RESERVE BANK OF FIJI

ECONOMIC REVIEW

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OVERVIEW

Developments in the global economy continue to favour domestic growth in Fiji. Driving the global expansion are the combined efforts from the US, Japan and selected Asian economies, notably China. The outlook also remains positive for Australia, New Zealand, and the Euro Zone. Nevertheless, downside risks in the form of continued high crude oil prices and heightened geo-political uncertainty still prevail.

On the domestic front, economic prospects remain firm. The Macroeconomic Committee has recently revised the economic growth projection for 2006 upwards to 3.1 percent, from the previous estimate of 2.7 percent. Encouraging performance from transport & communication; agriculture, forestry, fisheries & subsistence; finance, insurance, real estate & business services sectors are anticipated to drive economic growth to 3.1 percent this year. Cumulative to July, electricity generation increased, while sugarcane production fell, resulting in a decline in sugar production.

On the fiscal side, provisional cashflow data from the Ministry of Finance shows that the Government's expansionary fiscal stance continued into the first half of this year. The underlying deficit for the first six months increased, when compared to the corresponding period last year. Driving this fiscal outturn was an 18.7 percent rise in expenditure payments, which surpassed the 10.6 percent increase in underlying revenue collections.

On the financial conditions front, available data reveals that annual growth rate of total domestic credit and credit by commercial banks declined in July. Slowdowns in growth were noted in credit to private individuals, wholesale & retail trade and hotels & restaurants, real estate and manufacturing sectors. Credit for consumption purposes has also slowed. Additionally, new loans disbursed by commercial banks fell by 3.4 percent over the month. However, despite this moderation in commercial bank lending, domestic credit still remains at high levels.

Looking at the cost of funds, the upward movement of interest rates continued into July, reflecting the impact of the recent RBF policy measures. The weighted average commercial bank lending and deposit rates continued to rise. In addition, interest rates on new loans and new deposits also increased over the month.

Employment conditions improved over the year, evident through partial indicators. Cumulative to July this year, the number of newly registered taxpayers increased, while the RBF's Fiji Employer's Federation (FEF) Survey results also indicate optimistic employment outlook.

Inflation in July rose to 1.8 percent, from 1.6 percent in June. The underlying measure of inflation, the trimmed mean, rose to 1.6 percent from 1.5 percent. On the whole, inflation has picked up slightly, as the delayed increases in domestic fuel prices and the flow on effects of the import and excise duties take effect. For the year-end, the inflation forecast remains at 3.5 percent.

On the international trade front, the deteriorating trade position remains a concern. The Macroeconomic Committee recently revised the outlook for exports growth downwards, while imports growth has been revised upwards. The slowdown in exports stems from weaker-than-expected exports of garments, timber, gold and other domestic exports. In contrast, higher payments for mineral fuels, machinery & transport equipment, chemicals and food items are anticipated to fuel the imports bill. Moreover, the Overseas Exchange Trade (OET) data available so far this year also reveal depressing trade performance. Cumulative to June this year, merchandise exports fell by around 22 percent, while imports surged by 24 percent. The widening trade imbalance continues to underpin the deterioration of the current account position. For 2006, the current account deficit is forecast to widen further. Despite the higher capital & financial account surplus, the overall balance of payments deficit is expected to widen to 3.6 percent of GDP. This is largely due to the larger current account deficit.

Official reserves at the end of July stood at $621.5 million, sufficient to cover 2.6 months of goods imports.

SECTORAL DEVELOPMENTS

The Macroeconomic Committee has recently released revised economic growth projections for 2006 – 2008. While growth for 2006 has been adjusted upwards to 3.1 percent (from 2.7 percent in April this year), the projection for 2007 remained unchanged at 2.2 percent. For 2008, growth has been slightly revised downwards to 2.8 percent from the earlier projection of 2.9 percent.

On the sectoral front, in the year to July, positive growth was noted in electricity production. On the contrary, a weaker performance was registered in the cane and sugar industries.

Gross Domestic Product

The revised economic growth for 2006 now stands at 3.1 percent, revised upwards from the 2.7 percent projected in April. The transport & communication; agriculture, forestry, fisheries & subsistence; finance, insurance, real estate & business services; and community, social & personal services sectors, are expected to be the main drivers of growth this year. Other sectors that are also anticipated to do well are the wholesale & retail trade and hotels & restaurants; building & construction; electricity & water and manufacturing sectors. On the other hand, the mining & quarrying sector is envisaged to contract this year.

For 2007, the anticipated growth remains intact at 2.2 percent, being largely led by the transport & communication; finance, insurance, real estate & business services; manufacturing; and agriculture, forestry, fishing & subsistence sectors. The other sectors that are also expected to do well are the community, social & personal services; electricity & water; wholesale & retail trade and hotels & restaurants and mining & quarrying sectors.

Growth in 2008 has been revised downwards from 2.9 percent to 2.8 percent. Underpinning this growth are the transport & communication; agriculture, forestry, fishing & subsistence; and manufacturing sectors. In addition, the finance, insurance, real estate & business services; wholesale & retail trade and hotels & restaurants; community, social & personal services; and electricity & water sectors are also envisaged to register positive growth.

Electricity

Electricity production continues to increase, implying correlating increase in economic activities. Over the review period, total electricity generated by the Fiji Electricity Authority was around 441 megawatt hours (Mwh), an increase of around 9.2 percent over the same period last year.

Cane and Sugar

Despite sentiments of improved production this year, the cane and sugar industry recorded weaker performance in the first 2 months of the season, when compared with the same period last year. This was mainly led by mill related problems and low cane supply to the Fiji Sugar Corporation (FSC)[1].

According to the FSC, around 934,000 tonnes of cane was crushed, cumulative to July this year. This represented a decline of 3.3 percent over the comparable period last year. The Tonnes Cane to Tonnes Sugar ratio was around 10.6:1, slightly lower than the ratio of 11:1 experienced in July 2005, indicating a slight improvement in cane quality.

Consequently, in line with the lower cane harvest, sugar production fell by 1.9 percent on an annual basis to approximately 88,000 tonnes of sugar.

Public Finance

Government's fiscal stance continued to be expansionary into the first six months of 2006. Recent cashflow data indicate that cumulative to June, Government recorded an underlying deficit[2] of $85 million, equivalent to 1.7 percent of GDP. This compares with the deficit of $37.2 million (equivalent to 0.8 percent of GDP) recorded in the corresponding period last year.

The fiscal outturn in the six months to June was underpinned by an 18.7 percent rise in expenditure payments, which outweighed the 10.6 percent increase in underlying revenue collections (excluding

[1] Sourced from The Fiji Times 30 July, 2006
[2] Excludes asset sales of $28 million

asset sales). Notably, capital expenditure in the review period rose by 18.4 percent on an annual basis. However, capital expenditure was below target by a significant 69 percent. On a positive note, underlying revenue exceeded projections by 4.9 percent. The increase in revenue collections stemmed from buoyant collections of both direct and indirect taxes, particularly corporate taxes (increased by an annual 19.2 percent), excise duties (increased by an annual 9.4 percent) and VAT collections[3] (increased by an annual 21.3 percent).

Against projections, the underlying fiscal deficit was lower than the projected deficit of $277.7 million (equivalent to 5.6 percent of GDP). This was underpinned by lower expenditure payments (20.7 percent), largely as a result of the shortfall in capital spending.

Inflation

Inflation in July rose to 1.8 percent compared to 1.6 percent in June. Over the month, consumer prices rose by 0.4 percent. During the month, prices of transport, heating & lighting, miscellaneous items, durable household goods and clothing & footwear rose while prices of food items fell. Costs of alcoholic drinks & tobacco, housing and services on the other hand, remained unchanged. The higher price of transport was underpinned by increases in the price of domestic fuel and spare parts, whilst the increase in the cost of heating & lighting was driven by the higher price for kerosene. Additionally, the relatively higher prices of miscellaneous items, durable household goods and clothing & footwear could be attributed to the flow on effects of the increase in import duty introduced in November last year. The decline in food prices, on the other hand, was largely due to a fall in prices of market items.

The underlying measure of inflation, the trimmed mean, rose to 1.6 percent from 1.5 percent recorded in June.

On the whole, inflation has picked up slightly. This is in line with expectations as the delayed increases in domestic fuel prices and the flow on effects of the import and excise duties take effect. For the year-end, the inflation forecast remains at 3.5 percent.

Labour Market

Employment conditions are improving as suggested by partial indicators of employment. Cumulative to July, around 5,900 taxpayers were registered, equating to an annualised increase of around 15 percent. The highest number of new taxpayers so far have been registered in the community, social & personal services sector followed by the wholesale & retail trade, restaurants & hotel; finance, insurance, real estate & business services; manufacturing and construction sectors.

The outlook for employment remains favourable. According to the RBF's FEF June Survey, a net of around 66 percent and 50 percent of respondents expect an increase in permanent and temporary employment, respectively. When compared with the previous survey, the demand for temporary employment has picked up. On the wages front, the survey suggests that more respondents expect wages to rise between 0-5 percent in the next twelve months.

Money and Credit Aggregates

The annual growth rate of credit by commercial banks slowed down to 25.4 percent in July, from 25.9 percent in the previous month.

Credit for consumption increased at an annualised rate of 9.4 percent ($57.2m), while lending for investment purposes grew by 62.7 percent ($138.2m) during the review period. In addition, new loans disbursed by commercial banks fell by 20.7 percent over the year to $56.7 million in July.

Similarly, lending by Licensed Credit Institutions (LCIs) rose by 20.8 percent ($53.1m) to $308.5 million during the review period. The increase was largely due to higher lending to the real estate sector and private individuals.

On the supply side, total commercial bank deposits rose by 17.4 percent to around $2.6 billion in the year to July 2006, following a growth of 20.8 percent in the preceding month. This was largely attributed to increases in time deposits with commercial banks.

Interest Rates

Movements in interest rates have indicated further increases from the previous month. Commercial banks' time and savings deposit rates were both up by 31 basis points and 1 basis point to 5.96 percent and 0.74 percent respectively. The commercial bank lending rate rose over the month by 43 basis points to 7.60 percent. In addition, interest rates on new loans also increased to 9.26 percent from 8.48 percent, and on new deposits increased by 16 basis points to 7.53 percent during the current period.

[3] Excludes VAT that Government Departments pay.

Similar trends emerged from LCIs. The interest rate on new loans increased to 14.56 percent while the new time deposit rate fell by 10 basis points to 8.14 percent at the end of July.

External sector

Latest OET data shows that cumulative to June this year, merchandise exports fell by around 22 percent, this was similar to the decline in the corresponding period last year. The decline in receipts was largely attributed to lower proceeds from sugar, ginger, fish, textiles, clothing & footwear, mineral water and other re-exports, which more than offset the higher inflows from gold, re-exports of mineral fuels and other exports.

During the same period, merchandise imports rose by around 24 percent, compared to a growth of around 4 percent in the corresponding period in 2005. The increase in import payments continued to be evident across all categories. The higher outlays for investment goods (9.1 percent) was largely made up of higher payments for machinery & electrical equipments and chemicals, while the growth in consumption goods payments (7.7 percent) was largely attributed to the increased import payments of duty free goods, transport equipment, food, beverage & tobacco. For intermediate goods, the larger outlays (6.9 percent) was due to higher payments for mineral fuels and raw materials.

As per the latest Macroeconomic projections, exports (excluding aircraft) are projected to expand by 6.6 percent this year, compared to the previous forecast of a 9.3 percent increase. The anticipated slowdown is driven by weaker-than-expected earnings from garments, timber, gold and other domestic exports. Imports (excluding aircraft) are projected to grow by 17.5 percent this year, revised upwards from the previous projection of 13.3 percent. The growth is anticipated to be led by higher payments for mineral fuels, machinery & transport equipment, chemicals, food, manufactured goods and crude materials.

For 2006, the current deficit is forecast to deteriorate further while the capital and financial account is expected to record a higher surplus. The widening of the current account deficit continues to reflect the higher trade and investment income imbalance. On the whole, the overall balance of payments deficit is projected to widen to 3.6 percent of GDP, as a result of the higher current account deficit.

Looking ahead, exports (excluding aircraft) are expected to record a growth of 5.7 percent and 0.5 percent in 2007 and 2008, while imports are expected to increase by 3.7 percent and 4.1 percent respectively. The current account deficit is expected to widen further for both years also. On the other side however, the capital and financial account is projected to remain in surplus, with the overall balance of payments deficit expected to slightly narrow for 2007 and 2008 respectively.

Exchange Rate Developments

Bilateral movements in exchange rates reveal that during the month of July, the Fiji dollar generally strengthened against the US dollar (2.1%), Euro (1.1%) and Yen (1.6%), while it weakened against the Australian (1.9%) and New Zealand (0.4%) dollars.

The nominal effective exchange rate[4] (NEER) Index of the Fiji dollar continued to weaken in July by 0.4 percent. With regards to the indicators of the international price competitiveness of the domestic economy, in July 2006, the Real Effective Exchange Rate[5] (REER) Index of the Fiji dollar fell by 1.7 percent, based on developments in consumer prices.

RESERVE BANK OF FIJI

[4] The Nominal Effective Exchange Rate (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.

[5] 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.

Vol.23 No.08 2006

FIJI: FINANCIAL STATISTICS

KEY INDICATORS	Jul-06	Jun-06	May-06	Jul-05
1. Money and Credit				
(year-on-year % change)				
Narrow Money	-1.73	5.48	0.23	23.47
Currency in Circulation (monthly average)	11.23	23.13	10.53	9.14
Quasi-Money (Time & Saving Deposits)	32.59	31.77	31.68	10.10
Domestic Credit	27.43	29.38	30.34	20.00
2. Consumer Prices [1/]				
(year-on-year % change)				
All Items	1.8	1.6	1.5	2.8
Food	-1.5	-0.5	0.1	3.3
3. Reserves				
(end of period)				
Gross Foreign Reserves ($m)*	621.5	648.7	673.1	962.3
Months of Imports (goods)	2.6	2.7	2.8	4.7
4. Liquidity				
(end of period)				
Liquid Assets Margin to Deposit Ratio (%)	5.3	5.1	3.4	11.4
Banks' Demand Deposits ($m)	82.6	88.4	40.3	127.0
5. Interest Rates (% p.a.)				
(monthly average)				
Lending Rate (Excluding Staff)	7.60	7.17	7.11	6.77
Savings Deposit Rate	0.74	0.73	0.71	0.40
Time Deposit Rate	5.96	5.65	5.28	1.81
91-day RBF Note Rate (month end)	4.25	n.i.	3.25	1.75
Minimum Lending Rate (MLR) (month end)	5.25	5.25	4.25	2.25
Overnight Inter-bank Rate	5.21	4.26	4.25	1.00
5-Year Government Bond Yield	n.i.	n.i.	8.80	2.74
10-Year Government Bond Yield	9.52	9.38	9.08	5.30
6. Exchange Rates [2/]				
(mid rates, F$1 equals)				
(end of period)				
US dollar	0.5775	0.5657	0.5814	0.5848
Pound sterling	0.3098	0.3097	0.3085	0.3330
Australian dollar	0.7524	0.7666	0.7629	0.7692
New Zealand dollar	0.9334	0.9369	0.9083	0.8546
Swiss francs	0.7112	0.7005	0.7040	0.7517
Euro	0.4524	0.4473	0.4516	0.4818
Japanese yen	66.22	65.19	65.20	65.56
7. Commodity Prices (US$)				
(monthly average)				
UK Gold Price/fine ounce [2/]	632.67	597.11	673.56	424.86
London Daily Sugar Price/tonne [3/]	16.69[5/]	380.41	393.00	266.60
Crude Oil/barrel [4/]	73.90	68.90	70.18	57.58

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*
[5/] *World Market Sugar Price (No 11) from Jul-06*