

# REPUBLIC OF VANUATU

# MEDIUM-TERM DEBT STRATEGY (MTDS) 2025-2028




**Prepared by:**

Ministry of Finance and Economic Management (MFEM)

# CONTENTS


**GLOSSARY** 4

**PREFACE** 5

**EXECUTIVE SUMMARY** 6

**OBJECTIVES AND SCOPE OF THE DEBT MANAGEMENT STRATEGY** 7

**LEGAL FRAMEWORK** 8

**CHARACTERISTICS OF THE EXISTING DEBT PORTFOLIO** 9
External Debt Portfolio 9
Currency Composition 9
Domestic Debt Portfolio 10
Cost and Risk of Existing Debt Portfolio 10

**SOURCES OF FINANCING** 13
Domestic Financing 13
External Financing 13
Development of domestic debt market 14
Strategic Targets 15

**MONITORING AND EVALUATION** 15

**ANNEX 1. COST-RISK ANALYSIS OF ALTERNATIVE DEBT MANAGEMENT STRATEGIES** 16
Macroeconomic developments and baseline assumptions 16
Key macroeconomic risks 16
Description of the Stylized Debt Instruments 16
Baseline Interest and Exchange Rate Assumptions 17
Description of Shock Scenarios 18
Description of alternative Debt Management Strategies 19
Cost-Risk Analysis of Alternative Debt Management Strategies: Baseline Scenario 20
Cost-risk Indicators: Shock Scenarios 20

# Glossary

| | |
|---|---|
| ABP | Annual Borrowing Plan |
| ADB | Asian Development Bank |
| ADF | Asian Development Fund |
| ATM | Average Time to Maturity |
| ATR | Average Time to Refixing |
| BS | Budget Section (Treasury Division) |
| COM/Cabinet | Council of Ministers |
| DeM | Debt Management |
| DMU/DMO | Debt Management Unit (Treasury Division) |
| DMS | Debt Management Strategy |
| DoFT | Department of Finance and Treasury |
| DSA | Debt Sustainability Analysis |
| ES | Economic Section (Treasury Division) |
| GDP | Gross Domestic Product |
| IDA | International Development Association |
| IFAD | International Fund for Agricultural Development |
| IMF | International Monetary Fund |
| JICA | Japan International Cooperation Agency |
| MTDP | Medium-Term Development Plan |
| MTDS | Medium-Term Debt Management Strategy |
| MTDS AT | Medium-Term Debt Management Strategy Analytical Tool |
| MTFF | Medium-Term Fiscal Framework |
| OCR | ADB Ordinary Capital Resource |
| PFEA | Public Finance and Economic Act (2019) |
| PPG | Public and Publicly Guaranteed |
| RBV | Reserve Bank of Vanuatu |
| SOE | State-Owned Enterprise |
| T-bill | Treasury Bill |
| T-bond | Treasury Bond |
| USD | United States Dollar |
| VAT | Value Added Tax |
| VNPF | Vanuatu National Provident Fund |
| VUV | Vanuatu Vatu |

# Preface

The Government of Vanuatu is pleased to present the Medium-Term Debt Management Strategy (MTDS) for 2025-2028, the fourth such strategy in our nation's history. This document represents a critical milestone in our ongoing commitment to ensuring sustainable public debt management, fostering economic resilience, and securing the financial stability necessary to advance the wellbeing of all Ni-Vanuatu. As Vanuatu navigates a complex economic landscape marked by high debt distress risk, natural disaster vulnerabilities, and shifting global financing dynamics, this strategy provides a robust framework to balance cost and risk, diversify funding sources, and strengthen the domestic capital market.

The development of this fourth MTDS underscores the Government's dedication to building on the lessons and achievements of previous strategies. It reflects a maturing approach to debt management, incorporating updated macroeconomic projections, refined risk assessments, and strategic priorities aligned with the National Sustainable Development Plan (NSDP) – Vanuatu 2030: The People's Plan. The strategy's importance lies in its role as a roadmap to meet the Government's financing needs at the lowest possible cost while maintaining prudent levels of risk, particularly in the face of declining concessional financing and the need to develop domestic bond markets.

We extend our deepest gratitude to our partners who have provided invaluable technical assistance and expertise in formulating this strategy. Special recognition is afforded to the International Monetary Fund (IMF) Monetary and Capital Markets Department and the Pacific Financial Technical Assistance Centre (PFTAC), whose dedicated support has been instrumental. The efforts, combined with the collaborative work of the Debt Management Unit (DMU) and the Treasury and Fiscal team at the Ministry of Finance and Economic Management, have ensured a comprehensive and forward-looking strategy.

We also acknowledge the contributions of other development partners, including the World Bank, Asian Development Bank, and bilateral partners such as Australia, New Zealand, Japan and China whose ongoing support strengthens our capacity to implement sound fiscal and debt management policies. The participatory approach to this strategy's development, involving discussions with the Reserve Bank of Vanuatu and key stakeholders, has enriched its scope and applicability.

The Government of Vanuatu wholeheartedly endorses this 2025-2028 MTDS, recognizing its pivotal role in guiding our nation toward fiscal sustainability and economic resilience. This strategy not only addresses immediate financing challenges but also lays the foundation for long-term economic stability, ensuring that Vanuatu can continue to invest in critical infrastructure, social services, and climate resilience while safeguarding the interests of future generations.

**Hon. Johnny Koanapo Nies Rasou, MP**
Deputy Prime Minister and Minister of Finance and Economic Management
Republic of Vanuatu
September 2025

# Executive Summary

Vanuatu's Debt Management Strategy (DMS) for the period 2025-2028 is a comprehensive framework developed to address the challenges posed by recent economic disruptions, particularly natural disasters, and to ensure sustainable financing for the government. This strategy emphasizes minimizing borrowing costs, managing risks, managing repayments sustainably, and strengthening the local capital market.

**The primary objectives of the DMS include**:

- **Ensuring Sustainable Financing**: The DMS aims to meet the government's financing needs effectively while minimizing the cost of borrowing and managing associated risks especially around repayment.
- **Legal Framework Enhancement:** The strategy focuses on strengthening the legal framework for debt management by implementing necessary reforms.
- **Local Market Development**: A significant goal of the DMS is to continue developing Vanuatu's local market, including through better engagement and information sharing, and responding to market demand for instruments.
- **Strengthening internal debt information and analytics**: to support the above we will build out the debt analytics and reporting/monitoring function within MFEM.

This must be done in line with the Government's development objectives and the need to ensure adequate financing for service delivery. The updated strategy utilized the Medium-Term Debt Management Strategy (MTDS) Analytical Tool to explore viable combinations of borrowing, this is set out in Annex 1.

### Summary Initiatives under the Strategy

| Initiative | Priority | Timeframe |
|---|---|---|
| Fully transition to the new debt recording system (Meridian) | High | Near-term |
| Develop an effective investor relation program | Medium | Near-term |
| Develop a framework for alternative domestic instruments, including treasury bills | Medium | Near-term |
| Design and implement a domestic issuance calendar with more regular issuance planning | Medium | Near-term |
| Ensure staffing for the debt analytical function | Medium | Near-term |
| Development of an appropriate legal framework for debt management: Debt Law, Domestic debt issuance regulations. | Medium | Medium-term |
| Policy framework for Government guarantees and on-lending. | Medium | Medium-term |
| Develop a risk assessment framework for guarantees | Medium | Medium-term |
| Development of a draft yield curve for analysis purposes | Low | Near-term |
| Identified prioritized concessional external sources for development objectives | Medium | Medium-term |
| Prepare a template for the release of auction results | Medium | Medium-term |
| Development of an internal DSA model for debt assessment | Low | Medium-term |

# Objectives and Scope of the Debt Management Strategy

The government's previous debt management strategy (DMS) covering the period from 2023 to 2026 was approved by Cabinet and published on the Department of Finance and Treasury's website. It also included other objectives such as requiring a minimum concessionality of 35 percent in any external new loans, in line with the Public Finance and Economic Management (PFEM) Act. and strengthening the existing legal framework. Lastly, it also called for prepaying the costliest debt when revenue collection permitted.

This new DMS covers the period 2025-2028 and was prepared in part using the MTDS Analytical Tool (see details in Annex 1). The analytical work did include an assessment of potential viable borrowing combinations to identify the one best suited to achieve Government's debt management objectives. It included three specific cost and risk targets and indicated proposed measures to be undertaken during the period such as legal reform, improve dissemination of debt related reports, staffing the debt unit, and upgrading the existing debt management recording system, CS-DRMS, to the new Meridian system.

The scope of the present strategy includes only direct debt of the central government. It therefore excludes debt owed by state own enterprises (SOE). The analysis undertaken encompasses both domestic and external direct government borrowing so that only debt generating actual cash flows were entered into the data base. Lastly, the liabilities of the Reserve Bank of Vanuatu (RBV), including securities issued in the name of the central bank for monetary policy purposes, are regarded as outside the scope of government debt management and do not form part of this analysis.

The cutoff date for debt data was established in December 2024. Although the debt data included actuals disbursements and debt service payments until December 2024, there would be some loan operations with slightly differing in end of year stock amounts due to individual creditors still on reconciliation with their end of year auditing. This latest MTDS is the fourth Vanuatu Debt Management Strategy.

# Legal Framework

The overall primary legal framework for public debt management is based in the Public Finance and Economic Management Act of 2019. It gives the Minister of Finance the authority to borrow funds, externally and domestically, and to issue guarantees. It also assigns roles and responsibilities to the Council of Ministers (COM) and Parliament.

Part IV of the PFEM act outlines specific principles of responsible fiscal management. These include:

> (a) reducing and then managing total government debt at prudent levels;
>
> (b) achieving and maintaining levels of the State net worth that provide a buffer against factors that may impact adversely on the State's net worth in the future;
>
> (c) managing prudently the fiscal risks facing the State; and
>
> (d) pursuing policies that are consistent with a reasonable degree of predictability about the level and stability of tax rates for future years.

The government may depart from these principles, but only in exceptional circumstances. The departure must however be justified, temporary and disclosed to the Legislative Assembly and the time frame within which the government expects to return to the principles has to be specified.

According to the PFEM Act, the Minister of Finance can provide guarantees if such guarantees are considered in thepublic interest. The issuance of guarantees is done

> (a) after consultation with the Director General;
>
> (b) where such guarantee is consistent with the principles of responsible fiscal management set out in section 22; and
>
> (c) with the prior approval of a simple majority of Parliament.

The PFEM Act specifies that the Minister needs to provide “… an assessment of the risks associated with the guarantee or indemnity”, and to support this the government intends to draft procedures concerning guarantees and on-lending that specify the mechanics and conditions for issuing guarantees and/or any fees that might need to be levied.

# Characteristics of the Existing Debt Portfolio

At end December 2024, direct central government debt is expected to reach VUV 58 billion (USD 489.5 million), equivalent to 41 percent of Gross Domestic Product (GDP)

## External Debt Portfolio

External debt accounted for 70 percent of direct central government debt at December 2024. Outstanding external debt amounted to VUV 41.1 billion (USD 358.3 million), equivalent to 29 percent of GDP. Bilateral creditors account for the largest share of the external debt, (57 percent of external debt) with Exim Bank China and JICA of Japan being the largest creditors (representing 40 and 15 percent, respectively). Multilateral creditors accounted for 43 percent with IDA and the Asian Development Fund representing 27 and15 percent of total external debt. The Government has followed a borrowing policy of contracting external debt on concessional terms with a grant element of at least 35 percent.  Figures 1 and 2 below show the composition of external debt by creditors type and by creditors.

Figure 1: Composition of external debt by creditor type (end 2024)

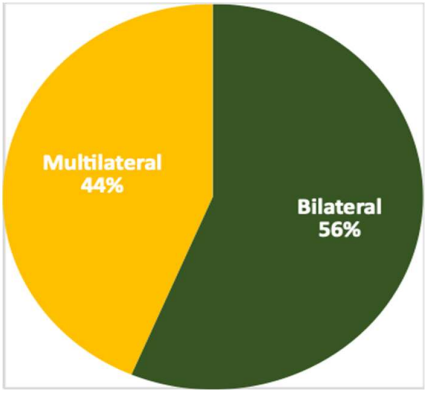
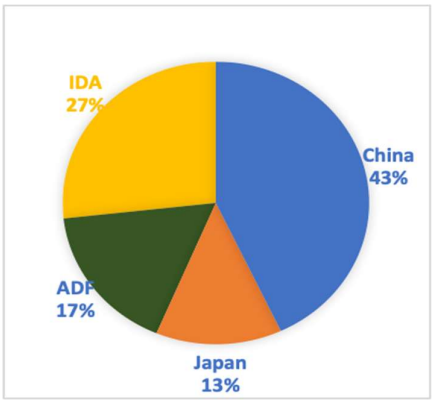



Figure 2: Composition of external debt by creditor (end 2024)




**Source**: Source: MFEM (DOFT)

## Currency Composition

**We have contracted external loans in three foreign currencies**: the Chinese yuan (RBM), the Japanese yen (JPY), and the Special Drawing Rights (SDR). At the end of 2024, their respective share of the external debt portfolio was 42 percent for the SDR, 40 percent for the RBM, 15 percent for the JPY.

Figure 3: Currency composition

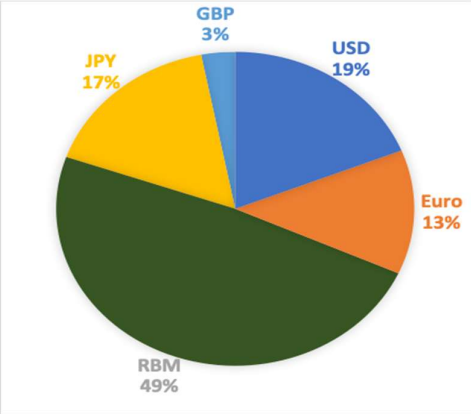
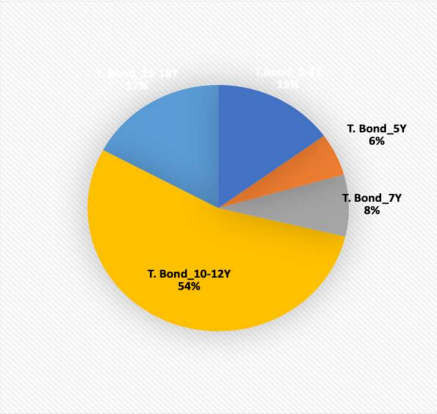



Figure 4: Domestic debt by maturities




**Source: MFEM (DOFT)** (DOFT)

## Domestic Debt Portfolio

**We have a low burden of domestic debt.** At the end of 2024, it was VUV 16.6 billion (USD 144.2 million), representing 12 percent of GDP. This is the result of the government policy of redeeming bonds as they mature and issuing new debt as needed resulting in a highly irregular issuance calendar. The domestic debt portfolio is comprised, in its totality, by marketable instruments. The government has issued, on ad-hoc basis, various financial instruments in the market (4, 6, 7, and mostly 10-year bonds). At the end of 2024, the portfolio was comprised of a 10-12 year bond (54 percent); 15-18 year bond (12 percent); 3-4 year bond (15 percent); 7 year-bond (6 percent); and 5 year bond representing 12 percent as shown in Figure 4 below. Noteworthy, is the high exposure to RBV with 44.2 per cent. Bonds are issued through auctions conducted by the Reserve Bank of Vanuatu (as fiscal agent) at par, with market participants determining the coupon rate.

**Central Government's debt is primarily held by public corporations and the Pension Fund.** As of the end of 2024, the major bondholders are the Vanuatu National Provident Fund (VNPF) which is the largest investor for the long-term Government securities, the Vanuatu Reserve Bank, and the National Bank of Vanuatu, as well as ANZ. There remains excess liquidity in the market, suggesting the government would benefit from an investor relations strategy to better tap the different market segments existing in Vanuatu. It is expected that due to the ongoing recovery and foreseeable rebuilding of the new VNPF and NBV building complexes, RBV will be the major player in the Bond market for 2025 (already by mid year 2025 to be 44.2 per cent).

## Cost and Risk of Existing Debt Portfolio[1]

**We have a relatively low cost associated with its overall debt as reflected by the ratio of interest payments to GDP at 1.8 percent at end-2024** For the overall portfolio, the weighted average interest rate is about 4.4 percent. This is primarily due to the larger proportion of external debt in the country's portfolio. Most external loans are contracted on highly concessional terms. This also was due to the relative moderate cost of domestic debt and its relative size compared to external debt. The domestic interest payment was equivalent to 0.6 percent of GDP at end-2024 and a weighted average interest rate of 5.1 percent.

[1] Risk and cost indicators indicated in this section are based on the debt portfolio data provided by the authorities and processed in the MTDS Analytical Tool (AT). It therefore may not exactly match with other data previously published by the authorities.

**Foreign currency risk is the most significant vulnerability in the portfolio**. Public and publicly guaranteed foreign denominated debt accounted for 71.3 percent of the portfolio. Furthermore, the percentage of short-term external debt to international reserves stood at 2.9 percent. This risk is mitigated by the long maturity structure and low interest rates of external debt.

**Refinancing and interest rate risks are low**. ATM and ATR are both 10.9 years and the share of debt maturing in one-year is 2.0 percent of GDP or 4.5 percent of total debt. This is mainly due to the large proportion of external debt, which has been contracted with long-term maturities. However, for domestic debt, the risk is slightly higher: ATM and ATR are 7.3 years, and debt refixing in one year represents 4.3 percent of the portfolio. The risks are mitigated by the high liquidity experienced in the country's financial market. The entire portfolio has been borrowed on fixed-term interest rate.

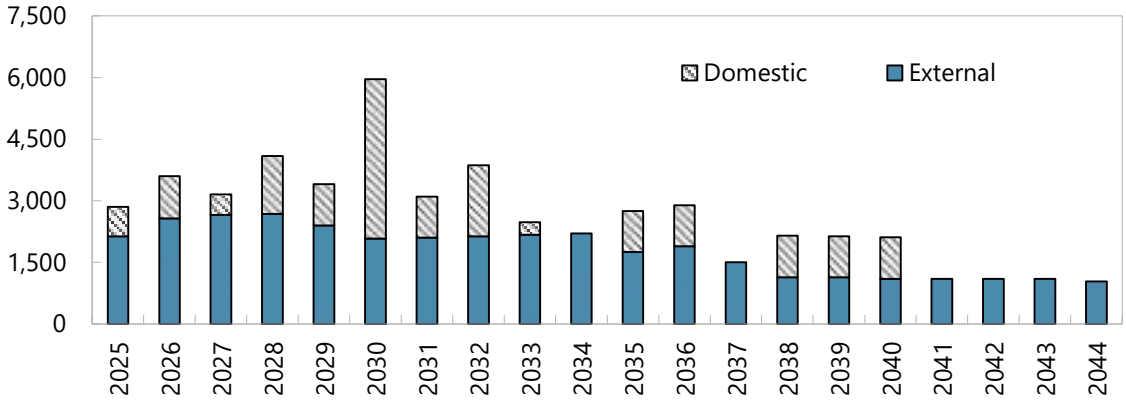
Table 2: Cost and risk indicators of the existing portfolio (end 2024)

| Risk Indicators | | External debt | Domestic debt | Total debt |
|---|---|---|---|---|
| Amount (in millions of VUV) | | 41,137.7 | 16,592.5 | 57,730.2 |
| Amount (in millions of USD) | | 358.3 | 144.5 | 502.9 |
| Nominal debt as percent of GDP | | 29.0 | 11.7 | 40.7 |
| PV as percent of GDP[1] | | 23.6 | 11.7 | 35.3 |
| Cost of debt[2] | Interest payment as percent of GDP[3] | 1.2 | 0.6 | 1.8 |
| | Weighted Av. IR (percent) | 4.2 | 5.1 | 4.4 |
| Refinancing risk[2] | ATM (years) | 12.2 | 7.3 | 10.9 |
| | Debt maturing in 1 yr (percent of total) | 4.6 | 4.3 | 4.5 |
| | Debt maturing in 1 yr (percent of GDP) | 1.5 | 0.5 | 2.0 |
| Interest rate risk[2] | ATR (years) | 12.2 | 7.3 | 10.9 |
| | Debt refixing in 1 yr (percent of total) | 4.6 | 4.3 | 4.5 |
| | Fixed rate debt incl T-bills (percent of total) | 100.0 | 100.0 | 100.0 |
| | T-bills (percent of total) | 0.0 | 0.0 | 0.0 |
| FX risk | FX debt (percent of total debt) | | | 71.3 |
| | ST FX debt (percent of reserves) | | | 2.9 |

**Source**: DoFT and IMF mission staff calculations
**Notes**:
1PV as percent of GDP is calculated based on projected debt service payments where discount rate of 5% is applied to those instruments on concessional or semi-concessional terms.
2 Cost-Risk indicators that use projected cash flows such as weighted average interest rate, refinancing and interest rate risks use projected exchange rate assumptions.
3 Interest payment as percent of GDP is calculated by dividing interest payment on outstanding debt at 2021 to 2021 GDP.

The redemption profile (Figure 5) illustrates the refinancing risks in the debt portfolio. It reflects the debt structure with the long-term repayment period for the external debt and medium-term period for domestic debt. The figure shows that Vanuatu will face repayment peaks in 2030. The peak in debt service is the result of 10-year bond issued during the pandemic, back in 2020, which is now maturing in 2030. A key effort under the MTDS will be the management of this repayment profile to ensure it does not create risk for the Government.

Figure 5: Vanuatu's debt service redemption profile




**Source**: MFEM
**Note**: Figures are based on 2024 repayments, and will have now adjusted based on borrowing and disbursement through the remainder of 2024 and into 2025

# Sources of Financing

## Domestic Financing

The domestic market is currently at a nascent stage of development. Government securities are only issued in the form of Treasury bonds with mostly 10-year maturities to the large pension fund. Starting in 2022, authorities have also issued a variety of tenors (3-year, 7-year and 15-year through 18-year). Currently, 10-12 year instruments account for more than 54 percent of the total outstanding stock of domestic bonds, 5 year only represents 12 percent of total.

At the moment the Government does not prepare an annual borrowing plan, nor publish any issuance calendar, with auctions taking place as required. The government intends to work on the development of an investor relations strategy, including the development and publication of an annual borrowing plan and issuance calendar.

A challenge to expanding the domestic debt market is the lack of a secondary market for government securities and an underlying repo market. To aid this the RBV is introducing a central fully automated registry system that will allow the issuance de-materialized instruments. Additionally, the RBV will be unveiling, in the coming months, a fully automized payment system that will improve transparency and efficiency in the market.

We will undertake in this MTDS period the development of closer engagement with market participants. It is envisioned to have a formal meeting early next year, to present the DMS and a draft annual borrowing plan will be prepared.

## External Financing

Official creditors are the main source of external financing for the government, this includes IDA (World Bank) and ADB, primarily through policy based grants blended with loans and contingent funding responding to disasters, which is primarily grants. On the bilateral side, Exim Bank China provides the bulk of the project based financing, alongside Japan. New loans signed have met the 35% grant element in line with the law.  Vanuatu will want to see future projects whereby companies are paid within Vanuatu (for more positives to both foreign reserves and improvement in current accounts).

Going forward, the government aims to diversifying external sources of financing. The Government has already established contacts with IFAD and some Arab development funds to attract additional funding sources. External financing on commercial terms will not be considered during the strategy period as it would be out of line with provisions in the PFEM Act.

## Development of domestic debt market

The domestic debt market is in a nascent stage. Through RBV's assistance in the front office communication between the government and market participants will improve from the current form, as the current format has lead to limited investor engagement and potential mismatches in offered maturities. Furthermore, the government will seek to issue market-determined instruments along the entire yield curve in order to provide pricing across tenors. Pricing and maturity profiles are other important elements in reinvigorating the Domestic market to responding to the government's financing needs (especially for recovery and important capital investments).

The primary market provides domestic financing to the government. Through this market, the debt manager implements the debt management strategy and establishes the relationship with market participants. Therefore, enhancing communication with banks and other financial institutions is critical. Thus, developing a comprehensive investor relations strategy to improve engagement with market participants is conducive to gathering information regarding the potential demand for short-term instruments

Benchmark bonds aim to increase the size of individual securities at key tenors, thereby fostering liquidity and helping to establish a yield curve. Developing a benchmark yield curve is an important objective for countries seeking to develop a liquid secondary market. Current bond issuances have maturities over 7 years, leaving little room for price discovery at the short end of the yield curve.

To expand the domestic market we will:

1. Enhance the legal framework

2. Ensure Predictability and transparency of issuances through regular auctions are a pillar for developing the primary market. Introducing a systematic auction schedule for government securities to enhance market liquidity and attract more investors. Moreover, we will publish the results of these auctions with information about bids and accepted amounts, cutoff price, etc.

3. We will design and implement an Investor Relations (IR) strategy. This will support making sound decisions on what tenors to issue and at what volume and at what frequency. Feedback will also aid the formulation of the MTDS and the Annual Borrowing Plan (ABP). To complement the development of an IR strategy, there will be an expansion of inter-agency coordination with the relevant agencies.

4. Additional staffing would be needed. All initiatives detailed above; to improve investor relations and expand the domestic bond market, would require additional work. Additional staffing and training will be required in order to implement such tasks.

## Strategic Targets

The Government will maintain the strategic targets included in the previous strategy. This first set of targets was based on the portfolio's characteristics and on the debt management objectives of Vanuatu. In preparing the new DMS 2025-28, the government intends to use the following key targets:

- The government will prioritize concessional financing from external sources in order to secure the necessary financing for its development objectives.
- Government will not be undertaking any debt prepayment operations.
- Government will continue to develop the domestic debt market to improve its depth, liquidity and efficiency. As part of this effort, it will develop closer engagement with the existing domestic investor base and aim to expand it to reduce excessive dependency on few investors.
- To minimize the impact of costs and risks to the government, these indicators shall be used as guidelines to provide measurable and quantifiable targets for monitoring purposes:

Table 5: Key targets 2025-2028

| | **Current** | **Target** |
|---|---|---|
| **Domestic debt ATM (years)** | 5 | Above 4 years |
| **Debt refixing in one year (%)** | 6.3 | Below 6 percent |
| **FX debt as percentage of total debt** | 83.3 | below 85 percent |

## Monitoring and Evaluation

**This debt management strategy has a time horizon of 4 years, and the Government intends to undertake a review of progress annually.** An assessment of government's progress against the MTDS key targets will be reported annually through an updated document. The review will include, in the domestic debt market, a thorough analysis of any difficulties encountered to expand the maturity profile of available instruments and progress on implementing an investor relations communication strategy.

# Annex 1. Cost-Risk Analysis of Alternative Debt Management Strategies

## Macroeconomic developments and baseline assumptions

The analysis in the strategy is based on the below framework:

Table 3: Macroeconomic Framework at time of preparation 2024-2028

| VUV millions | Estimated | Forecast | | | |
|---|---|---|---|---|---|
| | 2024 | 2025 | 2026 | 2027 | 2028 |
| Budget revenues | 39,175 | 46,253 | 41,297 | 43,538 | 44,908 |
| *Grants* | 8,250 | 15,771 | 13,555 | 14,663 | 14,109 |
| *Budget revenues and grants* | 47,426 | 62,024 | 54,852 | 58,201 | 59,017 |
| | | | | | |
| Total Expenditures | 40,914 | 64,094 | 58,816 | 59,603 | 58,375 |
| Budgeted interest payments | 1,157 | 1,516 | 1,402 | 1,318 | 1,284 |
| Primary Expenditures | 39,757 | 62,578 | 57,414 | 58,284 | 57,091 |
| | | | | | |
| Primary Balance | 7,669 | -554 | -2,563 | -83 | 1,926 |
| Overall Balance | 6,512 | -2,070 | -3,964 | -1,402 | 642 |
| International reserves (USD Million) | 633 | 633 | 633 | 633 | 633 |
| GDP | 141,671 | 151,307 | 162,620 | 175,904 | 186,365 |

Source: MFEM (DOFT)

## Key macroeconomic risks

Risks to the economic outlook for Vanuatu are tilted toward the downside. The slow recovery and rebuilding from the 2024 Earthquake, coupled with the impact of the liquidation of Air Vanuatu may continue to damage the reputation of the country as tourist destination and spillovers to other economic sectors through worsening business confidence. Likewise, weather-related events may severely affect the agricultural sector, hurting job creation and social conditions.

Table 4: Macroeconomic Risks

| Risks | Likelihood of Risk Event | Implication for Debt Management Strategy |
|---|---|---|
| **Growth**<br>The liquidation of Air Vanuatu may have long-lasting impact on tourism and growth. Further, the US announced a 23% tariff on Vanuatu exports (with kava accounting for ¾ of total) could also hit economic activity. | High | Increased fiscal requirement and deterioration of debt ratios |
| **Inflation**<br>Inflation, driven by imported inflation, is higher than projected. | Medium | Debt service costs may increase if the domestic yield curve adjusts to higher inflation. |
| **Natural Disasters**<br>The country is highly exposed to natural disasters. Vanuatu was hit for severe cyclones in 2023 and the Earthquake in December 2024 continues to grip the Country. | Medium | Broad-based negative impact that spills over to the fiscal outcome, inflationary expectations, and balance of payments deterioration with pressure on the exchange rate. |

## Description of the Stylized Debt Instruments

**Given the existing debt portfolio in Vanuatu and proposed borrowing strategies (see below), a total of 12 stylized debt instruments were used during the analysis.** The stylized debt instruments included six VUV and five USD-denominated instruments. Six financial instruments are already in the current portfolio, and four have been introduced to implement alternative strategies (such as AIIB and Korea for external debt, and 1,2 and 5-year bonds for domestic debt). All domestic debt instruments are market-based instruments, whereas all external debt is on highly concessional terms or semi-concessional terms (China).

Table 6 Description of stylized debt instruments

| Instrument | Interest type | Maturity | Grace |
|---|---|---|---|
| External | | | |
| China | Fix | 20 | 6 |
| JICA_Japan | Fix | 40 | 10 |
| ADB | Fix | 40 | 10 |
| IDA | Fix | 40 | 10 |
| Other (AIIB, Korea, Kuwait, Saudi) | Fix | 25 | 5 |
| Domestic | | | |
| T-Bill | T-bills | 1 | 0 |
| Treasury Bond_2Y | Fix | 2 | 1 |
| Treasury Bond_3-4Y | Fix | 3 | 2 |
| Treasury Bond_5Y | Fix | 5 | 4 |
| Treasury Bond_7Y | Fix | 7 | 6 |
| Treasury Bond_10-12Y | Fix | 10 | 9 |
| | | | |

Source: MFEM (DOFT)

## Baseline Interest and Exchange Rate Assumptions

**The analysis that follows is based on the Government's projections and the assumptions of the expected market (i.e., interest and exchange) rates during the strategy period (i.e., 2025-28).** The assumption for the path of the nominal exchange rate is based on the inflation differential between Vanuatu and the US. The average gap between these two rates leads to an average annual depreciation of about 1.2 - 1.5 percent.

Table 7: USD/VUV Exchange rate projections 2025-2028

| | 2025 | 2026 | 2027 | 2028 |
|---|---|---|---|---|
| Exchange rate | 115.3 | 117 | 119 | 121 |
| Depreciation (percent) | 1 | 1.5 | 1.8 | 1.8 |

Source: MFEM (DOFT) based on data from August 2024 & June 2025

**On the external side, concessional and semi-concessional fixed-rate loans, a constant interest rate assumption was made for the four years of the strategy period.** These instruments are non-market debt instruments and the conditions granted by these creditors to Vanuatu are not expected to change during the strategy period and are in line with the average interest rate of the existing debt portfolio. Interest rate projections are shown in table 7 below.

**For domestic debt, pricing is based on the actual coupons issued during 2024**. For 1-year T-bills, it is based on a 6-month RSB note issued in the market (annualized) with an additional risk premium over the T-bills currently issued by the central bank[2]. For all these instruments, it is assumed that domestic yield will remain constant in 2025 relative to 2024, but these will start increasing in 2026 as the government is expected to increase its presence in the domestic market (in part because of less external concessional financing), which it would lead to higher borrowing costs.

Table *8*: Interest rates projections 2025-2028

| | 2024 | 2025 | 2026 | 2027 | 2028 |
|---|---|---|---|---|---|
| **External debt instruments** | | | | | |
| China | 2.0% | 2.0% | 2.0% | 2.0% | 2.0% |
| JICA_Japan | 0.2% | 0.2% | 0.2% | 0.2% | 0.2% |
| ADB | 1.2% | 1.2% | 1.2% | 1.2% | 1.2% |
| IDA | 0.8% | 0.8% | 0.8% | 0.8% | 0.8% |
| Other (AIIB, Korea, Kuwait, Saudi) | 2.0% | 2.0% | 2.0% | 2.0% | 2.0% |
| | | | | | |
| **Domestic debt instruments** | | | | | |
| T-Bill | 3.0% | 3.0% | 3.2% | 3.5% | 3.5% |
| Treasury Bond_2Y | 3.2% | 3.2% | 3.5% | 3.7% | 3.8% |
| Treasury Bond_3-4Y | 3.5% | 3.5% | 3.7% | 3.9% | 4.0% |
| Treasury Bond_5Y | 4.0% | 4.0% | 4.2% | 4.5% | 4.5% |
| Treasury Bond_7Y | 4.5% | 4.5% | 5.0% | 5.0% | 5.0% |
| Treasury Bond_10-12Y | 6.0% | 6.0% | 6.7% | 6.9% | 6.9% |

Source: MTDS Team Calculation based on RBV and DoFT data (June 2025)

## Description of Shock Scenarios

**The analysis compared alternative borrowing strategies under different shocks to interest and exchange rates**. The MTDS AT allows the definition of four risk scenarios: two shocks to interest rates, an exchange rate shock, and a combined interest rate and exchange rate shock.

- For exchange rates, standard shocks of 15 and 30 percent were applied. These shocks were consistent with the standard Debt Sustainability Analysis (DSA) for low-income countries. Exchange rate shocks were applied in the second projected year of the analysis (2023).

[2] The assumption is that the government would issue a 1-year T-bill and, based on conversation with market participants, they take into consideration different factors to determine the required yield when placing bids for government securities (credit risk, repo rates, cost of funding, RB's T-bills yields, etc).

- For interest rates, a moderate and an extreme shocks were defined. The shocks were based on the discussion between PIFTAC and the DMU (both in late 2024 and reinforced again in the first quarter of 2025). The extreme shock doubled the standard shock. The shocks applied for the 2025-27 period are as follows:

    1. Moderate (combined with the exchange rate shock): 250 bps (or 2.5 percent)
    2. Extreme: 500 bps (or 5 percent).

### Description of alternative Debt Management Strategies

**For the purpose of the exercise, three strategies were developed with the national authorities**. The three strategies were used to assess the impact of various borrowing mix on the existing cost and risk indicators. In all four strategies, it is assumed that Japan will provide the funding in grants. According to the latest DSA, Vanuatu will be eligible to grant financing from IFIs given the new classification as a high debt distress country is confirmed. Such a switch to grant financing will come with a twenty percent reduction in the total available envelope from IFIs and are being fed into the borrowing strategies through the macro assumptions with the corresponding reduction in the gross financing needs in the coming years. During this exercise, the information about future grant flows from IFIs was not finalized and therefore, the strategies and macro numbers would need to be revised to include the final numbers. Table 8 below describes the different sources of financing used.

Table 9: Summary of borrowing assumptions, by strategy

| Average percentage of gross borrowing over simulation period | | | | |
|---|---|---|---|---|
| New debt | | S1 | S2 | S3 |
| China | FX | 13 | 11 | 25 |
| JICA_Japan | FX | 0 | 0 | 0 |
| ADB | FX | 12 | 10 | 18 |
| IDA | FX | 35 | 29 | 21 |
| Other (AIIB, Korea, Kuwait, Saudi) | FX | 0 | 0 | 7 |
| T-Bill | DX | 0 | 5 | 0 |
| Treasury Bond_2Y | DX | 0 | 5 | 0 |
| Treasury Bond_3-4Y | DX | 14 | 5 | 11 |
| Treasury Bond_5Y | DX | 0 | 8 | 0 |
| Treasury Bond_7Y | DX | 6 | 8 | 5 |
| Treasury Bond_10-12Y | DX | 20 | 20 | 15 |
| **External** | | 60 | 50 | 70 |
| **Domestic** | | 40 | 50 | 30 |
| | | **100** | **100** | **100** |

Source: MTDS tool.

- **Strategy 1 (S1- Status quo).** This strategy replicates the sources and type of financing currently being used by Government. It is used to serve as a measuring tool to assess the impact of the other strategies in the cost and risk indicators. The external vs. domestic financing take the form of 60 and 40 percent respectively and assumes that ADB, IDA and Japan provide the necessary financing in the form of grants and therefore, external borrowing comes from China and other sources of funding. It is assumed that China continues to lend on concessional terms. Domestic funding is implemented through the issuance of 3-,5-, and 10-year bond using the same proportion used in 2023.

- **Strategy 2 (S2- development of the domestic market).** The shares of external sources remain the same as in strategy one. However, this strategy has a larger share of domestic funding relative to the status quo (50 percent vs 40 percent). Further, this strategy introduces new instruments (1- , 2- and 5-year bonds) in the domestic capital market to attract new market participants and increase participation of commercial banks, but the share for the 10-year bond would decrease as a result.

- **Strategy 3 (S3-Expanding external sources).** This strategy uses the same domestic borrowing composition as in strategy 1 but increases the external share to 70 percent of borrowing needs (compared to 60 percent in the status quo).

### Cost-Risk Analysis of Alternative Debt Management Strategies: Baseline Scenario

**The three strategies assessed, under the baseline scenario, share similar cost/risk indicators due to reduced gross financing needs and limits absorption capacity.** Debt-to-GDP ratios would reach 38 percent of GDP remaining at the same level as in 2024 and therefore below the Government's threshold of 60 percent. The strategy S2 allocates a larger portion to domestic instruments deliver slightly higher refinancing risk than S3 but still below S1, and slightly higher borrowing costs due to issuance of more expensive and shorter-term instruments (relative to concessional financing).

**The ATR is also lower for S2 as shorter instruments account for a larger share of funding during the strategy period.** S2 has a slightly lower ATR at 11.1 years than S1 and S3 at 11.5 and 11.4 years, respectively.

Strategy 3, which assumes a higher reliance on external concessional funding, would allow the government to reduce refinancing risk (with lower ATM and debt maturing in 1 year) with almost no cost difference but with higher exposure to exchange rate risk**.**

Table 10: Resulting cost and risk indicators (End 2028)

| Risk Indicators | | 2024 | As at end 2028 | | |
|---|---|---|---|---|---|
| | | Current | S1 | S2 | S3 |
| Nominal debt as percent of GDP | | 40.7 | 38.6 | 38.7 | 38.6 |
| Present value debt as percent of GDP | | 35.3 | 30.1 | 30.7 | 30.2 |
| Interest payment as percent of GDP | | 1.8 | 1.4 | 1.4 | 1.4 |
| Implied interest rate (percent) | | 4.4 | 3.4 | 3.6 | 3.4 |
| Refinancing risk | Debt maturing in 1yr (percent of total) | 4.5 | 6.4 | 6.2 | 6.0 |
| | Debt maturing in 1yr (% of GDP) | 2.0 | 2.5 | 2.4 | 2.3 |
| | ATM External Portfolio (years) | 12.2 | 14.2 | 13.9 | 13.6 |
| | ATM Domestic Portfolio (years) | 7.3 | 5.1 | 5.1 | 5.0 |
| | ATM Total Portfolio (years) | 10.9 | 11.5 | 11.1 | 11.4 |
| Interest rate risk | ATR (years) | 10.9 | 11.5 | 11.1 | 11.4 |
| | Debt refixing in 1yr (percent of total) | 4.5 | 6.4 | 6.2 | 6.0 |
| | Fixed rate debt incl T-bills (percent of total) | 100.0 | 100.0 | 100.0 | 100.0 |
| | T-bills (percent of total) | 0.0 | 0.0 | 0.4 | 0.0 |
| FX risk | FX debt as % of total | 71.3 | 68.7 | 65.9 | 72.1 |
| | ST FX debt as % of reserves | 2.9 | 2.8 | 2.8 | 2.8 |

Source: MTDS team

### Cost-risk Indicators: Shock Scenarios

**When considering the shocks, strategy 3 delivers the lowest cost and risk indicators**. When looking at the interest rate relative to GDP or revenues, S3 has the lowest cost. S2

delivers slightly higher risk, and it is slightly more expensive. The composition of this strategy, which continues relying mostly on external concessional financing, complemented by medium and long-term bonds deliver the best cost/risk trade-off for the government.

**Under all the shocks, S3 performs relatively better than the alternatives**. The main reason is the strong reliance on long-term (and fixed rates) and cheap funding than more than offset the increase in borrowing costs due to the shock. However, it is important to highlight that this strategy may not be feasible as the government would need to seek additional funding to access concessional financing in an international context where developed countries are facing more budget constraints, limiting development assistance. In particular, this strategy assumes that funding from China almost doubles and from the ADB increases by 50 percent, on average over the medium-term (table 8).

**Figure 6: Debt to GDP ratio (end-2028)**

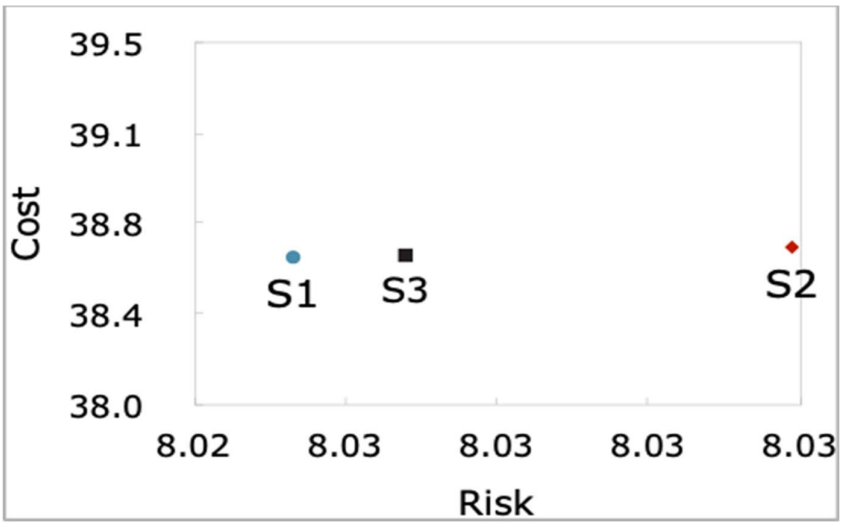



**Figure 7: Interest to GDP ratio (end-2028)**

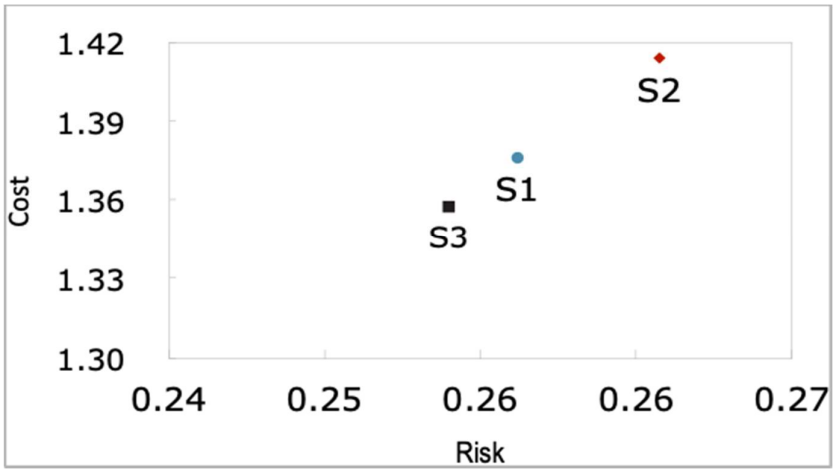



**Figure 8: Interest to revenues ratio (end-2028)**

