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Vanuatu: Letter of Intent

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The following item is a Letter of Intent of the government of Vanuatu, which describes the policies that Vanuatu intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Vanuatu, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

May 20, 2015

Ms. Christine Lagarde
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, DC 20431, USA

Dear Ms. Lagarde:

On the 13th of March 2015, a category-five tropical cyclone, Pam, hit Vanuatu, resulting in the loss of eleven lives and in extensive damage to infrastructure, agriculture, housing, and tourist facilities. The cyclone undermined food security for more than 60 percent of the country's population, destroyed or severely damaged more than a quarter of the housing stock, and disrupted the provision of essential services such as water, electricity, and telecommunication. With many schools damaged and several used as shelters, education has been disrupted. Damage to hospitals and clinics has interfered with health service delivery just as the need has surged.

The Damage and Loss Assessment completed in April puts the total value of the damages to property at VT29.3 billion or US\$283 million. Together with estimated production losses of VT19.3 billion, or US\$186 million, the total estimated cost of the cyclone amounts to VT48.6 billion, or US\$469 million, equivalent to 61 percent of GDP.

The disaster has set back our efforts to develop the economy. It has damaged critical infrastructure such as bridges, roads, wharves, and airports. The tourism sector—Vanuatu's main source of foreign exchange—has been hit hard, with several major hotels closed for repairs. Agriculture has suffered even more, as this year's crop has been destroyed in many parts of the country, and some areas will take years to recover; moreover, much livestock perished in the cyclone and many fishing boats were damaged. We expect our economic growth to be considerably lower this year than the robust expansion anticipated prior to this sudden and exogenous shock, even after taking into account reconstruction activity.

With Vanuatu's main export sectors—tourism and agriculture—severely affected by the cyclone and with imports boosted by emergency response, recovery and reconstruction needs, and infrastructure investment, we project a sharp deterioration of our trade balance for 2015, in the order of 35 percent of GDP. While this deterioration will be partially offset by insurance receipts, external assistance, and private capital inflows, it will put pressure on our external position, and we are concerned that our international reserves may fall to a dangerously low level.

The deterioration of the current account balance will also reflect a worsening of our fiscal position. Supporting the vulnerable population and restoring public facilities and infrastructure will necessitate considerable expansion in government expenditures even as revenues will suffer with the weak economy. Public sector recovery and reconstruction needs estimated at

VT17.7 billion, or 21 percent of GDP, will have to be accounted for as additional expenditures for 2015 and beyond. In mobilizing financial resources for recovery and reconstruction, we intend to remain prudent and avoid excessive debt accumulation. We will seek external grants as much as possible before resorting to concessional loans or domestic borrowing. So far, Vanuatu has received US\$50 million worth of emergency assistance in cash and in kind. We intend to seek synergies between our planned development projects and reconstruction work, as well as to reduce expenditures in other areas where possible. Despite these efforts and some insurance payments, we still have a fiscal financing gap of about 15 percent of GDP, over the period 2015–17.

Against this background, the Government of Vanuatu would like to request financial assistance from the International Monetary Fund to address Vanuatu's urgent balance-of-payments need and prevent an immediate and severe economic disruption. The assistance would be in the amount equivalent to SDR17 million (US\$23.5 million) as a disbursement of SDR8.5 million (50 percent of our quota) under the Rapid Credit Facility (RCF) and a purchase of SDR8.5 million under the Rapid Financing Instrument (RFI) to ease the pressure on our fiscal position and official foreign reserves. We have been holding extensive discussions with our key development partners on possible financial support and we expect that Fund assistance would help catalyze additional inflows of external resources.

While significant increases in budget deficits and public debt are inevitable as we rebuild our economy, we are committed to restoring our fiscal and financial buffers over time. We will embark on fiscal consolidation as soon as economic recovery takes hold and aim to put the ratio of public debt to GDP on a declining path. To this end, we will take the following steps: (i) strengthen spending discipline by stricter adherence to budget allocations, strengthening internal audit, and making other improvements in public financial management, with technical assistance from PFTAC; (ii) review our infrastructure investment program to ensure that debt-financed projects fit into our country's overall development strategy and are in line with our implementation capacity; (iii) mobilize additional fiscal revenues (which are currently low in comparison to regional peers) via further improving compliance, raising non-tax revenues, and other measures—possibly including introducing an income tax. Moreover, with technical assistance from the World Bank, we will enhance our debt management framework in order to lower borrowing costs and minimize debt risks. The government will finalize rationalization strategies for eight Government Business Enterprises (GBEs) and submit to Parliament a new GBE bill aimed at improving their discipline, accountability and financial viability. While enforcing expenditure control, we will make sure that vulnerable groups of the population are protected and sufficient funds are allocated for primary and secondary education and for health care.

We have lowered the policy interest rate and reduced the statutory reserve deposit requirement to support economic recovery and ensure that banks have sufficient liquidity. We will continue to support the economy and the banking system while maintaining adequate safeguards. In the same vein, our supervisory policies will make certain that banks continue to follow prudential norms for loan quality assessment with adequate risk management. Once the recovery takes hold and the situation normalizes, we will undertake a diagnostic assessment of bank balance sheets and, if necessary, seek to replenish bank capital. Building on several recent regulatory and supervisory steps, we will further strengthen Vanuatu's Anti-Money Laundering and Counter-

Terrorism Financing (AML/CTF) regime. We will introduce amendments to the 2014 AML/CTF Act that will bring it in conformity with international standards.

Our exchange rate regime has served the country well, and we will maintain the value of the vatu against the currency basket to preserve private sector confidence. Once the reconstruction stage is over, we will review our balance-of-payments outlook and assess whether the current level of the peg is consistent with external sustainability or whether an adjustment is needed to restore competitiveness.

Vanuatu will promote inclusive growth through structural reforms. Private sector development and employment creation are top priorities in our Priorities and Action Agenda. As assessed by the World Bank, our business environment compares favorably with regional peers, but we will seek improvement in the few lagging areas, such as the ease of starting a business. Our infrastructure plans target development in several islands and will improve connectivity across the country. The recently established—via a public-private partnership—submarine cable connection will provide additional opportunities. The government will continue its efforts to bring financial services to remote areas of the country, including via mobile banking and micro-credit. We are developing strategies for providing low-cost housing to the needy. In cooperation with the World Bank, we are working on improving access to electricity in rural areas as well as in and around Port Vila.

The Government of Vanuatu values its cooperation with the IMF and takes its obligations seriously. We do not intend to introduce measures or policies that would compound the balance-of-payments difficulties. We do not intend to impose new or intensify existing restrictions on the making of payments and transfers for current international transactions, trade restrictions for balance-of-payments purposes, or multiple currency practices, or to enter into bilateral payments agreements which are inconsistent with Article VIII of the Fund's Articles of Agreement. Furthermore, we commit to undergoing a safeguards assessment, providing IMF staff with access to the Reserve Bank of Vanuatu's most recently completed external audit reports, and authorizing our external auditors to hold discussions with IMF staff. The Reserve Bank of Vanuatu will publish soon on its website the audited financial statements for the year ended December 31, 2013.

Sincerely yours,

/s/

The Hon. Maki Stanley Simelum
Minister of Finance and Economic Management
Government of Vanuatu

/s/

Simeon Athy
Governor
Reserve Bank of Vanuatu