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PACIFIC FINANCE SECTOR BRIEFS

ADB PACIFIC LIAISON AND COORDINATION OFFICE

▲ Malekula, Vanuatu.

VANUATU

Vanuatu's economy has seen steady growth since 2003—a rarity in the Pacific. It has, however, more recently been buffeted by a series of negative shocks. Tropical Cyclone Pam caused widespread damage in 2015, and was followed by severe dry weather conditions due to El Niño. Economic growth slowed to 3.2% in 2018, from 4.4% in 2017, due to a sharp decline in agricultural output, caused by Cyclone Hola in March 2018 and the volcanic eruption in Ambae Island.

The country's economic growth is mainly driven by construction, tourism, and services, but it has also been aided by improved economic policy and effective fiscal management. The country's natural resources support tourism, agriculture, fisheries, and some forestry. Subsistence agriculture is critically important, being the main economic activity of 50% of the heads of rural households. However, the distribution of the benefits of Vanuatu's development remains a cause for concern. These benefits do not reach most of the 80% of the country's population that lives in rural areas.

Several challenges hinder the realization of Vanuatu's economic potential. Private sector development is constrained by inadequate physical infrastructure, poor governance, an outdated legal and regulatory environment for investment (although this is being modernized), and government involvement in inefficient enterprises that crowd out the private sector. In addition, a lack of access to affordable capital and related supporting infrastructure constrains the development of the domestic private sector, so the country relies heavily on foreign direct investment.

FINANCE SECTOR OVERVIEW

Vanuatu has a high degree of monetization, although expansion in private sector credit has been inconsistent due to the country's vulnerability to natural disasters. Vanuatu's ratio of broad money (M2) to gross domestic product has been consistently near or above 70% (Table 1).

VANUATU AT A GLANCE

Population

278,400 (2017)^a

GDP (current \$)

\$896 million (2018)^b

GDP per capita

\$2,944 (2018)^b

GNI per capita

\$2,920 (2017)^a

Domestic credit provided by the banking sector (% of GDP)

58% (2017)^a

GDP = gross domestic product,
GNI = gross national income.

^a Source: Asian Development Bank.
2018. *Key Indicators for Asia and
the Pacific*. Manila.

^b Source: Asian Development Bank.

Table 1: Nominal Gross Domestic Product, 2011–2017

	2011	2012	2013	2014	2015	2016	2017
GDP (\$ million)	749.0	782.0	782.0	773.0	712.0	787.5	854.0
M2 (\$ million)	605.5	614.5	554.8	570.4	559.1	649.5	
M2/GDP (%)	80.8	78.6	70.9	73.8	78.5	82.5	
Private sector credit (\$ million)	505.1	551.2	537.1	554.3	496.7	528.5	561.4
Private sector credit/GDP (%)	67.4	70.5	68.7	71.7	69.8	67.1	65.7

GDP = gross domestic product, M2 = broad money.

Note: Figures were converted from vatu to United States dollars using the Asian Development Bank-recognized exchange rates for each year.

Sources: Asian Development Bank and International Monetary Fund.

Table 2: Financial System of Vanuatu

Type of Institution	Number
Commercial banks	4
International banks	7
Insurance companies and intermediaries	34
Pension fund	1
Other financial institutions	2
Total	48

Source: Reserve Bank of Vanuatu.

On the other hand, private sector credit fluctuated from 2011 to 2017, with declines in 2013 and 2015 restricting 6-year average credit growth to around just 3.1% per year. Yet the outlook for Vanuatu remains favorable, with reconstruction activities and infrastructure investments commencing in the wake of Tropical Cyclone Pam.

The country's vulnerability to natural disasters requires a responsive and appropriate monetary policy to support economic recovery and financial stability. In 2016, the International Monetary Fund (IMF) recognized the quick response of the Reserve Bank of Vanuatu (RBV) to support economic recovery and restore financial stability after the damage brought by Tropical Cyclone Pam. The RBV lowered its policy rate, reduced the required reserve ratio, and activated its credit facilities. However, the impact of monetary policy on the economy is limited due to shallow financial markets, a lack of clarity regarding monetary policy goals, and inconsistent use of policy instruments. Financial deepening through consistent credit expansion and less-stringent collateral requirements can make Vanuatu's monetary policy more responsive and relevant.

FINANCE SECTOR STRUCTURE

Vanuatu's financial system is well served by banks. There are 11 banks licensed to operate in the country. One commercial bank (the National Bank of Vanuatu) is owned by Vanuatu nationals, while three banks (ANZ Banking Group, BRED Bank, and Bank of South Pacific Vanuatu) are subsidiaries of foreign-owned banks. The remaining seven banks provide international banking services to the people of Vanuatu. The country also has 34 insurance companies and intermediaries as well as a pension fund (Table 2). The RBV serves as the primary monetary authority and regulator of financial institutions in Vanuatu.

FINANCE SECTOR PERFORMANCE

Vanuatu's finance sector has recovered from the adverse impacts of Tropical Cyclone Pam, but vigilance is still needed.

The IMF (2016) noted that the financial soundness of Vanuatu banks, which had deteriorated after the cyclone, was improving due to the rise of capital and liquid asset ratios. Yet, the IMF (2018b) is concerned about the longer-term financial soundness of the banks, which has been weakening since 2010. The capital ratio has been declining but remains above the required level. Meanwhile, bank profitability started deteriorating slightly in 2016. The banking sector's improved capital and liquidity position is attributed to the RBV's accommodative position in the aftermath of Tropical Cyclone Pam, when it lowered the statutory reserve deposit requirement and the liquid asset requirement to relieve potential liquidity demands on banks. On the other hand, the country's nonbank finance sector remains small, and is not sufficiently supervised.

Although the value of loans to the private sector is still growing, its growth rate has fluctuated. Commercial bank loans to Vanuatu's private sector grew at an average of 2% per year from 2011 to 2017, with drops in 2013 and 2015 (Table 3). The IMF (2018b) observed that credit growth slowed significantly in 2015 alongside a significant decrease in credit to the business sector, however it rebounded strongly in 2017. Meanwhile, nonperforming loans went up slightly after Tropical Cyclone Pam in 2015, and rose significantly in 2017.

FINANCIAL INCLUSION

Financial development is comparatively high in Vanuatu, relative to other Pacific island economies. It surpassed the regional Financial Development Index average from 2004 to 2015. For instance, the access of households to financial services, in terms of ATM availability and the number of commercial bank loan accounts, surpasses that of most other Pacific island countries.

Table 3: Finance Sector Performance Indicators

	2011	2012	2013	2014	2015	2016	2017
NPL ratio (%)	7.8	7.8	14.1	10.7	12.3	10.8	15.0
Deposits (\$ million)	185.3	191.6	221.0	221.4	251.0	320.5	354.8
Commercial bank loans to the private sector	505.1	551.2	537.1	554.3	496.7	528.5	561.4
Deposit rate (%)	1.5	1.3	1.3	1.1	1.4	1.2	0.7
Lending rate (%)	5.5	6.1	5.0	4.7	3.6	3.0	3.2

NPL = nonperforming loans.

Note: Figures were converted using Asian Development Bank's 2017 exchange rate.

Sources: International Monetary Fund and World Bank.

Table 4: Financial Access Indicators

Access Indicators	2011	2012	2013	2014	2015
Number of bank branches	26	29	30	32	31
Number of ATMs	43	53	57	57	67
Number of depositors with commercial banks				107,125	116,303
Number of deposit accounts with commercial banks				128,382	139,947
Number of borrowers at commercial banks				13,384	14,453
Number of loan accounts with commercial banks				25,557	28,086

Note: Figures were converted using Asian Development Bank's 2017 exchange rate.

Source: International Monetary Fund. 2018a. *Financial Access Survey*. Washington, DC.

The Government of Vanuatu needs to make additional progress on financial inclusion, particularly on the outer islands.

Following the onslaught of Tropical Cyclone Pam and its adverse impacts on Vanuatu's economy, the IMF (2018b) stressed that economic diversification away from tourism was needed to boost growth and protect the economy against the threat from natural disasters. Moreover, the IMF (2018b) noted that the new Credit Unions Act would fill gaps in prudential standards and strengthen the RBV's supervisory framework.

Despite efforts to enhance financial inclusion, meeting the credit demand of many small and medium-sized enterprises remains challenging.

The IMF (2016) recognized the important role that the National Bank of Vanuatu—majority-owned by the government and Vanuatu's only domestic bank—has played in delivering financial services to the outer islands, particularly microfinance and financial literacy programs. The National Bank of Vanuatu (2018) recorded a 53% growth in microfinance lending in 2017, after it introduced rural land and seasonal labor loans to rural residents and seasonal workers in 2015. Its financial literacy program was also effective in increasing the number of bank accounts held by rural residents.

Meanwhile, credit unions have provided alternative financial services to rural people who are unable to access formal banking services. However, many small and medium-sized enterprises still find obtaining credit a challenge due to stringent collateral requirements, making Vanuatu prominent among the Pacific island countries in which access to finance is cited as a major constraint to business development.

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