



# RESERVE BANK OF FIJI

## ECONOMIC REVIEW

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### OVERVIEW

Economic conditions, on the international front look favourable led by recovery in the US economy. All our major trading partner economies are anticipated to record positive growth, due to the strong recovery in the US and Eurozone. Furthermore, growth prospects for selected non-Japan Asia (China, Hong Kong & Singapore) are also optimistic.

Domestically, there are indications that the Fiji economy will achieve its growth projection of 4.1 percent for this year after expanding by an estimated 5.0 percent in 2003. The main impetus to growth in 2003 was the wholesale & retail trade and restaurants & hotel sectors. In addition, notable contributions were from the transport, storage & communication; manufacturing; and construction sectors.

Sectoral performances are expected to improve further into the year. Results of the Reserve Bank's December 2003 Retail Sales Survey, project a further growth of 8 percent in retail sales over the 13 percent expansion estimated for 2003. Higher incomes are supporting domestic demand, with a rise in the number of new taxpayers recorded in the community, social & personal services; manufacturing, finance, insurance, real estate & business services; and wholesale, retail trade, restaurants & hotels sectors.

Consumption spending is expected to remain buoyant in 2004. Over the month, strong consumption growth continues to be supported by low commercial bank lending rates, favourable labour market conditions and the resulting growth in personal incomes.

Growth in investment is anticipated to remain steady in 2004. Although Government's capital expenditure is projected to decline, some of the shortfall is

expected to be met by private sector investment. A number of large projects are already under way and additional projects announced in recent weeks are expected to commence soon. Moreover, in line with the increased activity in the building and construction sector, loans and advances to the sector continue to register a marked increase.

Inflation stood at 2.8 percent in January, down from 4.2 percent in December 2003. Over the month, consumer prices rose by 0.7 percent, mainly attributed to higher prices of services, heating & lighting, food, durable household goods, miscellaneous items, alcoholic drinks & tobacco and transport. This was partially offset by lower prices of clothing & footwear and housing. Year-end inflation is projected to fall to around 3 percent.

Growth in the money and credit aggregates accelerated on an annual basis to December 2003, shadowing the robust performance in the real sector. Broad money grew by 25.2 percent, underpinned by growth in all its components. Private sector credit rose by 16.8 percent and has been rising for the fifteenth consecutive month, largely driven by higher commercial bank lending to private individuals (for housing & consumption purposes), building & construction and manufacturing sectors. Movements in commercial bank interest rates were mixed. The weighted average lending rate rose marginally to 7.39 percent, while time deposits and saving deposits rate declined by 7 basis points and 3 basis points respectively to 1.70 and 0.45 percent.

On the external front, latest Overseas Exchange Transactions (OET) data, cumulative to December 2003, shows that exports fell by around 8 percent,

while merchandise imports rose by around 12 percent.

At the end of January, Fiji's foreign reserves were

around \$738 million, sufficient to cover 3.1 months of imports of goods and non-factor services or 4.6 months of imports of goods only.

## **SECTORAL DEVELOPMENTS**

Sectoral performances are expected to strengthen this year, driven by strong domestic demand. The tourism industry is tipped to record another outstanding year, while growth prospects in all other sectors remain optimistic.

### **Tourism**

The tourism industry demonstrated a strong performance last year. A record number of visitors arrived in Fiji during 2003, surpassing the previous high of 410,000 in 1999. According to the Fiji Islands Bureau of Statistics, visitor arrivals for 2003 totalled 430,800, an increase of 8.3 percent over the 2002 total.

### **Retail Sales Survey**

Results of the Reserve Bank's December 2003 Retail Sales Survey, indicate that sales rose by around 13 percent last year, which was higher than the 9 percent growth projected in the June 2003 survey.

The good growth in total retail sales was led by robust trading in duty free items, food, drinks & tobacco and building materials & hardware categories. A combination of factors such as the hosting of the 2003 South Pacific Games, increase in construction activities and the strong growth in visitor arrivals are anticipated to have supported sales last year.

For this year, retail sales is expected to grow further, mainly driven by prospects of better sales of goods in the household goods & appliances, food, drinks & tobacco, duty free retailing and motorcars & other transport equipment categories. The expected growth in sales is anticipated to be supported by the overall expansion in domestic demand, due partially to the increase in visitor arrivals.

### **Consumption**

Value Added Tax (VAT) collections, a partial indicator of consumer spending, amounted to around \$31 million in January, representing a decline of around 9 percent from the same period in the previous year. According to Fiji Islands Revenue and Customs Authority (FIRCA), the decline is attributable to non-payment of VAT by Government departments<sup>1</sup>. However, VAT collections from Customs Services

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<sup>1</sup> VAT payments by Government departments is a separate category within net VAT collections by FIRCA.

and other domestic collections categories, representing around 87 percent of overall VAT collections, were higher during the review period, by around 2 and 15 percent respectively.

Since this is just the beginning of the year, it is anticipated that Government's outstanding dues for the period will be recovered shortly, leading to an overall increase in net VAT collections.

### **Income**

Total income tax collections in January amounted to around \$19 million, a substantial increase of around 30 percent over the comparable period last year. Pay As You Earn (PAYE)<sup>2</sup> collections, the largest component of income tax, approximated to \$16 million, representing an increase of around 18 percent over the same period last year.

According to FIRCA, the increase in income tax and specifically, the growth in PAYE is a result of the Cost of Living Adjustment payment to employees in December (part of which was reflected in PAYE tax paid in January), better compliance initiatives by FIRCA, the introduction of the Fiji Integrated Tax System in November last year and the increase in the number of new registered tax payers. The combination of these factors more than off-set the effects of the decline in the higher bracket corporate and income tax rate from 32 to 31 percent, which came into effect this year.

### **Public Finance**

It is estimated that the underlying fiscal deficit in 2003 was 6.1 percent of GDP, similar to revised Budget projection announced in 2003. However, the deficit is projected to decline to 3.9 percent of GDP in 2004, a reflection of Government's commitment to maintain debt at sustainable level. The challenge for Government is to contain expenditure, particularly demands for COLA by the public sector unions, which was not built-in the Budget. On the revenue front, FIRCA is confident that revenue target for the year is achievable.

### **Inflation**

In January, inflation stood at 2.8 percent, down from 4.2 percent in December 2003. Over the month, consumer prices rose by 0.7 percent, mainly attributed to higher prices of services, heating & lighting, food, durable household goods, miscellaneous items, alcoholic drinks & tobacco and transport. This was partially offset by lower prices of

clothing & footwear and housing. The underlying measure of inflation, the trimmed mean, was 1.8 percent in January, compared with 3.1 percent in December last year.

As anticipated earlier, the inflation rate fell in January, largely reflecting the erosion of base-related effects of the higher VAT rate. In the coming months, inflation is expected to remain around current levels. However, a potential risk that looms is the possible increase in taxi fares. Barring any exorbitant increase in taxi fares, the year-end inflation rate is forecast to be around 3 percent.

### **Labour Market**

Partial indicators of employment suggest a continuation of the 2003 labour market conditions. In January, around 1300 new taxpayers were registered with the Inland Revenue Department. Although this figure is around 18 percent lower than the same month last year, the figure is still historically high. Sectors that recorded the most new taxpayers include community, social & personal services; manufacturing, finance, insurance, real estate & business services and wholesale, retail trade, restaurant & hotel.

### **Financial Aggregates**

Broad money grew by 25.2 percent in December 2003, following a 15.6 percent growth in November. Both the components of broad money grew during the review period. Narrow money<sup>3</sup> rose by 26.5 percent, after an increase of 6.8 percent in November. This was underpinned by increases in both demand deposits and currency in circulation. Quasi money<sup>4</sup> also grew, rising by 24.1 percent, following a 23 percent growth in November, due to a rise in savings deposits and time deposits.

On the determinants of broad money, domestic credit and net foreign assets both recorded growth of 19.5 percent and 10.7 percent in December 2003, respectively. The increase in net foreign assets was largely underpinned by a rise in foreign reserves holdings. The rise in domestic credit was due to a 16.8 percent growth in private sector credit and an expansion of 49.6 percent in net credit to Government (mainly for investment in Government securities). Higher bank lending to Government was reflected in

<sup>2</sup> PAYE is a partial indicator of individual incomes.

<sup>3</sup> Narrow money is the sum of currency in circulation and demand deposits held with commercial banks by businesses, households and public enterprises, other than the central government.

<sup>4</sup> Quasi money comprises time and savings deposits of resident sectors other than central government.

their holdings of treasury bills.

Increases in private sector credit were driven by higher commercial bank lending to private individuals (for housing & consumption purposes), building & construction and manufacturing sectors. In contrast, lending to the agriculture, non-bank financial institution and the electricity, gas and water sectors fell during the review period.

On a monthly basis, in December 2003 total commercial bank lending rose by 1.2 percent, following an increase of 1.0 percent in the previous month. During the same period, New lending by commercial banks rose by 55.4 percent to \$82 million, driven largely by increased lending to sectors that are contributing positively to economic growth (wholesale & retail services, building & construction and manufacturing sectors).

Movements in commercial bank interest rates were mixed during the review period. The weighted average commercial bank lending rate rose by 3 basis points to 7.39 percent while the time deposits and saving deposits rate fell by 7 basis points and 3 basis points respectively to 1.70 and 0.45 percent. During the same period, the weighted average interest rate on new loans by commercial banks declined to 7.92 percent from points to 8.08 percent in November.

### **Exchange Rates**

The Nominal Effective Exchange Rate<sup>5</sup> index of the Fiji dollar rose by 0.9 percent in the year to January. The rise indicates an appreciation of the Fiji dollar against the basket of currencies.

The Real Effective Exchange Rate<sup>6</sup> Index of the Fiji dollar, a gauge of our international competitiveness rose, by 1.8 percent in the year to January. The increase indicates deterioration in our international competitiveness and was mainly attributed to the relatively higher domestic inflation outcomes. Domestic inflation was 2.8 percent while

average trading partner inflation was around 1.7 percent in January.

### **External Sector**

According to the latest OET data, cumulative to December 2003, merchandise exports fell by around 8 percent, compared with an increase of around 2 percent in the corresponding period in 2002. The decline in export receipts was largely attributed to negative contributions from gold, fish and timber, which more than offset positive contributions from sugar, textiles, clothing & footwear, and copra.

<sup>5</sup> The Nominal Effective Exchange Rate (NEER) index is the sum of the indices of each trading partner 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. The NEER 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.

<sup>6</sup> The Real Effective Exchange Rate (REER) index is the sum of each component of the NEER index, adjusted by the relative price differential between Fiji and each of the 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.

During the same period, merchandise imports rose by around 12 percent, following a growth of around 13 percent in the corresponding period last year. The increase in imports payments was largely attributed to positive contributions from investment goods (5.7 percent), particularly machines, machinery & electrical equipment and chemicals; consumption goods (4.1 percent), specifically food, beverages & tobacco, some types of other imports and merchantable goods; and intermediate goods (2.5 percent), attributed to raw materials and textiles, clothing & footwear.

## **RESERVE BANK OF FIJI**