Vanuatu

Strong growth in construction and tourism sustained economic expansion in 2018 despite a disaster-induced contraction in agriculture. Inflation slowed, and the current account moved into surplus. Growth is expected to remain stable in 2019 and 2020 as tourism benefits from the completion of major infrastructure projects. Inflation will ease further, and the current account will remain in surplus. With increased tourist arrivals, policies must ensure that benefits are broadly enjoyed and sustainable.

Economic performance

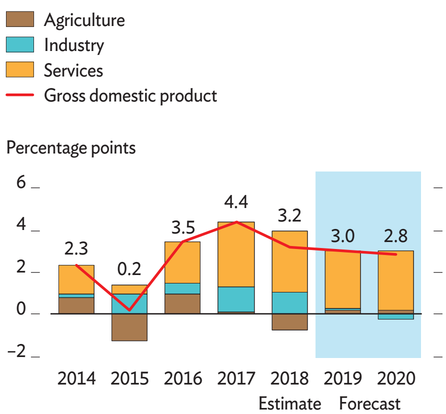
Economic recovery continued in 2018 as growth in services and industry supported expansion at 3.2% (Figure 3.36.1). This was down, however, from 4.4% growth in 2017 because of a sharp decline in the large agriculture sector caused by Cyclone Hola in March 2018 and a volcanic eruption on Ambae Island in Penama Province (Figure 3.36.2). Low prices for copra exacerbated a decline in output.

Growth in services increased from 2.9% in 2017 to 3.6% as tourism accelerated. Visitor arrivals rose by 7.8% to 358,000 visitors. This topped the previous record of 357,400 set in 2013. Arrivals by air rose by 4.7% in 2018, while cruise ship arrivals almost doubled that rate with growth of 9.2% (Figure 3.36.3). Slightly more than half of air travelers were from Australia, 13% from New Caledonia, and 12% from New Zealand. Travel and tourism are estimated to have contributed 45% of GDP in 2018.

Growth in industry remained strong as construction continued on major infrastructure projects: facilities to complement newly upgraded wharves in Port Vila and Luganville, rehabilitation of the main airport in Port Vila and other airports on outer islands, and road projects on multiple islands. Government capital expenditure doubled from 2017, most of it financed by development partners. Renewable energy projects and private investment into tourist-oriented facilities and other businesses contributed to industry growth.

Government recurrent expenditure fell by 2.8% despite employee compensation rising by more than a quarter following a Government Remuneration Tribunal ruling in favor of higher public service salary scales. Although grants from development partners declined by 39.4% with the completion of major projects, total revenue rose by 9.5%. Nontax revenue, derived mainly from the sale of secondary passports, rose by 79.5%

3.36.1 Supply-side contributions to GDP growth



Sources: Vanuatu National Statistics Office; ADB estimates.

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from 2017 and now provides a third of all revenue. Nontax revenue has surpassed the value-added tax (VAT) as the biggest single source of domestic revenue despite a higher VAT following a rate increase in January 2018. Excise taxes and taxes on international trade were also higher (Figure 3.36.4). With expenditure rising by only 4.4%, the fiscal surplus expanded from the equivalent of 5.1% of GDP in 2017 to 6.8%. This allowed for early repayment of approximately 6% of government debt at the end of 2018.

The higher VAT rate notwithstanding, inflation eased from 3.1% in 2017 to 2.2% last year. While food prices rose by 4.1%, prices for clothing and for housing and utilities increased by less than 2.0%. The price index for education fell by 11.1%.

A fall in merchandise exports was offset by higher exports of services in the form of tourism and lower imports of goods and services, allowing the current account to climb to a small surplus equal to 0.5% of GDP. Higher exports of kava and cocoa only partly offset large drops in the export value of fish, copra, beef, and timber. Meanwhile, higher fuel imports only partly offset lower imports by value of food, basic manufactured products, and machinery and transport equipment.

Economic prospects

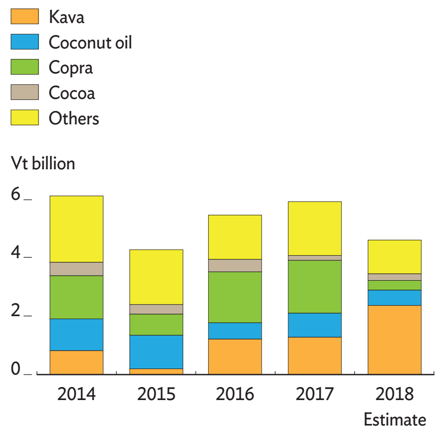
Growth is expected to moderate to 3.0% in 2019 and 2.8% in 2020. Tourism looks set to remain strong, but construction will likely contract with the completion of major infrastructure projects. The performance of agriculture is anticipated highly uneven because it will take several years to grow replacements for livestock and damaged coconut trees and other crops.

After several years of rapid growth fueled by reconstruction and infrastructure upgrading in the aftermath of Cyclone Pam, construction is expected to return to levels prevailing in earlier years. However, this reduction should be partly offset by expansion in retail trade, transportation, and accommodation and restaurants as these service areas benefit from higher tourist arrivals. Growth in public administration is expected to continue as the government implements various projects to promote education and tourism, enhance disaster resilience, and implement higher wages mandated by the Government Remuneration Tribunal.

Spending under the 2019 budget is 40.9% higher than actual expenditure in 2018, though realizing expenditure in 2019 depends on large grants from development partners. The government anticipates a fiscal deficit equal to 6.4% of GDP in 2019.

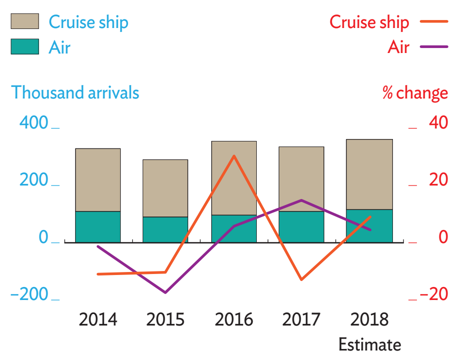
Inflation is expected to ease slightly to 2.0% in 2019 and 2020 as supply constraints caused by the recent disasters are resolved, bringing price stability for food and beverages (Figure 3.36.5). Transport inflation is also forecast to remain subdued with the completion of roads and other major infrastructure projects,

3.36.2 Principal exports



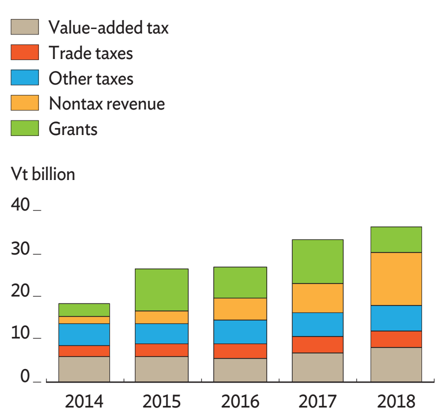
Sources: Vanuatu National Statistics Office; ADB estimates.

3.36.3 Visitor arrivals by mode of transport



Sources: Vanuatu National Statistics Office; ADB estimates.

3.36.4 Government revenues



Source: Vanuatu Department of Finance and Treasury.

and as international oil prices remain low. The current account surplus is expected to widen to the equivalent of 1.0% of GDP in 2019 and 1.5% in 2020 as tourism continues to grow and imports of goods and services decline with the completion of reconstruction projects (Figure 3.36.6).

There are several risks to the forecast. As in most Pacific island economies, disasters pose an ever-present threat. The sustainability of secondary passport sales also poses a risk to fiscal sustainability.

3.36.1 Selected economic indicators (%)

	2019	2020
GDP growth	3.0	2.8
Inflation	2.0	2.0
Current account balance (share of GDP)	1.0	1.5

Source: ADB estimates.

Policy challenge—tourism as a driver of sustainable, inclusive growth

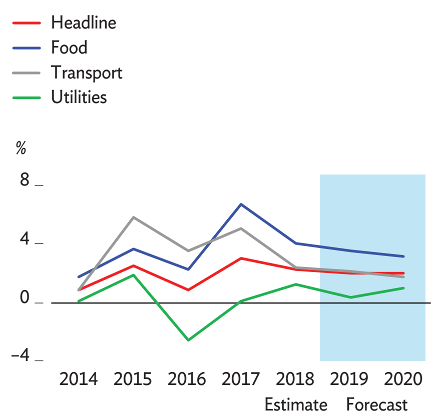
Visitor arrivals are expected to continue rising in Vanuatu with the completion of major infrastructure projects geared for tourism, including airport rehabilitation, wharf upgrades, and waterfront development in Port Vila and Luganville. Air Vanuatu is exploring prospects for increasing flight frequency and introducing new destinations in Australia and New Zealand. The increase in flights is part of a tourism plan called Shared Vision 2030, which targets visitor arrivals by air reaching 450,000 by 2030, a fourfold increase from 2018.

As a key generator of employment and income in Vanuatu, tourism is pivotal to poverty reduction. However, the industry is vulnerable to disaster and is currently concentrated in Port Vila and Luganville. Vanuatu faces a challenge in maximizing the positive benefits of tourism toward creating jobs and supporting inclusive, sustainable growth.

The government has made some progress in climate proofing new public infrastructure. This enhances the resilience of a tourism industry confronting frequent disasters and climate change. Improving facilities for water supply and sewage treatment outside Port Vila may encourage more tourists to venture into new areas, while providing benefits to local communities from improved water and sanitation. The expansion of technical and vocational training could help increase local employment in better-paid positions in growing hospitality and transport industries. Preserving Vanuatu's cultural and environmental assets will be crucial to the sustainability of tourism.

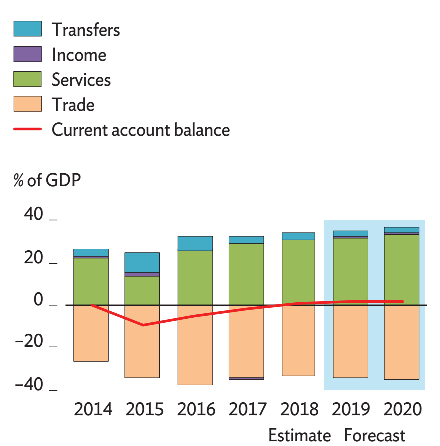
The benefits of tourism could be made more inclusive by enhancing links with suppliers in local communities of agriculture goods and services. Around 80% of the population depends on agriculture for livelihood, and an established network of farmers and traders already exists to provide services to hotels and other tourism facilities. The capacity and scope of these networks are limited, however, and many hotels and restaurants favor imported produce over local supplies. Ways to address these issues are proposed in the Vanuatu Agritourism Action Plan, which the government finalized in 2016.

3.36.5 Inflation



Sources: Vanuatu National Statistics Office; ADB estimates.

3.36.6 Current account balance



Sources: Reserve Bank of Vanuatu; ADB estimates.