RESERVE BANK OF FIJI

ECONOMIC REVIEW

Vol. 23 No. 07 Month Ended. July 2006

OVERVIEW

Global economic developments are encouraging for Fiji's economy. The world economy continues to exhibit solid expansion, with buoyant growth expected amongst our five major trading partners. Australia, New Zealand and the US continue to reflect broad based expansions, supported by improvements in both business investment and consumer confidence. Likewise, Japan is expected to achieve a record growth this year as it continues on its recovery path from a decade of a debt-deflation spiral. The Eurozone economy is also anticipated to expand this year, supported by private consumption, business investment and industrial production. The outlook for selected Asian (China, Hong Kong & Singapore) economies also remains positive this year.

In line with the global economic pickup, movements in international commodity markets are portraying an upward trend. As such, the higher gold prices, and to a lesser extent, sugar prices, bode well for Fiji and represent potential gains for their respective industries. On the other hand, the rising and volatile global crude oil prices are becoming increasingly burdensome on the domestic economy, particularly on our burgeoning imports bill.

Inflation continues to be low, recording a 1.6 percent annual increase in June, inspite of the high and volatile international crude oil prices. The anticipated adverse pass through of global oil prices into notably higher domestic prices across all sectors is slow. While domestic fuel pump prices are gradually adjusting, a few of the sectors that heavily consume domestic fuel are unable to fully transfer their higher fuel costs onto their consumers due to price regulations. Given this, increases in the price of domestic fuel have not flowed downstream into prices of goods and services produced by other sectors in the economy. As such, the year-end inflation forecast remains at 3.5 percent.

Interest rate movements in June continued to rise, as anticipated. Both the commercial bank time and savings deposit rates increased by 37 basis points and 2 basis points, to 5.65 percent and 0.73 percent, respectively. Commercial bank lending rate rose over the month by 6 basis points to 7.17 percent. The weighted average Licensed Credit Institutions' (LCIs) time deposit rate increased from 4.85 percent to 6.02 percent, while the weighted average lending rate declined marginally by 2 basis points to 10.79 percent during the review period.

Domestic demand continues to remain firm. Anecdotal evidence and partial indicators continue to show strong business and consumer confidence. In terms of consumer spending, net Value Added Tax (VAT) collections, a partial indicator of consumption, rose by around 16 percent in the year to May. The higher incomes and strong credit growth continues to underpin household spending. Pay As You Earn (PAYE) collections, a partial indicator of individual incomes, rose by around 12 percent on an annual basis, while consumer loans to private individuals increased at an annualised rate of 15.7 percent.

Money and credit aggregates continued to grow with the annual growth in commercial banks' credit increasing by 25.9 percent at the end of June. As in previous months, the major contributors were the building & construction, wholesale & retail trade, manufacturing, real estate sectors and private individuals.

Business investment also remains resilient. According to the *March Quarter Building and Construction Survey*[1] report released by the Fiji Islands Bureau of Statistics (FIBOS), the total value

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

of capital works put-in-place by the private sector rose significantly by around 41 percent, to $63 million.

FIBOS has recently released its provisional growth rate for 2005, with the Fiji economy now estimated to have expanded marginally by around 0.7 percent last year. The outlook for this year is more positive but is still low, with the next three years' growth average (2006-2008) forecasted at 2.6 percent. Apart from the tourism related sectors, most other sectors seem to have significant spare capacity with no hard evidence that the situation will change in the near term. The overwhelming challenge is that the long-standing internal structural impediments in certain non tourism-related sectors continue to inhibit supply thus preventing them from taking advantage of the buoyant domestic demand and favourable international conditions.

On the whole, while partial indicators have been for some time revealing firm domestic demand, this has not been fully translated into strong domestic economic growth.

It is clear from the national accounts that the buoyancy of domestic demand is translating into higher imports. Cumulative to April 2006, merchandise imports rose by around 18 percent. The increase in import payments was led by higher imports of mineral fuels and crude materials as well as higher payments for machinery and chemicals. Furthermore, exports performance has been disappointing, largely reflective of internal structural problems. Latest accrual trade data showed that cumulative to April 2006, merchandise exports fell by around 9.1 percent.

At the end of June, official reserves were provisionally estimated at $648.5 million, sufficient to cover 2.8 months of goods imports.

SECTORAL DEVELOPMENTS

On the domestic front, sectoral developments were generally positive during the review period. According to the FIBOS, the 2005 economic growth rate now provisionally stands at 0.7 percent.

In the year to May, consumption and individual incomes continue to remain firm. Similarly, electricity production noted growth on an annual basis during the review period. However, output in the cane and sugar industries registered weak performances in the first month of crushing.

Gross Domestic Product

The FIBOS has recently released its provisional growth rate for 2005. The economy is estimated to have expanded marginally by around 0.7 percent last year, lower than the Macroeconomic Committee's estimate of 1.5 percent.

The main drivers of the 0.7 percent economic growth were the building & construction; finance, insurance, real estate & business services; transport & communication; and community, social & personal services sectors. The sectors that contracted last year were the mining & quarrying, manufacturing and wholesale & retail trade, hotels & restaurants.

Consumption

Consumption continues to remain upbeat this year, evident by the growth in partial indicators of consumer spending. In the year to May, net VAT collections amounted to $182 million, an increase of around 16 percent during the review period.

This growth was underpinned by higher VAT collections from domestic sources (13 percent) and customs services (10 percent).[2] Collections from government departments, however, declined by 6 percent when compared with the corresponding period in 2005.

Income

Cumulative to May, net income tax revenue amounted to $133 million, indicating a 20 percent increase on an annual basis. In addition, PAYE collections, a partial indicator of individual incomes, amounted to around $82 million during the first 5 months of the year, representing around 12 percent annual increase.

Electricity

Electricity production also increased, reflecting parallel increase in economic activity. In the year to June, total electricity generated by the Fiji Electricity Authority (FEA) was 385,463 megawatt hours (mWh), an increase of around 9.3 percent over same period last year.

Building & Construction

The building & construction sector continues to perform favourably, evident by the value of work put-in-place. According to the *March Quarter Building and Construction Survey* report released by the FIBOS, around $80 million was spent on capital works during the first quarter of this year, an increase of 36 percent on an annual basis.

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

By categories, in the year to March, the total value of work put-in-place by the private sector rose significantly by around 41 percent (to $63m), followed by the public sector recording an increase of 23 percent (to $17m) during the review period.

Cane and Sugar

The sugar and cane industries registered poor performance during the first crushing month[2] of the season. Mill reports indicate that around 286,000 tonnes of cane was crushed during June this year, representing an annual decrease of 10.8 percent. The Tonnes Cane to Tonnes Sugar ratio was around 13:1, higher than the ratio of 12:1 recorded during the review period in the previous year. This indicates a decline in cane quality.

Similarly, sugar production amounted to a little over 22,000 tonnes, representing an annual decrease of 14.3 percent during the review period. Outputs in both the industries were lower in comparison to the equivalent period last year, due largely to mill-related problems, poor supply of cane and unfavourable climatic conditions.

Inflation

Inflation in June rose to 1.6 percent compared to 1.5 percent in May. Over the month, consumer prices fell by 0.1 percent. During the month, cost of food fell while prices of housing, durable household goods, miscellaneous items, clothing & footwear and transport rose. Prices of alcoholic drinks & tobacco, heating & lighting and services remained unchanged. The higher price of housing was a result of higher rentals recorded for private homes, while marginal increases in prices of furniture, electrical and non-electrical appliances, duty free goods, jewellery, travel and sports goods underpinned the increase in the price of durable household goods. 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 1.5 percent from 1.1 percent recorded in May. This was largely underpinned by increases in the prices of rents & rates, alcohol, jewellery, other education, heating & lighting, service & parts, motor cars and some items in the market and toiletries sub categories.

The anticipated adverse pass through of global oil prices into higher domestic prices across all sectors has been slow. While domestic fuel pump prices have gradually adjusted upwards, a few of the sectors that heavily consume domestic fuel are unable to fully transfer their higher fuel costs onto their consumers due to price regulations. In particular, bus companies, whose fares are under price control, receive grants from the government, thus limiting their case for higher fares. Taxi fares, which are subject to price regulation as well, are currently eligible for certain duty concessions, also limiting their scope for demanding an increase in fares. Similarly, charges by the FEA, another large buyer of fuel, remain contained due to price regulations. Given the above, increases in price of domestic fuel have not flowed downstream into prices of goods and services produced by other sectors in the economy. As such the year-end inflation forecast remains at 3.5 percent.

Labour Market

Employment conditions appear to be improving as suggested by partial indicators of employment and survey data. During the first half of this year, around 5,600 taxpayers were registered, representing an annualised increase of around 13 percent. The highest number of new taxpayers so far has been registered in the community, social & personal services sector followed by the finance, insurance, real estate & business services; wholesale, retail trade, restaurants & hotel; manufacturing and construction sectors.

Encouragingly, the Reserve Bank's June Survey of Job Advertisements registered a growth of about 18 percent, on a yearly basis. Recruitment intentions was the highest in the wholesale, retail trade, restaurants & hotels sector, followed by the community, social & personal services; finance, insurance, real estate & business services; construction and transport, storage & communication sectors.

Money and Credit Aggregates

The annual growth rate of credit by commercial banks slowed down to 25.9 percent in June, from 29 percent in the previous month. This was mainly driven by lending to building & construction, wholesale & retail trade, manufacturing, real estate sectors and private individuals.

Credit for consumption increased at an annualised rate of 12.2 percent ($72.5m), while lending for investment purposes grew by 58.8 percent ($130.4m) during the review period. In addition, new loans disbursed by commercial banks fell by 33.7 percent over the year to $58.7 million in June.

Similarly, lending by LCIs rose by 21.1 percent

[2] This year, crushing started on 31 May at the Rarawai mill followed by the Lautoka and Labasa mills on 5 and 6 June, respectively. The Penang Mill began crushing on 20 June.

($53.1m) to $304.2 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 20.8 percent to around $2.6 billion in the year to June 2006, following a growth of 19.6 percent in the preceding month. This was largely attributed to increases in time deposits with commercial banks.

Interest Rates

Generally, interest rates continued to rise. Both the commercial bank time and savings deposit rates increased by 37 basis points and 2 basis points, to 5.65 percent and 0.73 percent, respectively. The commercial bank lending rate rose over the month by 6 basis points to 7.17 percent. In addition, interest rate on new loans increased from 7.87 percent to 8.48 percent in June, while interest rate on new deposits fell by 6 basis points to 7.37 percent.

Furthermore, the weighted average LCIs new time deposit rate increased to 8.24 percent from 7.80 percent recorded in May while the lending rate on new loans fell to 12.55 percent, a decline of 58 basis points over the month.

External Sector

Latest accrual trade data showed that cumulative to April 2006, merchandise exports fell by around 9.1 percent, compared with a growth of around 23 percent in the same period last year. The decline in receipts was largely attributed to lower inflows from garments, sugar, timber, others, textiles, yarn & fabric, molasses, footwear & headgear, gold, and coconut oil, which more than offset the higher inflows from re-exports, mineral water, and yaqona.

During the same period, merchandise imports rose by around 18 percent compared with a growth of around 9 percent in the corresponding period last year. This was due to higher import payments from all catergories. The increase in import payments for intermediate goods (9.6%) was led by higher imports of mineral fuels and crude materials, while the higher payments for investment goods (6.8%) was led by increase in payments for machinery and chemicals. The increase in payments for consumption goods (1.5%) was due to higher outlays on food and manufactured goods.

Exchange Rates

Bilateral movements in exchange rates reveal that in June, the Fiji dollar generally strengthened against the New Zealand (3.1%) and Australian (0.5%) dollars, while it depreciated marginally against the US (2.7%) dollar, the Yen (0.02%) and the Euro (1.0%).

In nominal effective terms[3] – as measured against the currencies of five of Fiji's important trading partners – the Fiji dollar continued to weaken in June by 0.6 percent. The depreciation of the local currency over this period was primarily driven by its fall against the US dollar and other currencies.

With regards to indicators of the international price competitiveness of the domestic economy, in June 2006, the Real Effective Exchange Rate[4] (REER) Index of the Fiji dollar fell by 1.8 percent, based on developments in consumer prices.

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[3] 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.

[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.

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FIJI: FINANCIAL STATISTICS

KEY INDICATORS	Jun-06	May-06	Apr-06	Jun-05
1. Money and Credit				
(year-on-year % change)				
Narrow Money	5.48	0.23	11.74	19.48
Currency in Circulation (monthly average)	23.13	10.53	11.58	-0.36
Quasi-Money (Time & Saving Deposits)	31.77	31.68	27.22	8.97
Domestic Credit	29.37	30.34	30.65	17.01
2. Consumer Prices 1/				
(year-on-year % change)				
All Items	1.6	1.5	1.6	2.1
Food	-0.5	0.1	0.0	1.5
3. Reserves				
(end of period)				
Gross Foreign Reserves ($m)*	648.7	673.1	744.2	991.6
Months of Imports (goods)	2.8	2.9	3.2	4.8
4. Liquidity				
(end of period)				
Liquid Assets Margin to Deposit Ratio (%)	5.1	3.4	7.4	10.4
Banks' Demand Deposits ($m)	88.4	40.3	131.1	107.7
5. Interest Rates (% p.a.)				
(monthly average)				
Lending Rate (Excluding Staff)	7.17	7.11	7.01	6.77
Savings Deposit Rate	0.73	0.71	0.72	0.42
Time Deposit Rate	5.65	5.28	4.24	1.78
91-day RBF Note Rate (month end)	n.i.	3.25	3.25	1.75
Minimum Lending Rate (MLR) (month end)	5.25	4.25	3.75	2.25
Overnight Inter-bank Rate	4.30	4.25	4.16	1.16
5-Year Government Bond Yield	n.i.	8.80	5.20	2.74
10-Year Government Bond Yield	9.38	9.08	6.83	5.27
6. Exchange Rates 2/				
(mid rates, F$1 equals)				
(end of period)				
US dollar	0.5657	0.5814	0.5762	0.5876
Pound sterling	0.3097	0.3085	0.3198	0.3255
Australian dollar	0.7666	0.7629	0.7610	0.7715
New Zealand dollar	0.9369	0.9083	0.9092	0.8401
Swiss francs	0.7005	0.7040	0.7260	0.7541
Euro	0.4473	0.4516	0.4598	0.4871
Japanese yen	65.19	65.20	65.77	64.94
7. Commodity Prices (US$)				
(monthly average)				
UK Gold Price/fine ounce 2/	597.11	673.56	608.26	429.96
London Daily Sugar Price/tonne 3/	380.41	393.00	426.64	258.84
Crude Oil/barrel 4/	68.9	70.18	70.64	54.34

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*