

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

EBS/86/241

CONFIDENTIAL

October 30, 1986

To: Members of the Executive Board
From: The Secretary
Subject: Vanuatu - Exchange Arrangements

Attached for the information of the Executive Directors is a paper on a recent change in the exchange rate of the vatu.

Ms. Le Gall (ext. 7334) is available to answer technical or factual questions relating to this paper.

Att: (1)

INTERNATIONAL MONETARY FUND

Vanuatu--Exchange Arrangements

Prepared by the Asian Department and the Exchange
and Trade Relations Department

(In consultation with the Legal Department)

Approved by Hubert Neiss and Eduard Brau

October 29, 1986

In the attached communication dated October 22, 1986, the Central Bank of Vanuatu has informed the Fund of a devaluation of the vatu, which is pegged to the SDR. With effect from October 23, 1986, the vatu has been devalued from VT 122 = SDR 1 to VT 142 = SDR 1, representing a devaluation of 14.1 percent. The devaluation was implemented after careful consideration by the authorities of both its short-term and medium-term implications for the economy. As pointed out in the communication, this measure was taken in order to reverse the recent appreciation of the vatu against a number of currencies, in particular, the Australian, New Zealand, and U.S. dollars. It is expected to mitigate the adverse impact on the balance of payments of a sharp fall in the world price of copra, Vanuatu's major export, and of a decline in tourist receipts, as well as to raise government revenues. The relationship between the vatu and the SDR was last modified on February 13, 1986, when the vatu was devalued by 9.8 percent (EBD/86/42, 2/14/86).

In the Managing Director's summing up at the conclusion of the 1985 Article IV consultation with Vanuatu in November 1985, it was noted that Executive Directors welcomed the adjustment of the exchange rate earlier in that year, following the gradual appreciation in real effective terms of the exchange rate in recent years, and attached importance to the authorities' intention to maintain a flexible exchange rate policy. The devaluation of the vatu in February 1986 partially offset the deterioration in Vanuatu's external competitiveness. The subsequent devaluation in October has further improved financial incentives to the traded goods sector and should prove instrumental in strengthening Vanuatu's balance of payments. The staff welcomes the authorities' flexible management of the exchange rate in the face of the recent deterioration in the external outlook.

Vanuatu is on an 18-month consultation cycle. A mission to hold the next Article IV consultation discussions with Vanuatu is tentatively scheduled for March 1987, at which time exchange rate developments and policies will be analyzed and subsequently reported to the Executive Board.

Attachment

MR. P. R. NARVEKAR
ASIAN DEPARTMENT
INTERNATIONAL MONETARY FUND

THIS IS TO INFORM YOU THAT THE EXCHANGE RATE FOR THE VATU HAS BEEN READJUSTED AS OF THE OPENING HOURS TODAY, THE OCTOBER 23, 1986. WHILE THE VATU CONTINUES TO REMAIN PEGGED TO THE SDR, THE REVISED FIXED RATE FOR THE VATU VIS-A-VIS SDR IS VT 142 = SDR 1 AGAINST THE EXISTING RATE OF VT 122 = SDR 1, REPRESENTING A DEVALUATION OF 14.1 PERCENT.

THE PRESS STATEMENT ISSUED BY THE HON. MINISTER OF FINANCE IN THIS REGARD IS REPRODUCED BELOW FOR YOUR PERUSAL:

"AS YOU ARE AWARE, OUR NATIONAL ECONOMY HAS BEEN FACING SOME DIFFICULTIES IN THE PAST FEW MONTHS ESSENTIALLY DUE TO FACTORS BEYOND OUR CONTROL: A PRECIPITATE FALL IN THE INTERNATIONAL PRICES OF COMMODITIES LIKE COPRA, COFFEE, AND BEEF (SEMI-COLON) AND A DRASTIC REDUCTION IN TOURIST ARRIVALS ASSOCIATED LARGELY WITH PROBLEMS FACED BY THE AUSTRALIAN ECONOMY. REDUCED EXPORT EARNINGS AND EARNINGS ON TOURISM HAVE SENT IN THEIR SHOCK WAVES THROUGHOUT THE DOMESTIC ECONOMY: CUTBACK IN LOCAL EMPLOYMENT AND INCOMES (SEMI-COLON) SEVERE STRAIN ON GOVERNMENT FINANCES (SEMI-COLON) AND POSSIBLY LARGE DEFICITS ON BALANCE OF PAYMENTS IN 1986 AS WELL AS IN 1987, FOR THE FIRST TIME IN MANY YEARS.

IN ORDER TO COUNTER THESE ADVERSE DEVELOPMENTS, THE GOVERNMENT HAS BEEN TAKING A NUMBER OF MEASURES. WE CANNOT SHOW ANY SENSE OF HELPLESSNESS AND FRUSTRATION. A CRUCIAL LESSON WE HAVE TO LEARN FROM THE EXPERIENCES OF OTHERS IS THAT LIVING BEYOND OUR MEANS CAN HAVE DANGEROUS IMPLICATIONS FOR THE FUTURE. ONE OF THE IMPORTANT POLICY DEVICES AVAILABLE TO THE GOVERNMENT TO RESTORE SOME BALANCE BETWEEN

DOMESTIC EXPENDITURES AND REVENUE RECEIPTS AS WELL AS BETWEEN FOREIGN EXCHANGE PAYMENTS AND EARNINGS, IS THE EXCHANGE RATE WE SET FOR THE VATU. ON THE EXCHANGE RATE FRONT ALSO, DUE TO FACTORS BEYOND OUR CONTROL THE VATU HAS BEEN APPRECIATING AGAINST CURRENCIES RELEVANT FOR OUR TRADE AND TOURISM, PARTICULARLY THE AUSTRALIAN DOLLAR, THE NEW ZEALAND DOLLAR, AND THE U.S. DOLLAR, THAT IS, THOSE CURRENCIES HAVE BEEN DEPRECIATING IN THE INTERNATIONAL MARKETS. THIS CANNOT BE SUSTAINED FOR LONG WITHOUT ITS REPERCUSSIONS ON DOMESTIC EXPENDITURES AS WELL AS BALANCE OF PAYMENTS (SEMI-COLON) IF IT IS NOT CORRECTED IN EARNEST IT IS BOUND TO ADD TO THE IMBALANCES THAT HAVE SURFACED IN THE PAST ONE YEAR.

AFTER GIVING UTMOST CONSIDERATION TO THE IMMEDIATE AND MEDIUM-TERM IMPLICATIONS FOR OUR ECONOMY, THE CENTRAL BANK, WITH MY APPROVAL, HAS DECIDED THAT THE FIXED EXCHANGE RATE FOR THE VATU IN TERMS OF THE SPECIAL DRAWING RIGHT (SDR) WILL BE READJUSTED WITH EFFECT FROM THURSDAY THE 23RD OCTOBER 1986. THE REVISED RATE WILL BE 142 VATU FOR ONE SDR AS AGAINST THE PRESENT 122 VATU. THIS REPRESENTS A DOWNWARD ADJUSTMENT TO THE EXTENT OF 14.1 PERCENT. IT MUST BE EMPHASIZED THAT THIS IMPLIES ONLY A RESTORATION OF THE VALUE OF THE VATU WITH RESPECT TO TRADE AND TOURISM-RELATED CURRENCIES AND NOT AN OUTRIGHT DEPRESSION OF ITS REAL VALUE. THE VALUE OF THE VATU AGAINST ALL FOREIGN CURRENCIES WILL CONTINUE TO BE SET BY REFERENCE TO THE SDR VALUES OF THOSE CURRENCIES.

WE EXPECT THE EXCHANGE RATE ADJUSTMENT TO HAVE A POSITIVE IMPACT ON OUR EXPORT AND DOMESTIC INVESTMENT SECTORS, ON IMPORT DEPENDENCE AND ON BALANCE OF PAYMENTS GENERALLY. HOWEVER, ONE OF THE OVERRIDING CONSIDERATIONS IN OUR DELICATE EXCHANGE RATE POLICY HAS BEEN THE

AVOIDANCE OF INFLATION. THE GOVERNMENT WOULD ENDEAVOR TO ENSURE THAT THE PRESENT DEVALUATION HAS THE LEAST EFFECT ON THE RATE OF INFLATION IN THE ECONOMY. I WOULD IMPRESS UPON THE TRADING COMMUNITY TO REALIZE THAT IT IS BOTH POSSIBLE AND IMPERATIVE THAT A GOOD PART OF THE BURDEN IS BORNE AND ABSORBED BY THEM IN THEIR TRADE MARGINS WHICH ARE FOR THE PRESENT UNDULY HIGH.

THANK YOU.

PORT VILA

OCTOBER 22, 1986"

J.K. VIRANI

DEPUTY GENERAL MANAGER

CENTRAL BANK OF VANUATU

OCTOBER 23, 1986

Received in Cable Room: October 22, 1986