



RESERVE BANK OF VANUATU

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BOARD PAPER

Date : 14 October 2020

Tabled by : Governor

Subject : Monetary Policy Update

Purpose : To seek the Board's endorsement of the Reserve Bank's Monetary Policy Stance.

Introduction

The Board is responsible for approving the monetary policy stance of the Reserve Bank after deliberating and reviewing the assessments and recommendations of the Monetary Policy Committee (MPC). By conducting monetary policy, the Reserve Bank seeks to: i) maintain domestic inflation in a range between 0-4 percent, and ii) keep sufficient foreign exchange reserves above a minimum threshold of 4.0 months of import cover.

Background

At its meeting on 9th of October 2020, the Reserve Bank's MPC reviewed the recent developments in international economies and financial markets, and assessed their outlooks and implications for the domestic economy and the Reserve Bank's twin monetary policy objectives. Based on its assessments, the MPC is convinced that the Bank's current monetary policy setting remains appropriate, and recommended that the Reserve Bank Board of Directors maintain the Bank's current accommodative monetary policy stance. This means that the Reserve Bank's official interest rate (rediscount rate) will be kept unchanged at 2.25 percent.

Summary of Discussion

- The global economy has weakened substantially. The harsh preventative measures including travel bans and strict lockdown measure being implemented by countries across the globe to prevent the spread of the COVID-19 pandemic has significantly disrupted global economic activities and industrial production chains. During the first six months of the year 2020. The International Monetary Fund (IMF) cut its global GDP estimate twice in a short period during April 2020 (-3.0%) and June 2020 (-4.9%) to reflect the slump in the global economy. However, global economic conditions have started to recover as many countries started to ease lock down measures and allowed economic activities to resume.
- Domestically, the Macroeconomic Committee (MEC) now expects the domestic economy to contract (-4.1%) in 2020. Economic output in all sectors are forecasted to fall, led by contractions in the agriculture sector (-2.0%) and Services sector (-6.4%), while the industrial sector growth downgraded to 1.5 percent. The twin impacts of TC Harold and border shut down to international travel have adversely affected the Agriculture and Services sectors whereas the industrial sector was sustained by TC Harold reconstructions.
- A strong economic recovery was projected for 2021; the recovery will be broad based led by forecasted strong recoveries in the Agriculture and the Industrial sectors, especially constructions through the implementation of delayed projects from 2020.
- Inflation has remained within the Reserve Bank's target range of 0 – 4.0 percent, and is forecasted to remain within the target range in the medium term. Year ended inflation eased from 3.4 percent in December 2019 to 3.0 percent in March 2020. Domestic inflation is estimated to ease further towards the end of the year due to low aggregated demand and expected pass-through of low international oil prices.
- The Government's Fiscal position has remained strong with sufficient fiscal buffers maintained, though a budget deficit is anticipated for the current fiscal year due to the implementation of the Government's fiscal stimulus. The Government's net lending position with the banking system continues to improve with the Government accumulating deposit with the Reserve Bank and commercial banks.

- The Government has sufficient borrowing space available (VT3.6 billion) with the RBV should the Government choose to resort to monetary financing.
- Total money supply growth continued to decelerate year on year as negative total domestic credit growth, caused by Government deposit accumulation and weak private sector credit growth, continued to offset strong growth in total net foreign assets.
- Private sector credit continued to register negative year ended growth. As at August 2020 Private Sector Credit contracted both over the month (-1.3%) and over the year (-1.9%).
- Excess Reserves have remained at an elevated level. As on 11 September 2020, excess reserves stood at VT29,246.3 million.
- Foreign reserves stood at VT 61 billion at end August 2020, sufficient to finance around 13 months of imports.
 - Short term outlook – Foreign reserves to remain above 4 months of import cover
 - Medium/Long term outlook- Foreign Reserves to remain above threshold level but external debt repayments will continue to constrain the foreign reserves.

Challenges to the Bank's current monetary policy setting

Though the domestic economy is forecasted to rebound strongly in 2021, the downside risks to Vanuatu's economic outlook remain given that the health risks associated with the COVID-19 pandemic have not disappeared. The Virus continues to spread across Europe and the Americas, and the border closure to international travel may remain in force for much longer than anticipated.

Though commercial banks' loan portfolio quality remained healthy with standard loans making up the bulk of their total loan portfolios as at August 2020, it remains uncertain if the proportion of standard loans will remain once the loan repayment holiday has lapsed. The Reserve Bank has approved an extension to the loan repayment holiday from September 2020 to April 2021.

In light of the perceived risks to the outlook, the MPC recommends that the Board maintain the Bank's current monetary stance in order to continue to cushion and support the domestic economy.

Consultation:

The recent Monetary Policy Committee meeting is chaired by the Deputy Governor. Other members present include the Advisors, Department Directors and senior staff representing the various Departments in RBV and staff of Economic and Research Department.

Legal Implication: **None.**

Financial Implication: **None.**

Recommendation:

The MPC recommends that the Board maintain the Bank's current monetary policy stance unchanged.

The RBV stands ready for additional policy measures, as it considers appropriate, to protect its policy objectives and with a view to ensuring that monetary stability will be maintained in Vanuatu.



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SIMEON ATHY
GOVERNOR

14/10/20
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DATE