RESERVE BANK OF FIJI

ECONOMIC REVIEW

23 04 April 2006

OVERVIEW

Global economic and financial prospects remain positive. In the latest World Economic Outlook, the International Monetary Fund (IMF) estimated that the global economy expanded by 4.8 percent last year, up from the previous projection of 4.3 percent. The upward revision reflected stronger-than-expected economic activity in the latter half of last year, despite the higher crude oil prices and natural disasters.

For 2006, world growth is now projected at 4.9 percent, before easing to 4.7 percent in 2007. Growth this year is anticipated to be supported by the solid performance of emerging and developing economies, particularly led by the upbeat activity in China and India. The outlook for most of our major trading partners is also optimistic. The economic outlook remains upbeat for Australia, the US, Japan and the Euro-zone due to robust domestic demand, growing exports and high business investment. However, New Zealand's economic growth is projected to slow arising from weak domestic demand.

On the domestic front, this year's growth projection has been revised upward to 2.7 percent, from 2.0 percent forecast earlier. The improvement in the growth outlook is largely underpinned by favourable growth projected for the transport & communications; agriculture, forestry, fishing & subsistence; community, social & personal services and electricity & water sectors.

In line with this improved growth forecast, sectoral outcomes during the review period were generally favourable, with buoyant activity in the building & construction sector, copra production registering an annual rise and latest available visitor arrivals data indicative of the optimism prevalent in the tourism industry.

In addition, domestic demand remains firm. In particular, investment continues to be supported by the robust growth in construction activity. Last year, the total value of work-put-in-place rose by a phenomenal 70 percent. Consumption has also been on the rise so far this year - net Value Added Tax (VAT) collections, lending for consumption purposes and import payments for consumption goods all showed annual increases in the first 2 months.

On the fiscal front, provisional cashflow data from the Ministry of Finance shows a slight deterioration in Government's fiscal position for 2005. The underlying deficit for 2005 equated to 3.6 percent of GDP ($168.2 million), compared with an underlying deficit of 3.3 percent of GDP ($146.6 million) recorded for 2004. Underpinning the 2005 fiscal outturn was a 4.8 percent increase in expenditure, which more than offset the 3.4 percent increase in revenue collections. Notably, the fiscal outturn was better than the budgeted deficit of 4.4 percent of GDP ($203.5 million), on account of a marginal increase in revenue collections and a decline in expenditure payments of 2.7 percent, when compared with budgeted estimates.

Consistent with robust domestic demand, credit aggregates continued to grow strongly in the year to February 2006. During this period, total commercial bank credit grew by a historical high of 24.2 percent, predominantly driven by borrowing from private individuals, building & construction, wholesale & retail and the real estate sectors. Notably, loans for household purposes accounted for a significant share of the growth in credit to private individuals. New loans disbursed by commercial banks fell by 11.1 percent on an annual basis in February, and also declined over the month by 20.9 percent to $63.5 million.

Commercial bank time deposit and savings deposit rates increased by 47 basis points and 1 basis point to 2.80 percent and 0.47 percent, respectively. The commercial bank lending rate rose marginally over the month by 1 basis point to 6.63 percent. In addition, interest rates on new deposits and new loans by commercial banks rose by 89 basis points to 4.08 percent and 51 basis points to 7.42 percent, respectively. While the movements in interest rates are consistent with Reserve Bank's recent monetary policy tightening strategy, the overall effect of the new policy initiatives will become clearer in the coming months. In the meantime the Reserve Bank will maintain a tightening bias with respect to its monetary policy choice.

In March, inflation stood at 2.0 percent, against 2.2 percent recorded in the previous month. The underlying measure of inflation, the trimmed mean, remained at 1.1 percent, unchanged from February. In the approaching months, favourable prices of locally produced goods and services are expected to keep inflation below the 3 percent mark. The year-end inflation forecast remains at 3.5 percent.

Labour market conditions also improved during the review period. Cumulative to March this year, newly registered taxpayers increased by 9 percent on an annual basis, when compared with the same period in 2005. Looking ahead, the March Job Advertisements and RBF's Fiji Employers Federation survey results suggest that employment conditions are expected to improve in the coming months, both in the temporary and permanent categories.

In terms of the external sector, the latest Overseas Exchange Trade (OET) data showed that cumulative to February 2006, merchandise exports rose by 1.5 percent year-on-year, compared with a decline of around 40 percent in the same period last year. The increase in receipts was largely attributed to higher earnings from sugar, gold, merchanted goods, and other exports, which more than offset lower earnings from other re-exports, re-exports of mineral fuels, fish, ginger, timber, textiles, clothing & footwear and copra. For the same period, merchandise imports rose by around 18 percent, compared to a decline of around 0.3 percent registered in the comparable period in 2005. The increase in import payments was due to higher outlays for: consumption goods (13.3 percent) and investment goods (5.8 percent), which more than offset the decline in import payments for intermediate goods (1.6 percent).

Official reserves at the end of March are estimated at $793 million, sufficient to cover 3.4 months of imports of goods.

In summary, the local economy is expected to expand slightly more than was envisaged earlier. There is also evidence that investment is picking up. However, consumer spending remains (uncomfortably) high. This has forced the Bank to tighten monetary conditions and push interest rates higher. The new Bank policies are also designed to address the trade imbalance by depressing the demand for imports.

SECTORAL DEVELOPMENTS

During the review period, sectoral performances were generally positive. Partial indicators suggest that consumption activity remains favourable, supported by an annual growth in Net VAT and income. Activity in the building & construction sector continues to remain robust. Although more recent data is unavailable, last year's data shows that visitor arrivals continued with its upward trend. Production in the copra industry also remains favourable. On the downside though, gold production remained weak.

Consumption

Consumption was firm in the year to February. Net VAT collections, a partial indicator of consumer spending, amounted to around $75 million, representing a 2 percent increase during the review period on an annual basis.

This growth was underpinned by higher VAT collections from Domestic sources (6 percent) and Customs services (3 percent).[1] Collections from government departments, however, declined by 7 percent when compared with the corresponding period in 2005.

- **Income**

Cumulative to February, net income tax revenue amounted to around $41 million, indicating a 47 percent increase on an annual basis. Pay As You Earn collections, a partial indicator of individual incomes, amounted to around $35 million during the first 2 months of the year, representing around 19 percent increase over the comparable period last year.

- **Tourism**

The tourism industry performed exceptionally well, in terms of visitor arrivals, for 2005. According to provisional data from the Fiji Islands Bureau of Statistics (FIBOS), visitor arrivals in 2005 totalled

[1] VAT from the Customs Services, Government Departments and Domestic collections are 3 separate categories of net VAT collections.

almost 550,000, representing an annual increase of 10 percent.

The Fiji Visitors Bureau expects that this year, there would be 576,000 visitors, an increase of around 5 percent over last year's level. Visitor arrivals in 2007 and 2008 are anticipated to be around 610,000 and 658,000, respectively.

- **Copra**

Copra production continued with its favourable performance into the second month of this year. Latest statistics from the Coconut Industry Development Authority show that cumulative to February, copra production amounted to around 1,150 tonnes, representing an increase of around 4 percent over the corresponding period in 2005.

- **Building & Construction**

The construction sector performed strongly last year, evident by the value of work put-in-place. According to the 2005 Annual Building and Construction Survey[2] report released by FIBOS, $271 million was spent on capital works during the year, an increase of 70 percent on an annual basis.

By categories, cumulative to December last year, the total value of work put-in-place by the private sector rose by around 100 percent (to $210m), followed by the public sector, which recorded an increase of 11 percent (to $61m) during the review period.

The strong growth in domestic sales supports our expectations of a favourable performance by the building and construction sector this year.

- **Gold**

Production in the gold industry continues to remain weak. In the year to February, total gold output amounted to almost 12,000 ounces, 32 percent lower than the corresponding level in 2005.

Similarly, gold earnings for the same period totalled $11.7 million representing a decline of 8 percent over the comparable period last year.

In line with the weak performance of the sector, Emperor Gold Mining Company Limited has consequently downgraded its forecast for this year to 102,790 ounces, which is 35 percent (157,713 ounces) lower than the projection provided in October last year. However, the Macroeconomic Committee is assuming a production of around 96,286 ounces for this year, based on relatively poor performance of actual outturn previously, compared with forecasts provided by EGM.

- **Public Finance**

Provisional cashflow data from the Ministry of Finance indicates a slight deterioration in Government's fiscal position in 2005, compared to the fiscal outcome in 2004. The underlying fiscal deficit for 2005 is currently estimated at $168.2 million or 3.6 percent of GDP, as opposed to the underlying deficit of $146.6 million (3.3 percent of GDP) recorded for 2004. This compares favourably with a deficit of $203.5 million (or 4.4 percent of GDP) earlier estimated for 2005.

Underpinning the 2005 fiscal outturn was a 4.8 percent increase in expenditure payments, which more than offset the 3.4 percent increase in revenue collections. Capital expenditure declined by 2.6 percent, on an annual basis, last year. Nevertheless, against the 2005 budgeted levels, revenue collections rose marginally, while expenditure declined by 2.7 percent, on an annual basis. For this year, Government's underlying deficit is projected at around $232.0 million, equivalent to 4.7 percent of GDP.

- **Inflation**

Inflation in March stood at 2.0 percent, compared with 2.2 percent in February. Over the month, consumer prices fell by 0.6 percent. During March, prices of food and transport fell mainly due to lower prices recorded for wheat and cereal products and other primary produce, coupled with the fall in costs of petrol and diesel. Conversely, prices of heating & lighting, miscellaneous items, alcoholic drinks & tobacco, housing, durable household goods and clothing & footwear rose. Higher costs of heating & lighting are a result of the increase in prices of kerosene, while the rise in prices of the remaining subgroup may be attributable to the changes in import and excise duties since November last year. Costs of services remained the same.

The underlying measure of inflation, the trimmed mean, remained at 1.1 percent, unchanged from February. Inflation continues to hover within the 2-3 percent band. In the approaching months, inflation is likely to remain below 3 percent, mainly due to favourable prices of locally produced goods and services. This is expected to cushion the possible increase in prices of imported goods, resulting from the relatively stronger US dollar and higher energy

[2] The survey covers all private sector enterprises operating in the private and public sectors of the construction industry.

prices. The year-end inflation forecast remains at 3.5 percent.

- **Labour Market**

Labour market conditions improved over the year as suggested by partial indicators. Cumulative to March, around 4,200 individuals were registered with the Fiji Islands Revenue & Customs Authority (FIRCA), increasing by around 9 percent over the corresponding period last year. The community, social & personal services sector continues to record the largest number of new taxpayers followed by the finance, insurance, real estate & business services; manufacturing; wholesale & retail trade, restaurants & hotel sectors; transport, storage & communications and construction sectors.

Moreover, recruitment intentions are also on the rise. The Reserve Bank's March Survey of Job Advertisements reported an annual increase of 18 percent. The finance, insurance, real estate & business services sector recorded the most number of advertised positions. This was followed by the community, social & personal services; wholesale & restaurants & hotels; transport and construction sectors.

Similarly, the recent Reserve Bank's Fiji Employers Federation (FEF) survey revealed that a net of around 64 percent and 37 percent of respondents expect an increase in permanent and temporary employment respectively. This compares favourably against the last survey where 59 percent and 41 percent of respondents, anticipated increases in the permanent and temporary categories respectively. On the wages front, the survey suggested that more respondents expect wages to rise between 0-3 percent in the next twelve months.

- **Monetary & Credit Aggregates**

In the year to February 2006, total commercial bank credit grew by a historical high of 24.2 percent. Credit expansion continues to be primarily driven by borrowing from private individuals, building & construction, wholesale & retail and the real estate sectors. Over the year to February, total credit to the private individual sector grew by 25.7 percent. Loans for household purposes continue to dominate lending to private individuals (80.4 percent) and comprise 26.9 percent of total loans by commercial banks.

Credit for consumption increased at an annualised rate of 13.9 percent in February, compared with 11.4 percent recorded in January. Lending for investment purposes grew by 64 percent ($126.3m) during the review period, totalling $323.5 million at the end of February. New loans disbursed by commercial banks fell by 11.1 percent on an annual basis, and also declined over the month by 20.9 percent to $63.5 million.

On the supply side, total commercial bank deposits rose by 20.2 percent in the year to February 2006 to around $2.5 billion, following a growth of 17.9 percent in January. The increase reflected mainly higher placements by private sector business enterprises and private individuals in demand, savings and time deposits.

- **Interest Rates**

Interest rate movements during the February period were generally on an upward trend. Both the commercial bank time deposit and savings deposit rates increased by 47 basis points and 1 basis point to 2.80 percent and 0.47 percent, respectively. The commercial bank lending rate rose marginally over the month by 1 basis point to 6.63 percent. In addition, interest rates on new deposits and new loans by commercial banks also rose by 89 basis points to 4.08 percent and 51 basis points to 7.42 percent, respectively.

- **Exchange Rates**

Bilateral movements in exchange rates reveal that during the month of March, the Fiji dollar generally strengthened against the New Zealand (5.2 percent) and Australian (0.7 percent) dollars, while it depreciated against the Euro (4.8 percent), the US dollar (2.3 percent) and the Yen (1.3 percent).

The Nominal Effective Exchange Rate[3] (NEER) Index of the Fiji dollar fell by 0.7 percent in the year to March 2006, indicating a depreciation of the Fiji dollar against the basket of currencies.

The Real Effective Exchange Rate (REER) Index[4] of the Fiji dollar, a gauge of our international competitiveness, fell by 1.4 percent during the review period. The decline in the REER Index reflects an improvement in our international competitiveness and

[3] The NEER index is the sum of the indices of each trading partner country's currency against the Fiji dollar, adjusted by their respective weight in the basket. Each weight reflects a trading partner's contribution to Fiji's total trade in goods and services. This index measures the overall movement of the Fiji dollar against the basket of currencies. An increase in this index indicates a slight appreciation of the Fiji dollar against the basket of currencies and vice versa.

[4] The REER index is the sum of each component of the NEER index, adjusted by the relative price differential between Fiji and each of Fiji's major trading partners. This index measures the competitiveness of the Fiji dollar against the basket of currencies. A decline in the REER index indicates an improvement in Fiji's international competitiveness and vice versa.

was largely due to the better domestic inflation outcome. Domestic inflation was around 2.0 percent in March 2006, while average trading partner inflation was around 3.0 percent during the same period.

- **External sector**

On the external front, latest OET data showed that cumulative to February this year, merchandise exports rose by around 1.5 percent, compared with a decline of around 40 percent in the corresponding period in 2005. The increase in receipts was largely attributed to higher earnings from sugar, other exports, gold and merchanted goods, which more than offset lower receipts from other re-exports, re-exports of mineral fuels, fish, ginger, timber, textiles, clothing & footwear and copra.

During the same period merchandise imports rose by around 18.0 percent, compared to a contraction of around 0.3 percent in the corresponding period in 2005. The increase in import payments was due to: consumption goods (13.3 percent), and investment goods (5.8 percent), which more than offset the decline in payments for intermediate goods (1.6 percent). The higher payments for consumption goods was largely attributed to higher outlays for food, beverage & tobacco, other imports , duty free goods and transport equipment. The growth in payments for investment goods was largely due to increases in import payments for machinery & electrical equipment[5] which more than offset the decline in spending on chemicals. The decline in intermediate goods payments was underpinned by lower payments on mineral fuels which more than offset the increase in payments for textiles, clothing & footwear and raw materials.

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[5] This includes machinery such as power generating machinery & equipment, machinery specialized for particular industries (agriculture, factory, road making, textile etc), and compressors, cranes, woodworking machinery, amongst others.

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FIJI: FINANCIAL STATISTICS

KEY INDICATORS	Mar-06	Feb-06	Jan-06	Mar-05
1. Money and Credit				
(year-on-year % change)				
Narrow Money	n.a	n.a	n.a	39.12
Currency in Circulation (monthly average)	n.a	10.22	9.88	10.44
Quasi-Money (Time & Saving Deposits)	n.a	n.a	n.a	8.55
Domestic Credit	n.a	n.a	n.a	13.99
2. Consumer Prices [1/]				
(year-on-year % change)				
All Items	2.0	2.2	2.3	3.0
Food	1.2	3.0	3.7	3.5
3. Reserves				
(end of period)				
Gross Foreign Reserves ($m)*	793.1	853.6	905.8	980.2
Months of Imports (goods)	3.4	3.7	3.9	4.8
4. Liquidity				
(end of period)				
Liquid Assets Margin to Deposit Ratio (%)	n.a	8.8	9.4	9.3
Banks' Demand Deposits ($m)	n.a	121.2	113.8	66.1
5. Interest Rates (% p.a.)				
(monthly average)				
Lending Rate (Excluding Staff)	n.a	6.63	6.62	6.92
Savings Deposit Rate	n.a	0.47	0.46	0.36
Time Deposit Rate	n.a	2.80	2.33	1.87
91-day RBF Note Rate (month end)	3.25	2.25	n.i	1.75
Minimum Lending Rate (MLR) (month end)	3.75	3.75	2.75	2.25
Overnight Inter-bank Rate	4.24	n.t	n.t	1.29
5-Year Government Bond Yield	5.00	4.00	n.i	2.66
10-Year Government Bond Yield	6.74	6.73	n.i	5.15
6. Exchange Rates [2/]				
(mid rates, F$1 equals)				
(end of period)				
US dollar	0.5575	0.5708	0.5788	0.5978
Pound sterling	0.3192	0.3281	0.3276	0.3181
Australian dollar	0.7801	0.7743	0.7736	0.7757
New Zealand dollar	0.9102	0.8654	0.8501	0.8448
Swiss francs	0.7233	0.7547	0.7452	0.7167
Euro	0.4584	0.4816	0.4790	0.4626
Japanese yen	65.43	66.32	68.09	64.25
7. Commodity Prices (US$)				
(monthly average)				
UK Gold Price/fine ounce [2/]	555.96	555.63	547.21	435.13
London Daily Sugar Price/tonne [3/]	423.59	440.88	384.81	260.44
Crude Oil/barrel [4/]	62.25	59.92	63.57	53.12

n.a. - Not available/No activity
n.i. - No issues
n.t. - No trading
** Official reserves includes foreign reserves holdings of the RBF and Non-Bank Financial Institution, as per the new definition of official reserves*

Sources: [1/] *Fiji Islands Bureau of Statistics*
[2/] *Bloomberg and Reserve Bank of Fiji*
[3/] *Fiji Sugar Marketing Company Limited*
[4/] *Bloomberg*