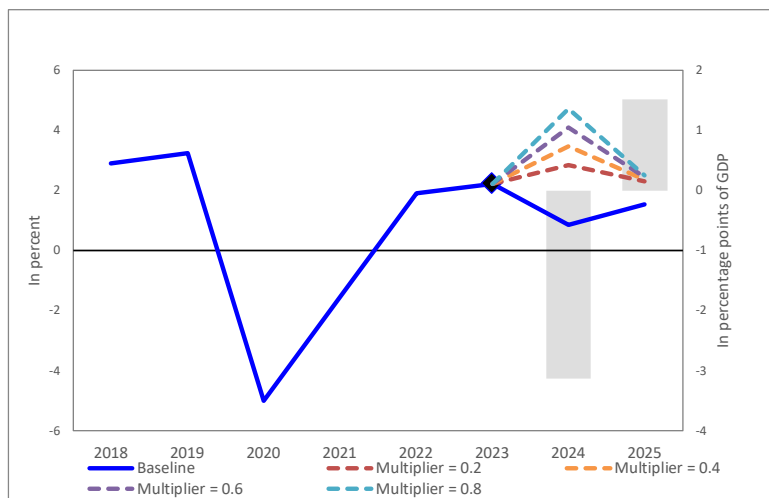
**Figure 4. Vanuatu: Realism Tools**

**3-Year Adjustment in Primary Balance  
(Percentage points of GDP)**



1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

**Fiscal Adjustment and Possible Growth Paths 1/**



1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

**Statement by Robert Bruce Nicholl, Executive Director for Vanuatu  
And Tanuja Doss, Senior Advisor to the Executive Director  
August 22, 2024**

Vanuatu's authorities are grateful to mission chief Mr. Papageorgiou and his team for their open and constructive engagement around the most recent Article IV mission. They also appreciate the high quality and candidness of the team's analysis and findings, and the careful thought underpinning their advice. The authorities broadly agree with staff's assessment of the outlook and with the thrust of staff's recommendations.

Vanuatu is a small developing state, with a population of just over 300,000 that is spread across an archipelago of 80 islands in the South Pacific. The country sits on the active 'Ring of Fire' tectonic boundary, and is extremely vulnerable to earthquakes, volcanoes, and cyclones. Vanuatu is heavily reliant on grants and concessional lending from multi-lateral development banks, and through long-standing bilateral relationships with donor countries engaged in the Pacific region. Vanuatu has an open but narrow economy that is constrained by shallow institutional capacity and a history of political instability. Following three changes of government in 2023, Ni-Vanuatu voted in a recent referendum to support a constitutional amendment, which is now in effect and aims to reduce Parliamentary instability.

***Context and outlook***

The economy experienced a gradual recovery in early 2024 following damage by twin cyclones in 2023 but this recovery has been set back by the realization of longstanding risks around the national airline, Air Vanuatu. In May this year, the authorities took the difficult decision to voluntarily cease all operations and commence liquidation. This led to an immediate and significant disruption to airline employees and service providers, residents who relied on domestic services to travel within the country, and foreign travelers who either held tickets or were planning travel. Air Vanuatu's flights and planes, particularly internationally, were frequently subject to significant delays and cancellations. Therefore, the economic impact from the grounding, while severe, is less than if the airline had been operating at full potential.

Since the cessation of operations, alternative international airline capacity has been restored, with other carriers in the region having increased flight connections to Port Vila. Vanuatu's authorities are working with partners for a satisfactory resolution to Air Vanuatu's financials and to the full restoration of domestic flights that connect outer islands to the capital and to one another. The authorities face a difficult choice between restoring certainty by resolving the situation as quickly as possible, or taking the time required to ensure a sustainable future model is put in place. They are mindful that such arrangements, to be successful, cannot repeat the lack of transparency, poor governance, and other past mistakes associated with the former national flag carrier. In particular, the authorities are seeking a solution that will not require direct public-sector management of airline operations. The authorities are in discussions with the liquidator around what organizational

structure a new airline could adopt to avoid repeating past shortcomings. Discussions with the liquidator and the outcome of the bidding process for interested parties to operate a new airline are expected to be concluded by early September. Until then, the intermediate economic and fiscal outlook remain uncertain.

The authorities agree with staff that the outlook for 2024 has worsened but are more optimistic about the ongoing magnitude of the recent shock both in and beyond 2024. Vanuatu's Macroeconomic Committee met in July and has revised economic and fiscal forecasts, downgrading GDP growth for 2024 to 2.8 percent and in 2025 to 3.8 percent. Given the historical lack of reliability and regular cancellation of Air Vanuatu flights, the new arrangements that have commenced for international flights and that are being considered to restore domestic flights are expected to lead to improved competition and reliability, which in turn is expected to support a stronger medium to longer term outlook for air travel demand than previously experienced.

### *Fiscal*

The authorities are aligned with staff on the need for fiscal consolidation and a credible strategy to secure medium-term fiscal prudence. The fiscal position is significantly challenged by the recent materialization of two long-standing risks—financial and economic exposure to the airline; and a disproportionate reliance on revenue from Vanuatu's Economic Citizenship Program (ECP). The authorities acknowledge consistent past advice from Fund staff on both of these risks, and recent budget updates include a scenario that shows the severe impact on Vanuatu's debt-to-GDP ratio if all ECP revenue were to be lost.

The liquidation of Air Vanuatu presents a substantial shock to the budget, including from a sharp drop in tourism related heads of revenue (primarily the Value Added Tax) and contingent liabilities associated with Air Vanuatu as a large and complex SOE. The authorities have already taken on some of Air Vanuatu's responsibilities, including paying for the benefits and entitlements of laid off staff and diverting part of the country's capital budget to repay some of the airline's debts. The authorities also anticipate further expenses associated with the liquidator and creditor processes, and the possibility of needing to recapitalize a replacement arrangement for domestic flight services. Furthermore, depending on the final arrangements, the government may need to subsidize domestic routes between islands on an ongoing basis to meet Community Service Obligations that ensure air travel remains reasonably accessible and affordable for Ni-Vanuatu.

The authorities are mindful that internal services arrangements will require a detailed understanding of the commercial challenges of maintaining domestic routes. These include a heavy reliance by the outer island populations on air travel, together with binding income constraints on residents' ability to pay and the relative costs and cost recovery opportunities across the range of routes. The authorities understand that this event offers opportunity to consolidate financial exposures and implement sustainable future arrangements. The authorities also understand that

they require expert external (financial and technical) advice and strong processes to arrive at sufficiently robust and stable new arrangements.

The second longstanding fiscal risk that has recently materialized is the loss of revenue from the sale of passports under the ECP, which has previously accounted for as much as 14 percent of GDP. The authorities note that staff link this drop in revenue to permanently lower future demand for the ECP as other jurisdictions remove or pause their visa waivers for holders of Vanuatu passports. The authorities assess that some of the revenue impact to date relates to a compositional shift in demand from one sub-category of the ECP to another, yielding lower average revenue per application. The authorities are confident that their close and continued engagement with the European Union in order to remove the temporary suspension of the visa waiver, and adjustments to charging arrangements, will result in a better revenue outcome than forecast by staff. The authorities are also considering options for increased revenue mobilization generally, but note that many of staff's recommendations are politically unpopular and/or will take a long lead time to implement. As an immediate action to bolster the effectiveness of current tax arrangements, the Department of Customs and Inland Revenue plans to hire additional revenue collection compliance officers and has been procuring a new VAT monitoring system that will be implemented with local businesses to limit tax avoidance, and to improve transparency and accountability.

The authorities agree with staff's debt sustainability assessment and the associated risks, and with the need to undertake urgent and credible fiscal consolidation to reduce the risks of public and external debt distress. The authorities realize they will also need to address overcoming capacity constraints to support both partner funded infrastructure projects and plans to address climate change related adaptation. The authorities are considering fiscal rules to support urgently needed fiscal consolidation together with strengthening the medium-term debt strategy. Elements under consideration include a deficit cap, further limiting government debt that may be held by the Reserve Bank of Vanuatu, and a stronger process for approving new policy proposals.

### ***Monetary and macroprudential***

Inflation is expected to return to the RBV's target band by the end of the year; due in part to lower aggregate demand following the airline liquidation. Another contributor is improved supply conditions, including stabilized shipping costs with the end of post-pandemic shipping service disruptions and associated cost increases. Given the government's reliance on the RBV to purchase unsubscribed debt to help bridge the financing gap, the RBV has sought to cool inflation through a combination of monetary policy instruments including adjustments to interest rates, tightening open market operations and raising the capital adequacy ratio to pre-pandemic levels. It has also increased the statutory reserve deposit on commercial banks to reduce excess banking system liquidity. Despite this, the RBV assesses that liquidity remains excessive and expects a need for further action. The authorities expect foreign exchange reserves to decline in the near term from lower service exports (namely tourism). Reserves are estimated to cover just under 7 months of imports at the end of 2024, down from an estimated 8 months at the beginning of the year. The

authorities agree with staff's assessment that the exchange rate is likely overvalued and are in discussions with staff to receive technical assistance to review the currency basket.

The authorities agree that the financial sector is currently stable, but that risks are weighted to the downside. They also agree that improved monitoring and governance arrangements are urgently needed. The balance sheets of the government, its SOEs, the RBV and major banks are interlinked because of guarantees and the spread of government debt holdings. While the authorities do not anticipate the liquidation of Air Vanuatu alone to destabilize the financial sector, they recognize that the strong sovereign-bank nexus does amplify existing risks. The RBV acknowledges that the level of nonperforming loans in the banking sector remains high, in part due to insufficient supervision and onerous resolution mechanisms. Longstanding pressures on correspondent banking relations remain, despite recent actions by the authorities to strengthen the AML/CFT framework. The RBV recognizes that further measures to improve the integrity, governance and transparency of the banking sector and SOE administration are necessary to address remaining concerns. The authorities have requested a Financial Sector Stability Review that Fund staff will conduct through 2025, and for the Asia-Pacific Group on Money Laundering to assess the AML/CFT framework through a Mutual Evaluation in 2026.

### *Structural reforms*

Vanuatu has realized the downside to structural vulnerabilities in recent years with a major cyber-attack in 2022-23 that caused the loss of access to most government data and records, a drain on labor with an increase in the uptake of seasonal work program opportunities in Australia and New Zealand, a range of delays to capital projects, and political instability. The authorities are mindful that these vulnerabilities are not likely to abate in the foreseeable future, nor are they easily overcome with structural policy changes alone. This means that a focus on SOE efficiency and effectiveness, fiscal prudence (including expenditure efficiency, revenue mobilization and collection efficiency) and a clear and deep understanding of the climate challenges ahead will need to drive improved administration and fiscal policy generally, which will in turn reinforce donor confidence and maintain necessary support.

While the immediate priority is to facilitate a satisfactory and sustainable conclusion to the voluntary liquidation of Air Vanuatu, the authorities agree that urgent action is needed to address long-standing weakness in governance and institutional capacity. Greater parliamentary stability will be fundamental to support the government in passing the Commercial Government Business Enterprises Act, in turn strengthening management and monitoring of Vanuatu's SOEs. The authorities share staff's concerns that a poor track record of SOE reporting and governance contributed to Air Vanuatu's failure. Similar risks still exist in other, larger SOEs that could trigger a greater economic and fiscal impact than the Air Vanuatu liquidation; implementation of the CGBE Act will help mitigate these risks. The authorities are committed to progressing overdue recommendations from the Fund's 2016 Safeguards Assessment and will work with staff to develop a credible timeline and milestones for completion. The authorities are also committed to

improving the governance and independence of the RBV and have committed to amending the RBV's governing Act. They have requested an FSSR from the Fund, which will help to identify and prioritize the next actions to take, to be supported by technical assistance.

As a small nation of scattered islands in the path of recurring severe cyclone activity, Vanuatu is highly vulnerable to the accumulating impacts of climate change. This vulnerability is further compounded by limited domestic capacity to plan and execute appropriate measures for adaptation. Vanuatu has started the process for gaining accreditation for Green Climate Fund grants. Vanuatu relies heavily on grants and concessional lending from donors and partners to adopt climate transition actions. The authorities agree with staff's assessment that there is both a large financing gap, and a large capacity gap, to meeting their climate goals, but are working constructively with partners to overcome this challenge.