RESERVE BANK OF FIJI

ECONOMIC REVIEW

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OVERVIEW

Growth in the global economy this year has been buoyant, with a slightly higher pace than in 2005. Performances of Fiji's five major trading partner countries are anticipated to be favourable, supported by higher private consumption, business investment and industrial production. International oil prices, which have firmed over the month, remains a downside risk to global economic growth.

Latest data suggest that domestic demand had remained strong up to October. Net Value Added Tax (VAT) collections, a partial indicator of consumer spending, posted a 16 percent annual increase in October. This was supported by stronger income positions gained through a series of Cost of Living Adjustments (COLA) and performance based increases received by workers, both in the public and the private sector throughout the year. Cumulative to October, net income tax collections amounted to around $315 million, indicating a 17 percent increase on an annual basis.

The current political crisis is expected to adversely affect economic growth into the medium term. While the economic impact of the political crisis would be small in 2006, the major impact is expected in 2007. The Emperor Gold Mining Company (EGM) announced on 5th December this year that continued operations of the mine were no longer economically viable, therefore the mine was to cease production. Since ten months of production has already taken place, the closure of the mine would have a significant impact on next year's economic growth. The contraction in gold output this year is estimated to be around 56 percent, compared with 44 percent envisaged earlier. Jobs have been lost. Furthermore, production in the cane, sugar and copra industries remain subdued. Looking ahead, the economic growth projection for next year will likely be revised down.

The tourism industry has been the first to be affected by the political crisis. The Fiji Islands Visitors Bureau (FIVB) has revised its 2006 projections for visitor arrivals downwards from 576,000 to 562,000. This reflects significant cancellations of bookings the industry has received in the final 2 months of the year. While this is 2.4 percent below the initial target, the FIVB believes that it is still an optimistic target, given the current situation. It is also quite likely that the visitor arrivals projection for 2007 will also be revised down. Lower visitor arrivals will make it difficult to fill up the additional hotel rooms coming on line next year.

Inflationary pressures continued to increase as expected. In November, inflation stood at 3.0 percent compared to 4.0 percent in October. The underlying measure of inflation, the trimmed mean, rose to 1.9 percent on an annual basis. The increased price pressures emanated from the recent increases in excise and fiscal duties introduced in the 2007 Budget. Nevertheless, the current year-end inflation projection for 2006 adequately incorporates these factors and remains at 3.5 percent. The forecast for 2007 also remains unchanged at 4.0 percent, incorporating the increase in the VAT rate to 15 percent.[1] Even though the current political uncertainty could derail growth prospects for the

[1] The increase in the VAT rate will remain in the forecast until confirmation of its removal is obtained.

coming year and ease demand side pressures, the increases in VAT and excise and fiscal duties will cause a structural shift in prices that is not influenced by demand.

While employment conditions had improved across most sectors of the economy for the first three quarters of the year, the closure of EGM and the laying off of casual and part-time employees of some hotels and resorts are threatening to undermine the gains realised in the labour market this year. It is expected that around 1,800 people will lose their jobs in the EGM closure. Given that there are very limited alternative employment opportunities in Vatukoula, this shut-down is anticipated to cause further rural-urban migration and a rise in squatter settlements in the main town areas of Suva, Lautoka and Nadi. In terms of tourism, industry liaison have warned that more casual and temporary workers in hotels and resorts would be laid off while permanent staff would be forced to either work reduced hours or take annual leave. The impact on employment in other sectors will be firmed up, as we confirm the response of the international community to Fiji's military-appointed government, as well as the private business sectors response to the downturn in economic growth.

Official foreign reserves as at the end of November are provisionally estimated at $805.7 million, sufficient to cover 3.3 months of goods imports.

SECTORAL DEVELOPMENTS

In the year to October, sectoral performances were mixed. In terms of recent economic developments, partial indicators suggest that consumption activity remained upbeat, supported by growth in net VAT collections and income. On the downside however, production in the cane, sugar and copra industries remained subdued.

Consumption

Consumption continues to post robust performance, cumulative to October. Net VAT collections, a partial indicator of consumer spending, amounted to around $403 million, representing a 16 percent annual increase during the review period. During this period, net VAT collections accounted for 8.2 percent of GDP, compared with 7.5 percent of GDP in the previous year. Of this, domestic cash collections represented 4.0 percent of GDP.

This growth was underpinned by higher VAT collections from government departments (17 percent), domestic sources (11 percent) and customs services (8 percent)[2], when compared with the corresponding period in 2005.

Income

Cumulative to October, net income tax collections amounted to around $315 million, indicating a 17 percent increase on an annual basis. In addition, Pay As You Earn collections, a partial indicator of individual incomes, totalled around $173 million during the first 10 months of the year, representing a 17 percent increase over the comparable period last year.

Electricity

Electricity production remains favourable. Cumulative to November, total electricity generated by the Fiji Electricity Authority was around 675,931 mega watt hours, an increase of 8.9 percent on an annual basis.

Cane and Sugar

Cane and sugar industries continue to register poor performances. Mill reports indicate that 2,544,000 tonnes of cane was crushed up to November this year. This represents a decline of 6.9 percent on an annual basis. Furthermore, the Tonnes Cane to Tonnes Sugar ratio has remained around 10:1 on an annual basis indicating no change in the quality of cane.

In line with the cane harvest, around 252,000 tonnes of sugar was produced by the Fiji Sugar Corporation Limited up to November, representing a deterioration of 11.5 percent on an annual basis.

The frequent mill breakdowns and unfavourable climatic conditions experienced earlier within the season have resulted in lower cane being crushed. In addition, land tenure issues and the burning of cane have compounded the problems faced by this industry.

Copra

Copra production fell. Latest statistics from the Coconut Industry Development Authority show that in the year to October, copra production amounted to around 9,300 tonnes, representing a decline of 12 percent over the corresponding level in 2005.

In the review period, the minimum mill gate price of copra remained unchanged at $500 per tonne with Government's subsidy towards the mill gate price

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

being $72.22 per tonne.

Inflation

Inflation in November stood at 3.0 percent, compared with 4.0 percent in October. On a monthly basis, consumer prices rose by 0.3 percent, primarily led by higher prices of alcoholic drinks & tobacco, food, clothing & footwear, durable household goods and miscellaneous items. On the other hand, costs of heating & lighting and transport fell while costs of housing and services remained unchanged. The higher costs of alcoholic drinks & tobacco, food, clothing & footwear, durable household goods and miscellaneous items could be attributed to the increase in fiscal and excise duties that came into effect immediately after the 2007 National Budget announcement. Prices of heating & lighting and transport, however, fell, due largely to the decrease in cost of domestic fuel prices in early November and the fall in electricity fuel surcharge in mid-November.

The underlying measure of inflation, the trimmed mean, fell to 1.9 percent compared to 2.1 percent recorded in the previous month.

In the remaining month of the year, upward pressure on prices is likely to persist in view of anticipated higher prices for market items and the increase in fiscal and excise duties outlined in the 2007 National Budget. Despite the above considerations, the year-end inflation forecast for 2006 remains at 3.5 percent.

The forecast for 2007 also remains at 4.0 percent incorporating the increase in the VAT rate to 15 percent. Even though the current political uncertainty could derail growth prospects for the coming year and ease demand side pressures, the increases in VAT and excise and fiscal duties will cause a structural shift in prices that is not influenced by demand.

Labour Market

While employment conditions had improved across most sectors of the economy for the first three quarters of the year, the closure of EGM and the lay off of casual and part-time employees of some hotels and resorts is threatening to undermine the improvements in the labour market this year. It is expected that around 1,800 people will lose their jobs in the EGM closure. Given that there are very little alternative employment opportunities in the area, this shut-down is anticipated to cause further rural-urban migration and a rise in squatter settlements in the main town areas of Suva, Lautoka and Nadi. In terms of tourism, industry liaison have warned that more casual and temporary workers in hotels and resorts would be laid off while permanent staff would be forced to either work on reduced hours or take annual leave. The impact on employment in other sectors will be firmed up as we confirm the response of the international community to Fiji's military-appointed government as well as the private business sectors response to the downturn in economic growth.

On the wages front, the base wages and salary levels of some workers towards the year-end are anticipated to increase with a combination of COLA and merit based awards. In particular, civil servants recently received the remaining 2.0 percent increase for 2005 as agreed in the Industrial Relations Framework. Additionally, hotel workers are anticipated to receive a 5.0 percent increase, as agreed in 2005, while the bank and financial sector employees are expected to receive an increment averaging 5.0 percent.

Money and Credit Aggregates[3]

As reported in the previous month's economic review, money supply rose by 15.1 percent on an annual basis in October. This increase was attributed to expansions in both time deposits and domestic credit, notably private sector credit.

Growth in domestic credit continues to be driven largely by increased lending to the private sector. In the year to October domestic credit rose by 25.4 percent compared with the same period last year. Over the same period credit to the private sector expanded by 25.5 percent, to F$2.3 billion.

Commercial banks' credit slowed to 22.7 percent as at end-October, down from the peak of 29 percent in May. Furthermore, the annual growth rate of credit for consumption purposes continued its downward trend during the review period, recording 10.1 percent in October, declining from 10.3 percent in September and 12.2 percent in the June quarter. Investment lending by commercial banks increased by 54.4 percent during the review period.

In line with the slowdown in credit by commercial banks, lending by Licensed Credit Institutions (LCIs) also slowed in October. The annual growth rate of loans stood at 17.2 percent in October, after recording

[3] Available monetary and credit data remains the same as per the November review.

17.6 percent in the previous month.

Interest Rates

Interest rates continued to rise in October, as reported in the previous economic review issue. Both the commercial banks' time and savings deposit rates increased by 56 basis points and 2 basis points, to 7.19 percent and 0.82 percent, respectively, in October. The commercial bank lending rate also rose over the month by 11 basis points to 7.80 percent. In addition, interest rates on new deposits increased to 9.63 percent from 8.29 percent, and the interest rate on new loans extended by commercial banks also rose by 14 basis points to 10.13 percent during the current period.

Similar trends emerged for LCIs. The new time deposit rate rose to 9.52 percent, an increase of 66 basis points over the month, and the interest rate on new loans increased to 15.82 percent, from 15.12 percent recorded in September.

External sector

Latest accrual trade data showed that cumulative to September 2006, merchandise export earnings fell by around 0.1 percent, compared with a growth of around 1.6 percent in the same period last year. The decline in receipts was largely attributed to lower inflows from garments, gold, molasses, timber, footwear & headgear, textiles and coconut oil, which more than offset the higher earnings from fish, mineral water, fruits & vegetables, yaqona, sugar, re-exports and other exports.

During the same period, merchandise import payments rose by around 19.7 percent compared with a growth of around 9.6 percent in the corresponding period in 2005. Import payments for all three categories, intermediate, investment and consumption goods, rose. The increase in intermediate goods payments (11.3%) was led by higher outlays for mineral fuels and crude materials, while the higher outflows for investment goods (5.5%) was led by an increase in payments for machinery and chemicals. The increase in consumption type import payments (2.9%) was due to higher outlays for food and manufactured goods.

Exchange Rate Developments

Movements in exchange rates reveal that in November, the Fiji dollar generally strengthened against the US dollar (1.5%) and Yen (0.6%), while the local currency weakened against the Euro (1.8%) and the New Zealand (0.3%) and Australian (0.2%) dollars.

The Nominal Effective Exchange Rate[4] (NEER) Index of the Fiji dollar fell by 0.2 percent in the year to November 2006, indicating a depreciation of the Fiji dollar against the basket of currencies, while the Real Effective Exchange Rate[5] (REER) Index of the Fiji dollar, a gauge of our international competitiveness, rose by 0.2 percent during the same period.

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[4] 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.

[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.

FIJI: FINANCIAL STATISTICS

KEY INDICATORS	Nov-06	Oct-06	Sep-06	Nov-05
1. Money and Credit				
(year-on-year % change)				
Narrow Money	n.a.	-7.59	-4.36	27.28
Currency in Circulation (monthly average)	n.a.	9.34	9.44	11.08
Quasi-Money (Time & Saving Deposits)	n.a.	35.74	32.47	13.67
Domestic Credit	n.a.	25.39	27.42	22.51
2. Consumer Prices [1/]				
(year-on-year % change)				
All Items	3.0	4.0	2.8	1.9
Food	4.6	4.5	1.6	0.6
3. Reserves				
(end of period)				
Gross Foreign Reserves ($m)*	805.7(p)	840.2	817.2	885.0
Months of Imports (goods)	3.3	3.4	3.3	4.3
4. Liquidity				
(end of period)				
Liquid Assets Margin to Deposit Ratio (%)	n.a.	4.0	3.3	10.0
Banks' Demand Deposits ($m)	n.a.	48.3	39.2	147.5
5. Interest Rates (% p.a.)				
(monthly average)				
Lending Rate (Excluding Staff)	n.a.	7.8	7.69	6.66
Savings Deposit Rate	n.a.	0.82	0.80	0.40
Time Deposit Rate	n.a.	7.19	6.63	1.87
91-day RBF Note Rate (month end)	n.a.	4.25	n.i.	2.25
Minimum Lending Rate (MLR) (month end)	n.a.	5.25	5.25	2.75
Overnight Inter-bank Rate	5.64	5.36	5.30	1.93
5-Year Government Bond Yield	n.a.	n.i.	n.i.	2.88
10-Year Government Bond Yield	n.a.	9.94	9.60	5.50
6. Exchange Rates [2/]				
(mid rates, F$1 equals)				
(end of period)				
US dollar	0.595	0.5861	0.5785	0.5775
Pound sterling	0.3058	0.3081	0.3083	0.3336
Australian dollar	0.7593	0.7611	0.7723	0.7819
New Zealand dollar	0.8764	0.8792	0.8797	0.8245
Swiss francs	0.7196	0.7315	0.7215	0.7581
Euro	0.4524	0.4605	0.4554	0.4899
Japanese yen	69.23	68.81	68.15	69.04
7. Commodity Prices (US$)				
(monthly average)				
UK Gold Price/fine ounce [2/]	626.07	586.76	599.54	475.76
London Daily Sugar Price/tonne [3/]	12.35	12.07	12.45	306.80
Crude Oil/barrel [4/]	58.48	58.36	62.77	55.39

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*