## SUMMARY

- *Global economic growth is expected to be driven by the steady growth in China and India. Strong demand from these economies plus adverse global weather conditions causing crop shortages are expected to keep pushing up commodity prices exported by Vanuatu.*

- *However, natural disasters such as earthquakes in New Zealand and floods in Australia are expected to have a negative impact on tourism activity in the Pacific region. Moreover, growth in some advanced economies still remains fragile and volatile with risks of political unrest in oil producing countries likely to affect current global economic growth forecast.*

- *The Vanuatu economy is showing signs of slowing this quarter, although exports and the construction sector have remained strong. Several private construction projects such as the Tana Ruset and the Furret Construction have since commenced. The monetary indicators remain sound during the quarter.*

- *The December quarter outcomes are consistent with the 2.2 per cent growth as recently revised by the Macroeconomic Committee. Based on current conditions, the outlook is for growth to pick up to 3 per cent in 2011 before accelerating to 4 per cent in 2012.*


## INTERNATIONAL ECONOMY

Having risen by an estimated 5 per cent in 2010, the International Monetary Fund (IMF) forecasts[1] the global economy will expand by 4½ per cent in 2011 and 2012.

Growth rates remain modest in many advanced economies and are predicted to be sluggish through 2011. US economic growth was reasonably strong, whereas the Japanese economy contracted again in the fourth quarter of 2010. The German economy continued to expand solidly, masking a much weaker performance by many other European countries. The Australian economy has been disrupted by adverse weather conditions at the end of 2010 and at the beginning of 2011, although the Reserve Bank of Australia (RBA)[2] anticipates that the economy will be growing strongly by the middle of 2011. While the New Zealand economic recovery moderated at the end of 2010. In contrast, very robust economic growth has continued in most emerging economies and this is projected to carry on though 2011, the increases is particularly strong in China and India.

However, global economic prospects, therefore demand for Vanuatu's exports, remain vulnerable to downside risks. A high level of uncertainty still surrounds the size of losses in the European banking sector; whilst worries persist around the capacity of several European countries to finance their high fiscal deficits. Both these issues could tighten financial conditions and undermine economic growth in 2011. In addition, accelerating inflation in emerging markets is reducing households' purchasing power, in turn weakening consumption within these countries.

## DOMESTIC ECONOMY

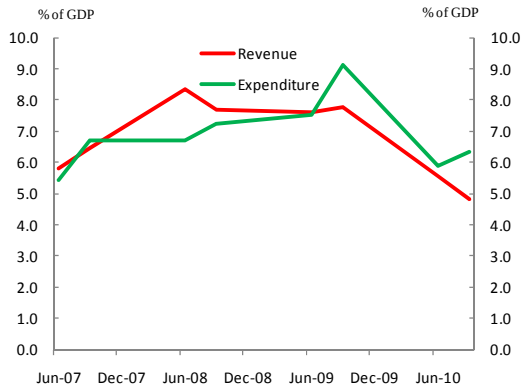
### The Primary Balance

The Government's primary deficit reached 1.5 per cent of GDP during the quarter relative to the 0.3 per cent recorded a quarter previously and 1.4 per cent recorded a year ago. The size of the primary deficit was high in the quarter due to lower than expected economic activity and non-performing revenues with expenditures being keep under control.

Though inflows declined the Government expenditure rose during the quarter owing to the three supplementary budget bills (teachers, correctional staff recruitments and the advance to AVL) during the quarter.

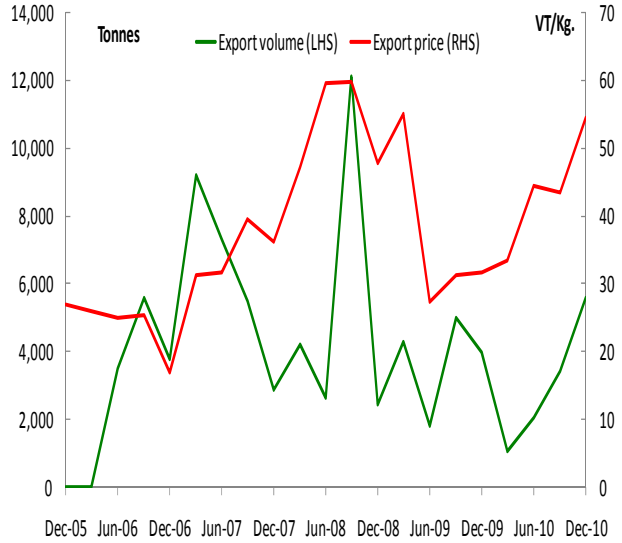
[1] IMF, January 2011 World Economic Outlook (WEO) Update
[2] RBA, 1 February 2011, Minutes of the Monetary Policy Meeting of the Reserve Bank Board

**Chart 1: Primary Balance[3] (per cent of GDP)**




Source: Department of Finance and Treasury

**Chart 2: Copra Exports (average prices and volumes)**




Source: Vanuatu Statistic Office

## EXPORTS (Goods)

Total exports have increased over the previous quarter by 3 per cent, and are 39 per cent higher than a year ago. However, exports of all agricultural commodities except copra and kava have weakened from the previous quarter. Improvements in export values were mainly driven by price increases for agricultural commodities which have seen copra exports increase by 64 per cent and kava exports increase by 5 per cent from the previous quarter.

### Copra

Two major uses of copra are for coconut oil and copra meal production. Adverse weather conditions, related to the La Niña phenomenon, resulted in a global shortage of edible oils at the end of 2010. This shortage has pushed up the price of edible oils and the price of products used in their production.

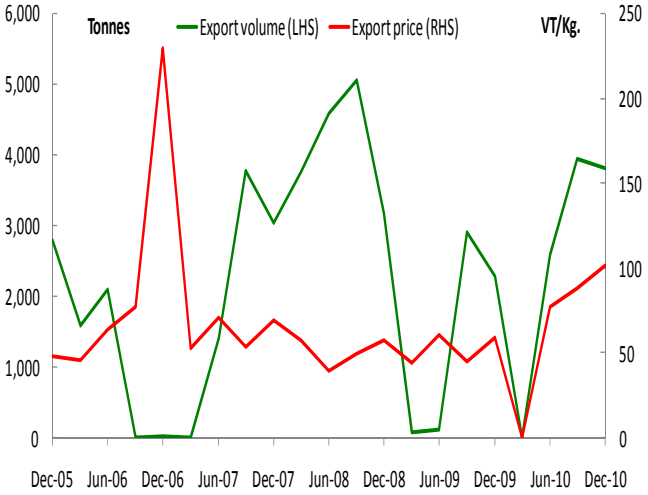
The average export price of copra increased significantly in the fourth quarter of 2010, up 25 per cent on the previous quarter and 71 per cent on its level a year earlier.

A steep rise in average copra prices has in turn induced copra exporters within Vanuatu to boost their output. Copra export volumes expanded very sharply in the fourth quarter of 2010, up 64 per cent on the previous quarter and 41 per cent on their level of a year ago. At 5,605 tons, copra exports reached their highest quarterly volume since 2008, quarter 3.

### Coconut Oil

Coconut oil average export prices, given production problems faced by other edible oil producing countries referred to earlier, have been driven upwards through 2010. The average price of exported coconut oil was up by 14 per cent on the previous quarter and 72 per cent on its year earlier level in the fourth quarter of 2010. Higher average coconut oil prices have also driven exporters to increase output. The volume of coconut exports was 4 per cent down on the previous quarter but 66 per cent above its level of a year ago and still at its second highest level for over two years in quarter four, 2010.

**Chart 3: Coconut Oil Exports (average prices and volumes)**



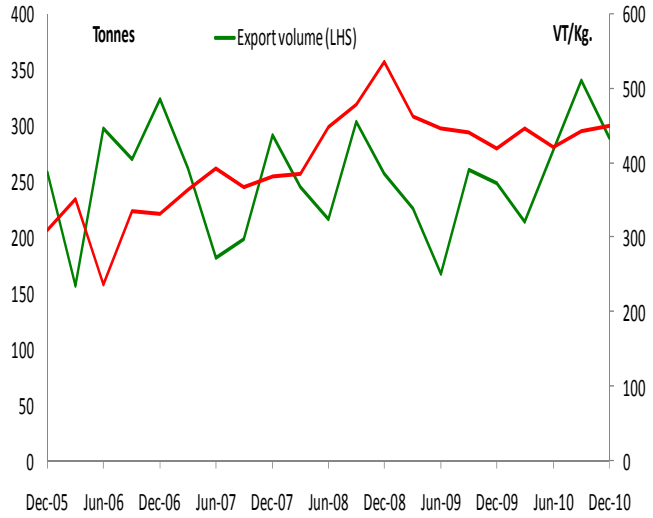

Source: Vanuatu Statistic Office

[3] Primary Balance excludes interest payments

**Beef**

The volume of beef exported during the December quarter of 2010 totaled 289 tons, a 15 per cent decrease from the previous quarter. However, this was still a 16 per cent expansion from the corresponding quarter a year earlier and the second highest level of export volumes for over two years.

**Chart 4: Beef Exports (average prices and volumes)**



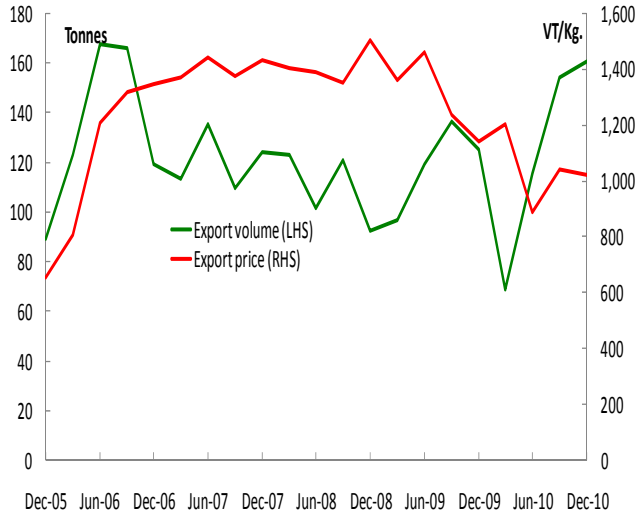

Source: Vanuatu Statistic Office

The average price of beef exports continued on the upward trend it has followed in the second and third quarters. Beef export prices rose by 2 per cent on the previous quarter and 8 per cent on the previous year in quarter 4 of 2010 to reach their highest level since 2009, quarter 1. Very strong international demand combined with a slight appreciation of the Australian dollar (on average) during the quarter has driven both beef export prices and volume expansions during 2010, in particular from Papua New Guinea, Solomon Islands, Fiji and Australia.

**Kava**

The volume of kava exports have been increasing steadily this year with quarter four seeing an increase of 5 per cent. Despite a price floor being imposed, kava production remains strong with the domestic market retaining a larger share. Moreover, according to VCMB local buyers are buying kava from farmers at different prices thus production of kava has not been affected.

**Chart 5: Kava Exports (prices and volumes)**

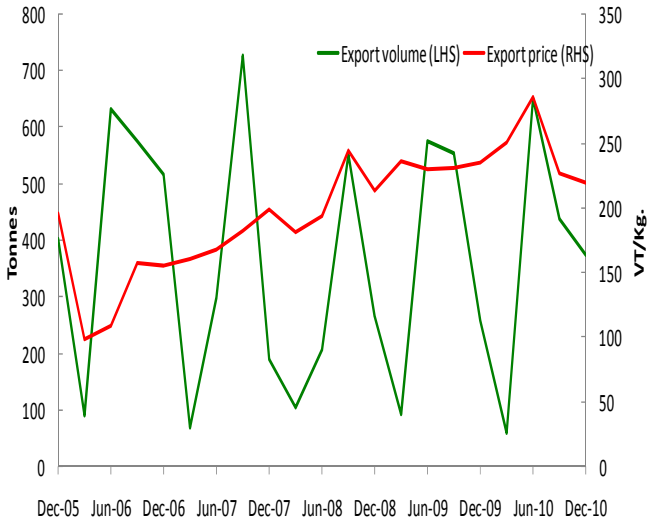



Source: Vanuatu Statistics Office.

**Cocoa**

The volume of cocoa exported during quarter 4 of 2010 was 14 per cent down from the previous quarter. However, over the past five years, quarter 4 export volumes have always been below quarter 3 levels. Furthermore, in the fourth quarter of 2010, export volumes were 46 per cent above their year earlier level and at their highest fourth quarter level for four years. The average export prices fell for the second consecutive quarter, by 3 per cent in the quarter and 7 per cent in the year. However, prices remain relatively high (above levels recorded between 2000 and 2007), therefore they are encouraging producers to continue expanding output.

**Chart 6: Cocoa Exports (average prices and volumes)**

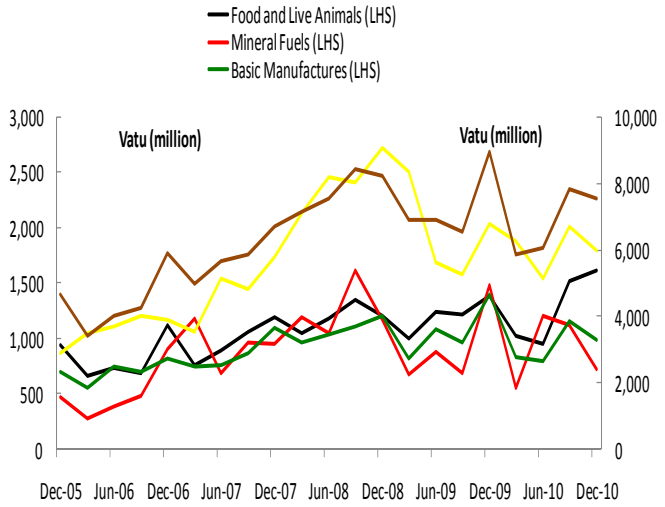



Source: Vanuatu Statistic Office

## IMPORTS (Goods)

Total goods imported fell both by 4 per cent on the previous quarter and by 16 per cent on their level a year ago, during 2010, quarter 4. Despite a 17 per cent year increase in imports of food and live animals, there were significant declines in imports of mineral fuels (by 51 per cent), basic manufactures (by 29 per cent) and machine and transport equipment (12 per cent) from their level a year earlier. These data suggest that despite the increase in food and live animal consumption, which is not unexpected given that these are necessity goods and the population is rising, household consumption weakened during the fourth quarter of 2010.

**Chart 7: Selected imported consumer items**

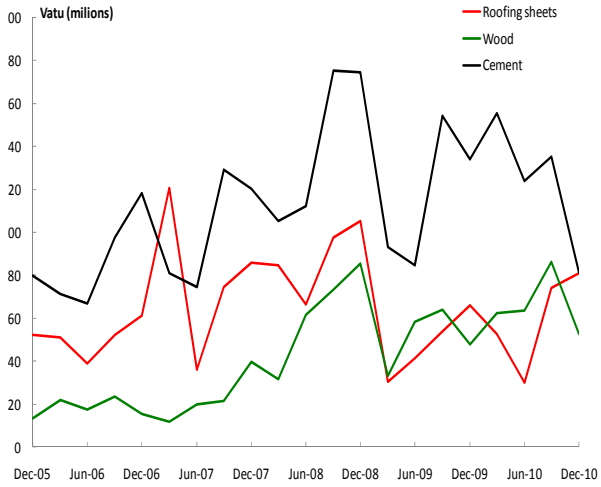



Source: Vanuatu Statistics Office.

### Construction Materials

The value of total imports of construction materials dropped from a level of VT 1 billion a year ago to VT 569 million during the quarter under review. This represented a decrease of 20 per cent from the third quarter of 2010. In terms of the import value of major components of construction materials, cement imports fell by 39 per cent, and wood imports fell by 38 per cent. This is in line also with the previous business survey that most imported cement from the two previous years has been kept in stock. On the other hand, imports of roofing sheets increased by 10 per cent from the last quarter.

**Chart 8: Imports of construction materials**




Source: Vanuatu Statistic Office

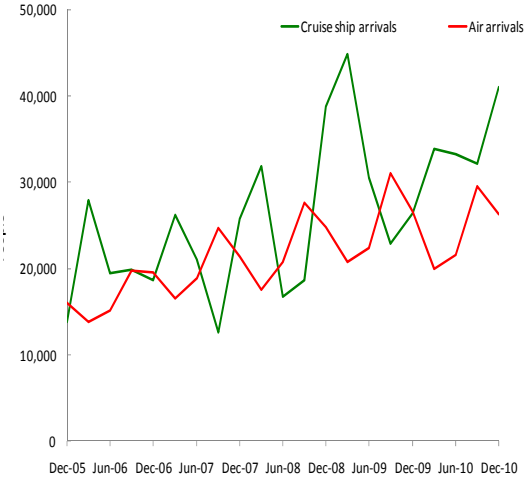
## EXPORTS (Services)

### Visitor arrivals

Visitor arrivals data, when split by method of travel, continued to show two very different stories for 2010. Air visitor arrivals for quarter 4 of 2010 were both 11 per cent lower than the previous quarter and 1 per cent lower than a year ago. By contrast, cruise ship arrivals for the quarter stood at 27 per cent higher than the previous quarter and 55 per cent higher than a year earlier.

Given the relative length of stay of cruise ship (one day) relative to air arrival (eleven days) visitors, the per-visitor contribution to the Vanuatu economy is considerably greater for visitors who've arrived by air than cruise ships. The concern is that the increase in cruise ship visitors through 2010 may not fully offset the negative contribution to the economy from the decline in air arrivals.

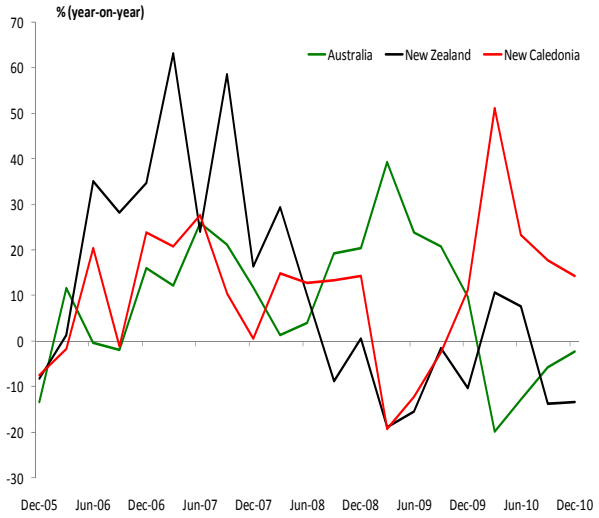
**Chart 9: Visitor arrivals (Air and Cruiseship)**




Source: Vanuatu Statistics Office.

The vast majority (84 per cent) of visitors to Vanuatu in 2010 were from Australia, New Zealand and New Caledonia. Comparing visitor arrivals with their numbers a year ago for visitors from these three countries, arrivals from both Australia and New Zealand were down on their year earlier levels in the second half of 2010.

**Chart 10: Visitor arrivals (Year ended contributions)**

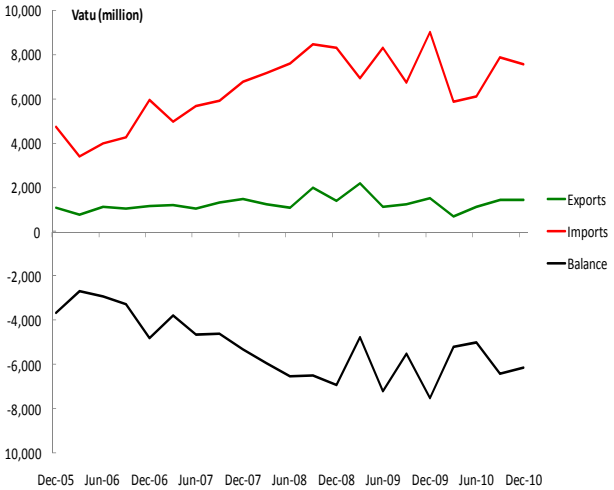



Source: Vanuatu Statistic Office

**TRADE BALANCE (GOODS)**

The trade deficit in goods improved both on quarter (by 4 per cent) and in the year (by 18 per cent) in 2010, quarter 4. However, disappointingly the improvement was a result of a fall in both imports and not a rise in exports. Imports were down both on quarter (by 4 per cent) and level (by 16 per cent) from a year ago, suggesting domestic demand weakened. Whilst exports were also down on the previous quarter (by 1 per cent) and year (5 per cent), indicating external demand also weakened.

**Chart 11: Trade Balance, quarterly**




Source: National Statistics Office

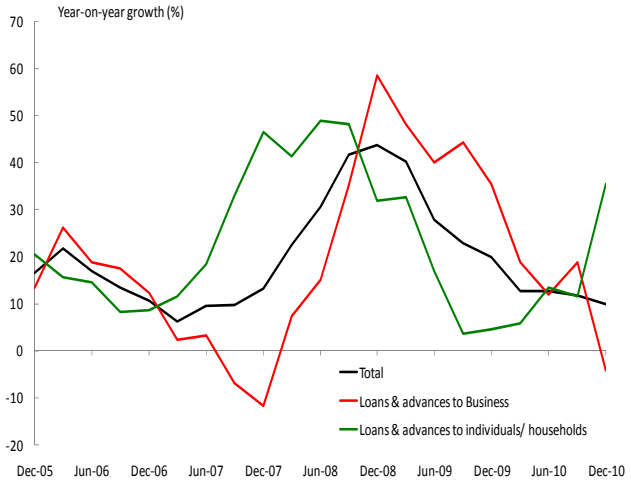
**PRIVATE SECTOR LENDING**

Total private sector lending increased this quarter by 2 per cent, and it is 10 per cent higher than it was a year ago. Growth was mostly fueled by individual loans which increased by 25 per cent from the previous quarter and are 35 per cent higher than they were a year ago.

The increased in private sector lending was also in line with the year on year increase in loans and advances (in level terms) to individuals coinciding with the low inflation recorded annually.

However, business loans decreased this quarter by 17 per cent and are 4 per cent lower than they were a year ago.

**Chart 12: Private sector lending (Year ended)**

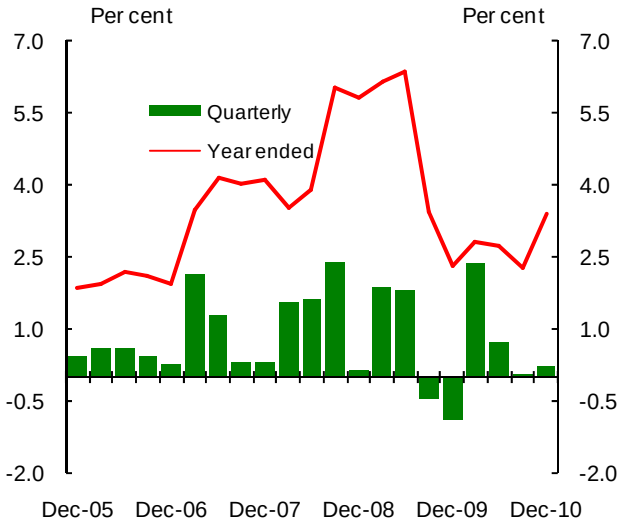



Source: Reserve Bank of Vanuatu.

**INFLATION (Consumer Price Index (CPI))**

The annual inflation rate, as measured by the Consumer Price Index (CPI) for the fourth quarter of 2010 was 3.4 per cent; a relatively steep rise from 2.3 per cent recorded in both the previous quarter and the corresponding quarter of 2009. Prices that increased especially sharply from their level a year ago include food, alcoholic drinks and tobacco and housing and utilities. Over the previous quarter, CPI inflation was up by only 0.2 per cent. This implies that the relatively sharp increase in the annual inflation rate in the fourth quarter of 2010 reflects "base effects" and the relatively weak CPI number reported for the fourth quarter of 2009.

**Chart 13: Consumer Price Index**



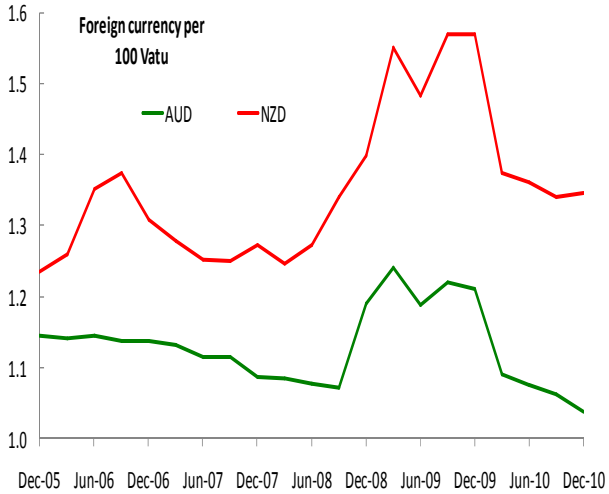

Source: National Statistics Office.

**EXCHANGE RATES**

During the fourth quarter of 2010, the Vatu depreciated on average by 1 per cent against the Euro and 2 per cent against the Australian dollar relative to the previous quarter. This means that more Vatu is needed to buy one euro (EURO) or one Australian dollar (AUD). The depreciation of the Vatu against both the Euro and the Australian dollars has widen the current account deficit; with partial offsetting effects from the services and transfer accounts. Furthermore, the average depreciation is expected to raise Vanuatu exports with trading partners' income improving.

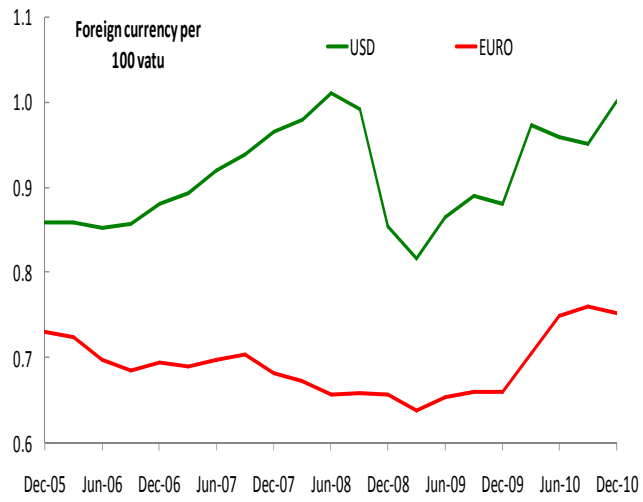
In contrast, the Vatu has strengthened on average against the US dollar by 5 per cent and by 0.4 per cent against the New Zealand dollar relative to the previous quarter. The strong vatu vis-à-vis New Zealand has eroded Vanuatu's attractiveness domestically and reduced the purchasing power of inbound travelers leading to the 44 per cent decline in tourist arrivals from New Zealand and 20 per cent decline from the US.

**Chart 14: Exchange Rates (Australian and New Zealand Dollar)**



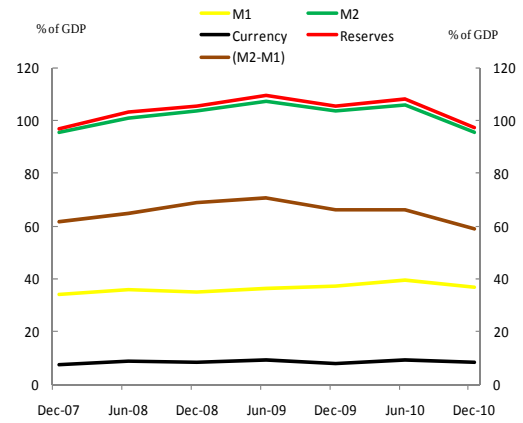

Source: Department of Customs and Inland Revenue

**Chart 15: Exchange Rates (US Dollar and Euro)**




Source: Department of Customs and Inland Revenue

**Chart 16: Monetary Indicators (per cent of GDP)**




Source: Reserve Bank of Vanuatu

**Monetary Indicators**

The financial sector indicators remain sound during the quarter. The ratio of currency in circulation, $M_1$ and $M_2$, to GDP maintained their upward trends during the quarter. These ratios show the performance of the banking system in savings mobilization.

The ratio of the difference ($M_2$-$M_1$) to GDP indicates the non-transaction demand for money, with a higher ratio indicating a shift in the composition of financial asset holdings in favor of interest bearing assets with longer maturities. Evidently, this ratio is been higher during the quarter, accounting for approximately over 60 per cent of GDP, suggesting a stronger preference for interest bearing financial assets. Anecdotally, the DMBs fear of the rising cost of funds had led them to set lower interest rates on time deposits.

Chart 16 shows that this ratio remains close to 70 per cent last year but reduced to above 60 per cent reflecting stronger domestic demand. As a result, the total net foreign assets of the Reserve Bank and the Domestic Money Banks (DMB) slowed during the quarter. The decline was more pronounced in the DMBs as a result of rising demand to finance imports.

The monetary base (reserve), though slowing down during the quarter, continue to dominate the money supply and domestic credit as indicated by the high ratio of the monetary base to GDP, compared with the money supply (currency)/GDP ratio shown in Chart 16 above. This is because the monetary base determines the liquidity of the economy. The high level of the monetary base/GDP ratio during these periods is predominately accounted for by the considerable size of aid monies and foreign direct investment.

## SUMMARY TABLE

| QUARTERLY ECONOMIC DATA | Dec-08 | Mar-09 | Jun-09 | Sep-09 | Dec-09 | Mar-10 | Jun-10 | Sep-10 | Dec-10 |
|---|---|---|---|---|---|---|---|---|---|
| Visitor arrivals by air, (thousands) | 24,778 | 20,732 | 22,345 | 31,030 | 26,567 | 19,895 | 28,144 | 29,513 | 26,247 |
| Visitor arrivals by air, % y/y | 15.9 | 18.3 | 7.8 | 12.3 | 7.2 | -4.0 | 26.0 | -4.9 | -1.2 |
| Visitor arrivals by cruise ship (thousands) | 38,859 | 44,898 | 30,587 | 22,914 | 26,419 | 33,930 | 33,316 | 32,186 | 41,036 |
| Visitor arrivals by cruise ship % y/y | 50.4 | 40.7 | 83.2 | 22.7 | -32.0 | -24.4 | 8.9 | 40.5 | 55.3 |
| Exports (values), % y/y | -0.3 | 5.7 | 2.5 | -45.6 | -11.9 | -46.7 | 20.9 | 36.6 | 39.4 |
| Copra, % y/y | 11.7 | 19.1 | -68.3 | -78.3 | 8.8 | -84.9 | 82.7 | -5.4 | 141.9 |
| Beef, % y/y | 23.1 | 10.8 | -23.0 | -20.9 | -24.3 | -8.8 | 57.2 | 31.4 | 24.8 |
| Cocoa, % y/y | 50.2 | 16.1 | 228.9 | -5.4 | 6.8 | -32.0 | 40.8 | -22.2 | 35.7 |
| Imports (Values), % y/y | 22.5 | -3.7 | 9.2 | -20.5 | 8.7 | -15.2 | -26.5 | 16.7 | -16.0 |
| Consumption goods % y/y | 22.3 | -3.5 | -8.5 | -22.6 | 8.8 | -15.4 | -12.0 | 20.0 | -15.7 |
| Construction materials, % y/y | 21.4 | -22.7 | 8.9 | -17.0 | 24.5 | 17.7 | -32.9 | 13.5 | -43.1 |
| Trade Balance, goods and services (Vatu million) | -1382 | -1289 | -2093 | 1165 | -2981 | -1267 | -279 | | |
| Lending data, % y/y (total) | 43.7 | 40.1 | 29.4 | 22.7 | 19.8 | 12.5 | 12.6 | 11.6 | 9.9 |
| to households | 31.9 | 32.7 | 16.9 | 3.7 | 4.7 | 5.9 | 13.4 | 11.6 | 35.4 |
| to businesses | 58.6 | 48.2 | 43.5 | 44.3 | 35.4 | 18.6 | 11.8 | 18.7 | -4.2 |
| Exchange rates (foreign currency per 100 vatu) | | | | | | | | | |
| AUD | 1.19 | 1.24 | 1.19 | 1.22 | 1.21 | 1.09 | 1.08 | 1.06 | 1.04 |
| USD | 0.85 | 0.82 | 0.86 | 0.89 | 0.88 | 0.97 | 0.96 | 0.95 | 1.00 |
| NZD | 1.40 | 1.55 | 1.48 | 1.57 | 1.57 | 1.37 | 1.36 | 1.34 | 1.35 |
| Euro | 0.66 | 0.64 | 0.65 | 0.66 | 0.66 | 0.71 | 0.75 | 0.76 | 0.75 |
| Consumer Price Index, % y/y | 5.8 | 6.1 | 6.4 | 3.4 | 2.3 | 2.8 | 2.7 | 2.3 | 3.4 |

*Source: National Statistics Office, Department of Customs and Inland Revenue, Reserve Bank Vanuatu.*