

ANZ RESEARCH

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# VANUATU

## REBUILDING THE ECONOMY



## From zero-COVID...

COVID-19 elimination strategy has served Vanuatu well with zero community cases recorded until recently.

But the closed border has shuttered the key tourism industry and sent the economy into a downward spiral.

With vaccines and treatments available, "learning to live with the virus" is the global mantra now.



## ...to endemic-COVID

With no prior infections, high vaccination coverage is the key to building a protective immunity wall and transitioning to endemic COVID.

After a slow start, the pace of vaccination has picked up in recent months.

If speed is maintained, Vanuatu will be in a good position to reopen its border in Q2 2022.



## Rebooting the economy



Focus on restarting tourism and tapping into the latent demand for overseas resort holidays in key markets.

Next comes diversification of growth drivers.

## GDP scenarios for 2022



Best case: April border opening  
**GDP +5.8%**

**Base case: June opening  
GDP +2.9%**

Worst case – no reopening in 2022  
**GDP -1.8%**



## Irreversible damage

If border remains shut for 2022:

- Possibility of permanent damage, with businesses potentially exiting tourism.
- Higher deficit and debt.
- Heightened loan defaults and financial stability risks.



## Certainty matters

Businesses need to plan ahead for a resumption of international tourism.

Important for Vanuatu to provide vaccination targets and potential dates for a border reopening.





## Executive summary

### Reset, transition, reboot and diversify

- Vanuatu's international border closed in March 2020 to keep COVID at bay. While that ensured zero cases, it also pulled the rug from under the tourism industry. GDP fell by 14.3% in 2020 and 2.6% in 2021, together a decline of 8.6%, the seventh worst outcome in the world.
- The pandemic is not over. The highly transmissible and now dominant Omicron will be nearly impossible to keep out. With vaccines, the less severe nature of Omicron illness and good treatments, the world is learning to live with the virus – endemic COVID.
- From neighbouring Fiji, Vanuatu is learning to transition to this new position from a strategy of zero-COVID and is aspiring to reopen its borders in the first half of 2022.
- Building an effective immunity wall, especially for the most vulnerable, is the key.
- The pace of vaccination has picked up in recent months and is on track to reach 90% of the nation's adult population in Q2, laying the groundwork for a border reopening by June 2022.
- The strength of the economic recovery depends on the timing of border reopening. We anticipate an April resumption (perhaps a best case) will deliver GDP growth of 5.8%, whereas a June reopening (base case) would see the economy grow by 2.9% this year. If the borders remain shut over 2022, we see GDP falling by 1.8% and damage to the economy and jobs may be irreversible.
- Once the international border restrictions ease and tourism starts to recover, the challenge will be to broaden growth drivers. Building on its strong services culture to establish niches in the provision of services in back-office functions, commercial agriculture, foreign direct investment into retirement living and higher net overseas migration are some options.
- If reforms are implemented with some urgency, the economy could look very different in five to ten years, when a diversified and balanced economy delivers a higher growth rate and improved prosperity for ni-Vanautu.

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## GDP projections

### A question of balance: living with the virus

The world is learning to live with COVID, subject to a high immunity wall. Mobility and testing restrictions have eased in countries with a high vaccination coverage and more nations are gradually reconnecting with the rest of the world. Tourism and hospitality businesses, shuttered during lockdowns, are slowly reopening. And workers whose jobs rely on the movement of people are returning to work.

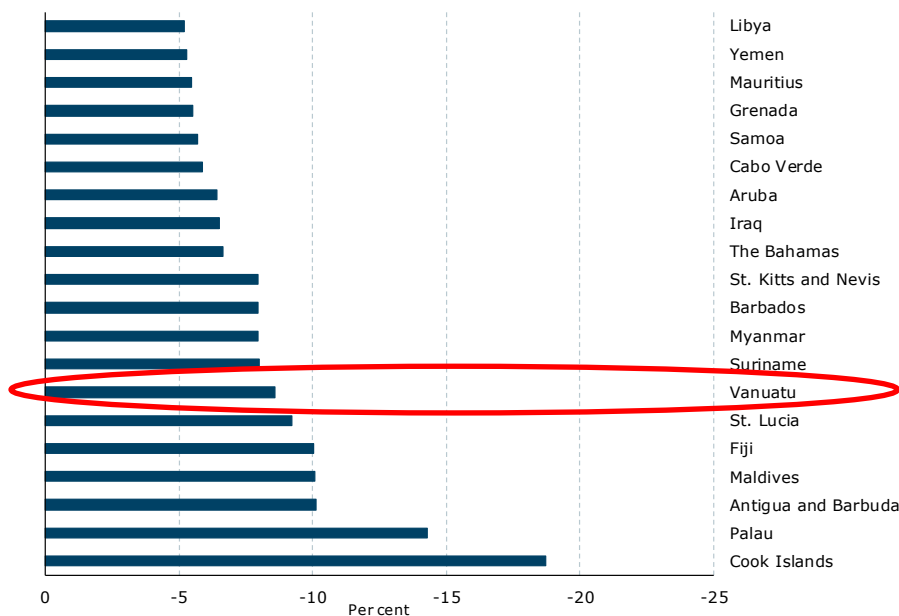
Vanuatu is maintaining a hard border. While it managed to keep the virus out of the community until 4 March, its economy is one of a small group that has been hit very hard by the pandemic (Figure 1).

Keeping Omicron out has ultimately proved impossible, and Vanuatu is seeing cases at its quarantine facilities and now in the community, even though all arrivals were required to present negative polymerase chain reaction (PCR) tests prior to their travelling to Vanuatu.

A more proportionate response perhaps would be a shift from a zero-COVID to an endemic-COVID strategy.

Having entered the community, Omicron will most probably spread, but by having a strong protective immunity wall, Vanuatu can minimise the health risks (see Box 1, page 8).

**Figure 1. GDP: cumulative decrease over 2020–21, lowest 20 countries**



Source: IMF, ANZ Research

### Building an immunity wall

Vanuatu has no community immunity from prior COVID infections, but it can draw on lessons from neighbouring Fiji. A reopening roadmap could perhaps aim for getting at least 90% of the adult population vaccinated with two doses and people in the most vulnerable groups boosted by a third dose.

The uptake of vaccines has been slow. Vaccine hesitancy has been a problem, particularly on some of the outer islands. However, the pace of vaccination has picked up, putting Vanuatu in a good position to have an immunity wall by the end of the first half of this year (see Box 2 for Vanuatu's latest vaccination status).

The province of Shefa, which takes in the tourist island of Efate, has the most vaccine coverage. Vanuatu may choose to ease border restrictions in Shefa first, to commence an economic recovery, before opening other provinces once adequate vaccination coverage is reached.



## GDP projections

### Seeds of an economic revival

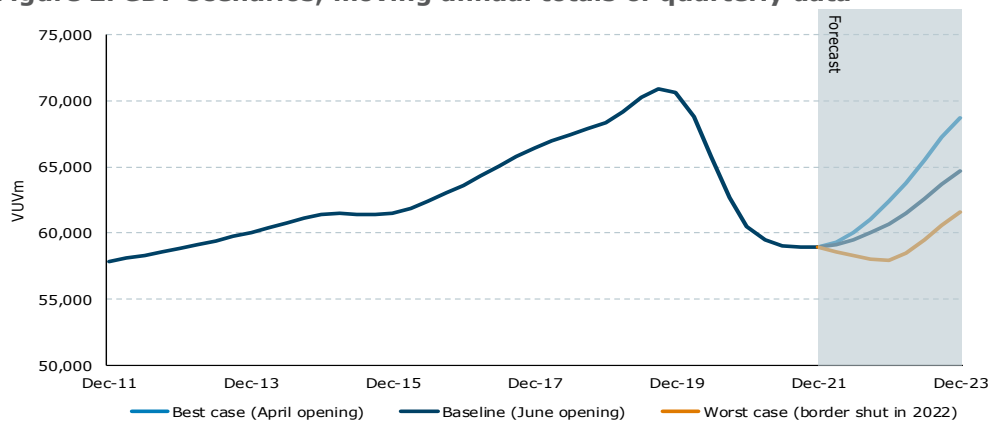
Vanuatu received a record 120,628 visitors in 2019, which saw GDP rise by 3.3% (y/y) from 2.9% a year earlier. When the tourism industry was put out of action by border closures in 2020 and 2021, most of the 11,500 people working in tourism lost their jobs. Businesses, especially in Port Vila and Luganville, came under severe pressure.

When vaccination rates allow international travel to resume, we expect inbound demand to recover. Australia, a key market, accounts for 75% of tourist receipts, and Australian tourists are very likely to respond when borders open. Vanuatu's competitive offering of nature-based luxury holidays and well-spaced resorts will appeal to most COVID-conscious travellers.<sup>1</sup> New Zealand, another key market, has also opened its border to fully vaccinated New Zealand travellers.

However, the recovery will be a slow build. Most Australians are booking winter holidays now, so Vanuatu will miss out on a chunk of bookings for its peak June-July season as borders remain shut.

Under a best-case scenario, where the restrictions ease in April, we think visitor arrivals could reach 35% of 2019 levels, boosting GDP by 5.8%. A June reopening, our base case, could see travellers reaching 25% of the 2019 peak and GDP increasing by 2.9%. We don't see Vanuatu returning to its pre-pandemic peak GDP before 2024.

**Figure 2. GDP scenarios, moving annual totals of quarterly data**



Source: Vanuatu National Statistics Office, ANZ Research

### Risks of permanent damage if border remains shut for all of 2022

If the border remains shut this year, we think GDP will fall by 1.8%. The government, however, is projecting GDP to increase by 3.7% this year, even if the border remains shut, which is perhaps optimistic. Until the border opens, it is unlikely the economy will regain a firm footing. It is doubtful whether household budget support and spending through offshoring of labour along with government spending will be enough to turn around the fortunes of Vanuatu.

There are opportunities to develop other industries, but they are medium-term projects and will take time to add to GDP (see discussion below).

Industry liaison suggests some tourism service providers will come under extreme pressure if Vanuatu's borders remain closed this year. A third year without revenue may be the proverbial straw that breaks the camel's back.

1. Australians are cashed up. The 'cash' savings ratio lifted to 25.6% in March 2021 from 15.6% in December 2019. That eased in December 2021 to 22.7%, but is well above the 16.7% peak reached at the height of the global financial crisis in September 2009. House price growth has also been strong, up 20% y/y in 2021, the strongest annual gain since the late 1980s. So this could translate into a pending increase in discretionary spending, including overseas travel. With not all resort-style destinations open, Vanuatu's wellness based (less crowded) leisure experience, along with being a competitive destination, should attract market share away from some of Australia's favourite overseas destinations in 2022 and 2023.



## GDP projections

For Vanuatu's recovery, losing critical tourism businesses would be a major setback to GDP and jobs. Many workers displaced from the tourism sector, including crafts people, tour operators, security personnel and trades people have returned to farming or are seeking overseas employment. The micro-businesses that sell arts and crafts souvenirs to cruise ship arrivals are particularly vulnerable, leaving a gap in servicing cruise ship calls.

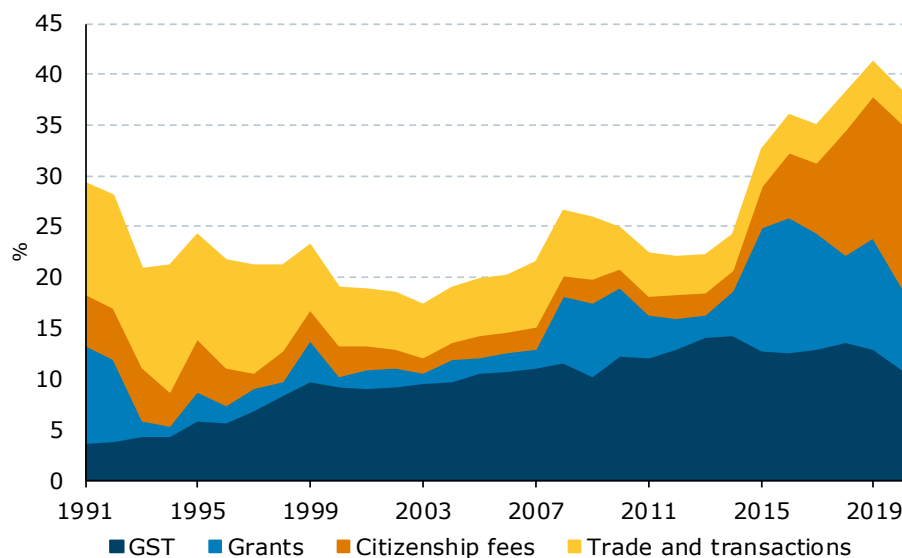
### Revenue pressure to limit the upside from government spending

Budget papers show government revenue rising to VUV43,986m in 2022 from VUV40,943m in 2021 (+7.4% y/y). Notwithstanding more budget support grants, the improvement is based on the economy growing by 3.7% in 2022 and an expectation that tax revenue will rise to VUV20,567m from an estimated VUV18,725 in 2021.

Without a revival in tourism, it is difficult to see an up-tick in tax collections. Hence, the upside to GST collections and overall tax revenue will be limited, putting a squeeze on government revenue and, by extension, government expenditure as a source of economic growth.

Revenue will also come under pressure if the government can no longer raise funds through its 'citizenship by investment' program. The revenue from this source has escalated in recent years and now ranks as the number one government revenue generator ahead of GST (Figure 3). If this revenue source comes unstuck, Vanuatu's fiscal position will be vulnerable.<sup>2</sup>

**Figure 3. Government receipts current prices, per cent of nominal GDP**



Source: Budget papers, IMF, ANZ Research

The government may choose to borrow to offset revenue shortfalls, but so far it has been cautious about taking on more debt. Instead, it is relying on cash reserves built up through windfall gains in its investment development fund (honorary citizenship program) and donor grants to fill revenue gaps.

### Economic diversification comes next

Once borders reopen and tourism gets underway, the challenge will be to build on the nation's strong services culture to establish niche back-office service functions, develop commercial agriculture and revisit population policy to broaden its growth drivers and revenue base.

Some services, such as **back-office service functions** in developed economies, are becoming trade-exposed, losing their shelter from (overseas) competition. The internet has opened such functions to new competition from overseas.

2. Early this year, the European Commission proposed a partial suspension of the visa waiver agreement with Vanuatu to address perceived risks to 'golden passport' programs. On 4 March, in a press [statement](#), the European Council accepted the Commission's recommendation and suspended the visa waiver program. This means ni-Vanuatu holding ordinary passports issued since 25 May 2015 will now require a visa to travel to EU countries. As yet, and to the best of our knowledge, no statement has been issued by the government of Vanuatu.



## GDP projections

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Vanuatu is bi-lingual, with ni-Vanuatu speaking both English and French, so it can tap into this market with call centres, accounting and finance functions and digital content creation, providing employment opportunities for its urban population.

Vanuatu also has a bright future in **commercial agriculture**. Across the world, the most pervasive change in the food supply chain is away from bulk, commoditised goods towards the small but rapidly growing market for ethical and sustainable products. This is especially the case in developed markets, in which demand is growing for Vanuatu's premium crops, such as kava, cocoa, coffee, copra, pepper and vanilla.

Support for smallholders, with inputs for sustainable new planting along with research and training, could lift production volumes and exports for Vanuatu. With economies of scale, major investments in infrastructure – including transport, product preservation and processing – could attract global capital and shift crop output to a higher plane, improving value to smallholders. To attract foreign investment, though, producers large and small will need security of titled land or long-term leases of customary (indigenous owned) land.<sup>3</sup>

**Population growth** is another avenue for growing the economy. Population growth, through net overseas migration, will only work if new citizens live in Vanuatu. Until its suspension, there was no requirement for holders of honorary citizenship program passports to live in-country. The USD130,000 passport application fee could be waived, to encourage new citizens to settle permanently in Vanuatu. Population growth through net overseas migration will facilitate economic activity through investment in buildings, both residential and non-dwelling buildings, such as retail shopping centres as well as infrastructure and utilities.

With Vanuatu's pristine beaches, bio-diversity environment and security, **foreign direct investment** in **retirement villages** providing end-to-end care is also an option through which Vanuatu could diversify its economic base.

Vanuatu's economy could look very different in five to ten years when a diversified and balanced economy delivers a higher growth rate and an improved standard of living for its people.

3. At present, most of the land in Vanuatu is owned under customary title.

## Transitioning from zero-COVID to endemic-COVID: the case of Fiji

Fiji has successfully transitioned from zero-COVID, to a lot of cases (initially Delta then Omicron) then to endemic-COVID. With a population of nearly 900,000, Fiji has (at the time of writing) 110 active cases and 7 patients in hospital. The international border is open to a growing list of partner countries, and nearly all domestic restrictions, including an overnight curfew, have been lifted. Children are back in school, and mask wearing in public places and indoors is the only remaining restriction.

By 'successful transition', we mean the surge in cases in Fiji did not put unsustainable pressure on its health system. In fact, during the Omicron wave in January none of the patients admitted to hospital had severe illness or required critical care in an ICU unit. Sadly, some deaths were recorded, but were mostly adults who had not had two doses of vaccine.

The key to a successful transition is high vaccination coverage, topped up by natural infections, giving the nation a protective immunity wall against severe illness (Figure 4).

When Fiji opened its international border to tourists on 1 December, it was one of the safest destinations for leisure travellers. One of the most vaccinated countries in the world, 96.3% of adults (over 18) had received at least one dose, and 86.9% of adults were fully vaccinated. Nearly every hotel and tour operator in Fiji was registered under the Care Fiji Commitment (CFC) protocols, a WHO-approved standard of best-practice health and safety measures. Fiji Airways achieved the highest possible COVID-19 Safety Rating, with its Travel Ready program.

## Slowing the spread of COVID to manage health risks

Omicron is highly transmissible and evades the infection protection defences put up by vaccines quite easily. So, infections are very likely to rise, even in a well-vaccinated population. The good news is that vaccines still reduce the severity of illness, breaking the link between case numbers and hospital admissions.

The problem Vanuatu will have is that symptomatic Omicron cases need to stay at home until they recover, usually three to four days. This can disrupt supply chains, as workers stay home. To ensure minimum disruption, Vanuatu's authorities should consider advance bulk purchases of rapid antigen tests (RAT) and making them available so workers can return to work as soon as they test negative.

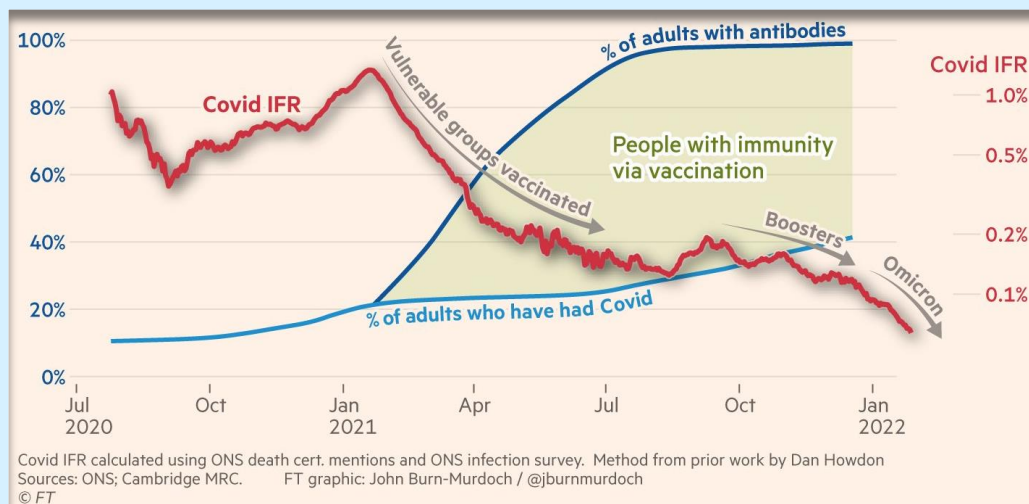
Vanuatu should prepare for excess hospital admissions, particularly outpatients and short-stay care. Some patients may require critical care, so preparedness in this area including beefing up oxygen supplies and ventilated beds is important too.

All up, a high vaccination coverage and readiness to handle community cases will provide for least disruptive transition to an inevitable endemic COVID.

### Figure 4. COVID vaccines provide strong protection against severe illness

COVID has grown gradually less lethal over the pandemic, mainly due to immunity, the majority of which has come via vaccines.

Evolution of COVID's infection fatality ratio in England, overlaid on levels and sources of immunity.



Source: Twitter John Burn-Murdoch @jburnmurdoch



## Vanuatu's vaccination status

### Slow start but pace is picking up

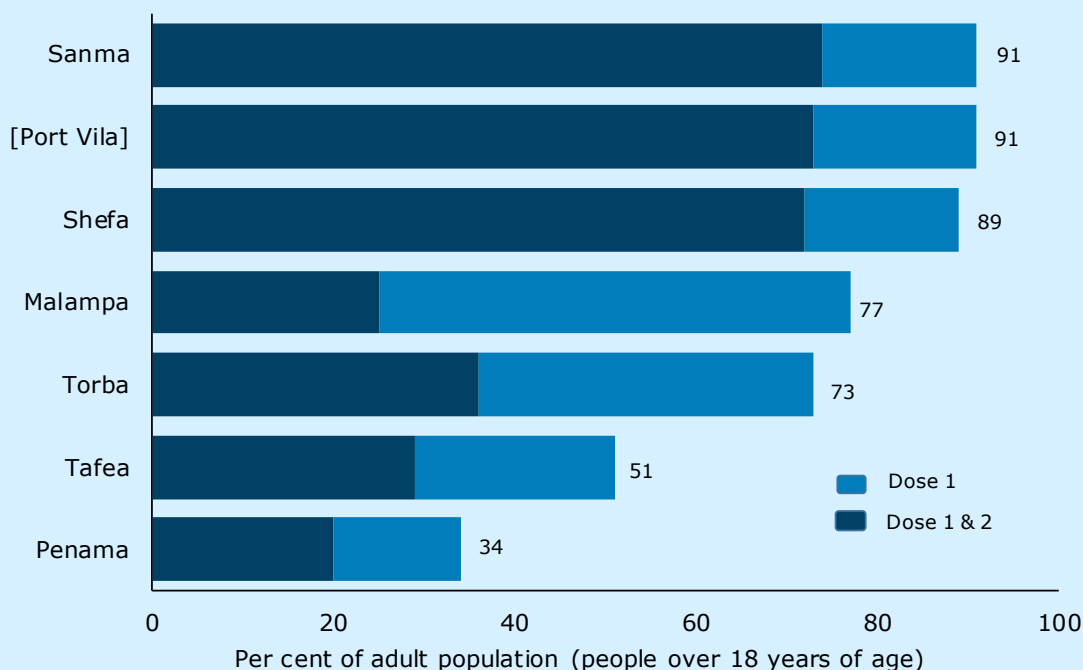
Vanuatu has an adult (over 18 years) population of about 170,000. Vaccines have been rolled out from June 2021. So far, 65% of adults have received one dose, with 44% fully vaccinated. Most of the vaccines have been administered over the past three months. The government hopes to have covered 90% of all adults with one dose and 70% with two doses by the 20 March, as an interim target.

Encouragingly, amongst the high priority areas (identified as more densely populated provinces), 76% of the adult cohort have received one dose and 51% two doses. The province of Sanma ranks number one amongst the fully vaccinated population, with 74% fully vaccinated (Figure 5).

Vanuatu's population is spread over several islands and getting 90% of the adult population one dose, let alone two doses, could be challenging, especially in the outer islands.

The government may choose a slightly lower vaccine coverage to ease restrictions, especially as Omicron is considered less severe than earlier strains. That said, we know the virus disproportionately impacts the elderly. Accordingly, getting most of this cohort (which the government identifies as people over 55 years) fully vaccinated before easing restrictions would minimise the risk of excess hospital admissions and pressures on the hospital infrastructure.

**Figure 5. Vaccination coverage by Provinces**



Source: Vanuatu Ministry of Health, ANZ Research  
Data current as at 30 January 2022



## Foreign currency markets

### Business as usual

Despite the loss of foreign currency inflows caused by the collapse of its tourism receipts and its various other difficulties, Vanuatu's foreign currency markets have continued to function, as normal. Foreign reserves, boosted by drawdowns on foreign currency grants and flows associated with the investment development fund, never came under pressure. As a result, all import invoices were settled on a timely basis.

With a reopening of the economy, we believe it will be more of the same. The current account deficit will probably deteriorate, as imports rise and oil prices stay high, but this will be offset by a surplus in the capital and financial account due to inflows associated with donor assistance. This, in our view, should see foreign reserves retain a comfortable buffer in terms of months of imports. Accordingly, we see little, if any, tightening of exchange controls and timely clearance of foreign currency payments including profit and dividend repatriation.<sup>4</sup>

The USD/VUV reference exchange rate, as ever, will be driven by overnight movements in basket currencies against the USD, in particular the AUD/USD and NZD/USD exchange rates.<sup>5</sup> We are forecasting the reference rate to appreciate, on a quarterly average basis, to VUV115 by June 2022, largely due to the modest strengthening of the USD/AUD exchange rate on the back of improving currency fundamentals (better commodity prices and strengthening domestic economy). The USD/VUV rate is then expected to stabilise at VUV110 through to end of 2023 as both the AUD and NZD stabilise at USD0.75 and USD0.70 respectively (Figure 6).

**Figure 6. Vanuatu's key foreign exchange rate forecasts (quarterly average)**

	Dec 21 Actual	Mar 22	Jun 22	Sep 22	Dec 22	Mar 23	Jun 23	Sep 23	Dec 23
<b>USD/VUV</b>	111.63	113.14	115.06	113.26	111.19	110.46	110.37	110.34	110.34
<b>AUD/VUV</b>	81.52	79.58	81.31	81.92	82.65	82.84	82.78	82.75	82.75
<b>NZD/VUV</b>	77.47	73.97	75.56	76.26	77.09	77.32	77.26	77.24	77.24
<b>EUR/VUV</b>	127.49	126.91	130.40	129.87	129.35	129.97	130.97	131.30	131.30
<b>JPY/VUV</b>	0.98	0.99	1.01	0.99	0.96	0.95	0.95	0.95	0.95

Source: Bloomberg, ANZ Research

4. Foreign reserves may come under pressure if the tourism recovery is delayed.

5. Vanuatu has adopted a currency peg as its exchange rate policy. The official exchange rate is the USD/VUV rate which is announced to the market around 9am each trading day and remains fixed for the rest of the day. The key currency crosses are derived as a linear function of basket currencies and their associated currency components, which in turn is based on basket weights. So, the USD/VUV is calculated as a function of AUD/VUV, NZD/VUV, EUR/VUV and JPY/VUV exchange rates.

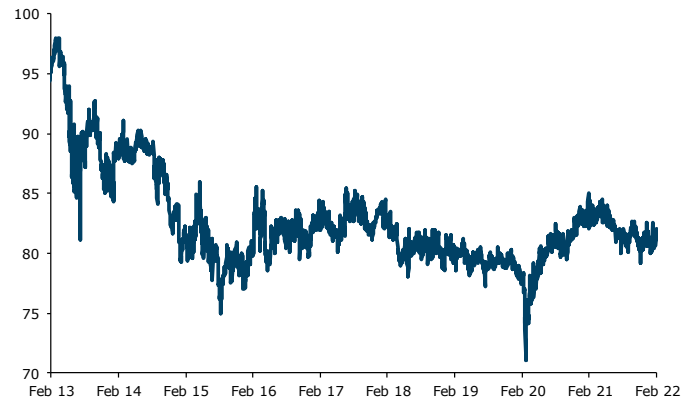


# Foreign currency markets

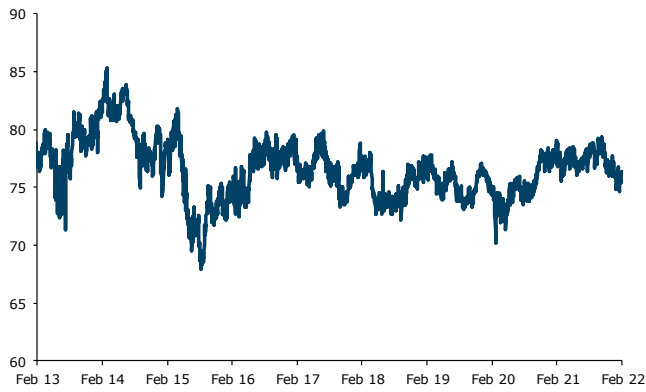
**Figure 7. USD/VUV**



**Figure 8. AUD/VUV**



**Figure 9. NZD/VUV**



**Figure 10. EUR/VUV**



Source: Bloomberg, ANZ Research



## Gross value added by industry sector

Year-ended December	% of GDP 2018	VUVm		Annual % change <sup>(1)</sup>				
		2018	2018	2019e	2020e	2021e	2022f	2023f
Agriculture, Forestry and Fishing	17.7	12,131	0.9	3.4	3.2	3.5	4.1	4.2
Manufacturing	2.5	1,721	3.8	4.5	0.7	1.1	1.5	3.0
Electricity and Water Supply	2.1	1,402	0.7	7.0	0.4	0.9	1.4	4.2
Construction	6.1	4,147	6.8	2.0	3.4	2.3	2.1	1.8
Retail Trade	12.9	8,796	1.4	1.5	-13.4	-2.3	0.4	14.1
Wholesale trade	4.4	3,054	1.4	2.5	-16.3	-2.3	1.2	13.6
Transport	4.2	2,878	-10.9	4.3	-53.2	-3.1	3.6	80.7
Accommodation & Food Services	4.5	3,072	2.0	6.5	-83.2	-3.4	46.3	183.7
Information and Communication	7.0	4,783	2.5	6.4	3.1	2.4	4.1	8.3
Finance and Insurance	6.7	4,547	2.6	7.0	-11.3	-14.7	0.3	7.5
Real Estate Services	7.8	5,318	1.8	2.0	-8.1	-9.3	-3.4	7.1
Administrative Services	2.9	1,960	-1.0	3.0	-12.4	-3.5	1.5	3.2
Government Services	11.3	7,706	0.6	1.0	3.4	2.6	0.7	0.4
Others <sup>(2)</sup>	1.5	1,155	9.8	1.6	-24.7	-5.5	1.3	23.2
Total GVA at Basic Prices	91.6	62,670	1.3	3.3	-10.2	-1.0	2.1	10.3
Taxes less subsidies on products <sup>(3)</sup>	8.4	5,700	25.2	2.4	-60.2	-42.8	37.2	196.4
<b>GDP</b>	<b>100</b>	<b>68,370</b>	<b>2.9</b>	<b>3.3</b>	<b>-14.3</b>	<b>-2.6</b>	<b>2.9</b>	<b>16.2</b>

(1) Constant 2006 prices.

(2) Others include Mining & Quarrying and Other Services.

(3) Taxes less subsidies on products are net of imputed bank service charges.

e: estimate, f: forecast

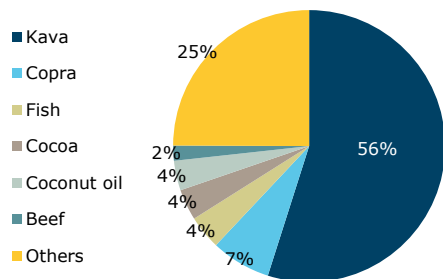
Source: Vanuatu National Statistics Office, ANZ Research



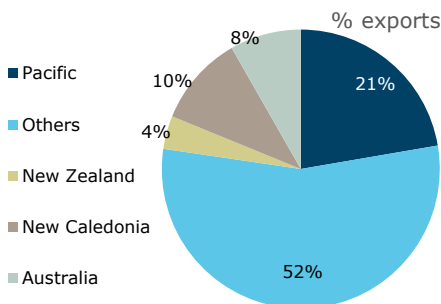
## Country profile

Demographics	1990	2000	2010	2020
Population, total	146,575	184,964	236,216	307,150
Male population	75,381	94,604	119,888	155,690
Female population	71,194	90,360	116,238	151,460
Urban population	27,432	40,087	57,783	78,400
Rural population	119,143	144,877	178,433	228,750
Global links	1990	2000	2010	2020
Merchandise trade (% GDP)	68.1	41.5	49.8	39.4
External debt – total (current prices, USDm) <sup>1</sup>	38.2	112.3	177.7	455.7
Total debt service (% exports of goods, services and primary income)	2.3	1.6	1.6	7.3
Personal remittances received (USDm)	8.2	13.5	11.8	87.5
Net official development assistance and official aid received (USDm) <sup>2</sup>	46.8	35.5	109.5	130.6

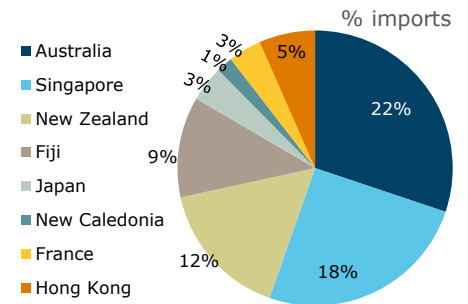
### Goods exports by commodity, 2020



### Destination of goods exports, 2020



### Goods imports by country, 2020



### Industry structure (% of GDP)

2018

Agriculture	17.7
Construction	6.1
Service industries	67.8

Source: World Bank, World Trade Atlas, Vanuatu National Statistics Office

Notes: (1) External debt data is sourced from the World Bank is defined as debt owed to non-residents payable in currency, goods, or services. It is the sum of public, public guaranteed, and private nonguaranteed long-term debt, use of IMF credit and short-term debt. Budget papers show total public sector external debt for 2020 at USD345.2m (preliminary estimate). (2) Net official development assistance consists of disbursements of loans made on concessional terms and grants by official agencies of the members of the Development Assistance Committee.

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