



# RESERVE BANK OF FIJI

## ECONOMIC REVIEW

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### OVERVIEW

Growth prospects for all our major trading partner countries and selected Asian (China, Hong Kong & Singapore) economies are expected to be positive this year. However, high crude oil prices continue to pose a downside risk to this optimistic outlook. Over the month, crude oil prices rose (reaching US\$70.86 on 27/06) on concerns that rising demand may outpace supply. Prices had reached a new historical high of US\$74.67 per barrel, on 03/05.<sup>1</sup> Looking ahead, international crude oil prices are anticipated to remain high, on concerns that higher world demand, especially from US and China, will outpace the additional capacity of crude oil supplies to the world market.

Domestically, economic prospects remained positive with the recent data on sector performances in line with expectations. Domestic demand remain resilient particularly expenditure for consumption purposes as reflected by partial indicators. Net Value Added Tax (VAT) collections<sup>2</sup> totalled around \$146 million, representing an annual increase of 9 percent during the review period. This expenditure is supported by rising incomes (as evident from tax collections), credit from financial institutions as well as general improvement in labour market conditions.

Net income tax revenue, cumulative to April, totalled around \$116 million. This represents a rise of 31 percent over the comparable period last year. During the same period, Total Pay As You Earn (PAYE) collections, a partial indicator of individual incomes, amounted to around \$66 million, 12 percent higher than the level recorded in the same period last year.

Despite the high international crude oil prices,

inflation continues to be benign and stood at 1.5 percent in May compared to 1.6 percent in the previous month.

This favourable outcome continues to be partly a result of the monetary policy tightenings taken by the central banks of our major trading partners. Domestic inflationary pressures are also expected to remain subdued partly accruing to expected dampening effects of rate hikes on domestic demand. However, upside risks to inflation remain as global crude oil prices continue to be volatile with the gradual appreciation of the US dollar. For the present, the year-end inflation forecast remains at 3.5 percent.

Money and credit aggregates continued to grow with the annual growth in commercial banks' credit recording a new historical high of 29 percent at the end of May. The major contributors were the building & construction, wholesale & retail trade, manufacturing and real estate sectors, and private individuals.

Interest rate movements were generally on an upward trend, as anticipated. The commercial bank time deposit rate increased by 104 basis points to 5.28 percent while the savings deposit rate fell marginally over the month by 1 basis point to 0.71 percent. The commercial bank lending rate rose over the month by 10 basis points to 7.11 percent. The weighted average Licensed Credit Institutions' (LCIs) time deposit rate increased significantly to 7.80 percent from 5.89 percent recorded in April, while the lending rate on new loans fell to 10.81 percent, a decline of 118 basis points from the previous month.

Employment conditions continue to improve over the year as suggested by partial indicators. Cumulative to May, around 5,000 individuals were registered as

<sup>1</sup> The previous high was US\$74.66 per barrel (on 21/04).

<sup>2</sup> This is a partial indicator of consumer spending.

taxpayers, increasing by around 9 percent over the corresponding period last year.

On the latest accrual trade data, cumulative to March, merchandise exports rose by around 4 percent, compared with a growth of around 9.6 percent in the same period last year. The increase in receipts was largely attributed to the higher inflows from sugar, mineral water, fish and gold, which more than offset the decline in earnings from coconut oil, footwear, textiles yarn & fabrics, garments and timber. During the same period, merchandise imports rose by around 24 percent, compared with a growth of around 1.6 percent in the corresponding period in 2005. The increase was due to higher import payments for all categories of goods.

On the whole, the effects of previous monetary policy tightenings are beginning to be felt, liquidity has tightened and interest rates have begun to move up. However, flow-on transmission from the official indicator interest rate to market interest rates (particularly lending rates) has been slow. In light of this, the Bank has increased the policy indicator rate by 100 basis points to 4.25 percent from 3.25 percent. The Reserve Bank's Minimum Lending Rate will therefore also increase to 5.25 percent. This action provides further support to previous monetary policy tightenings with the objective of dampening consumption demand and in turn imports.

At the end of May, official reserves were around \$693 million, sufficient to cover 3 months of goods imports.

## **SECTORAL DEVELOPMENTS**

Sectoral performances during the review period were mostly favourable. In particular, partial indicators suggest that consumption activity remains upbeat, underpinned by positive growth in Net VAT collections and income. Electricity generation also registered growth during the review period, implying correlating growth in economic activity. In addition, copra production also rose.

### **Consumption**

Consumption remained buoyant into the fourth month of this year. Net VAT collections, amounted to around \$146 million, representing an annual increase of 9 percent during the review period.

This strong performance was underpinned by increases in domestic cash collections (10 percent) and customs services collections (7 percent).

Collections from Government Departments, however, declined by around 11 percent on an annual basis.

### **Income**

Cumulative to April, net income tax revenue totalled around \$116 million, representing a rise of 31 percent over the comparable period last year. During the same period, total PAYE collections, a partial indicator of individual incomes, amounted to around \$66 million, 12 percent higher than the level recorded in the comparable period last year.

### **Copra**

In the first four months of this year, copra production totalled 2,900 tonnes, denoting a marginal increase over the corresponding level in 2005.

The minimum mill gate price of copra remained unchanged at \$500 per tonne, during the review period. The Government's subsidy towards the mill gate price was \$92.55 per tonne.

### **Inflation**

Inflation in May stood at 1.5 percent compared to 1.6 percent in April. Over the month, consumer prices rose by 0.7 percent. During the month, prices of food, transport, durable household goods, heating & lighting, miscellaneous items and clothing & footwear rose. Conversely, the cost of alcoholic drinks & tobacco fell, while prices of housing and services remained unchanged. The higher prices of heating and lighting were a result of increases in costs of kerosene, while the rise in prices of the remaining subgroup items can be attributed to the changes in import and excise duties made in November last year.

The underlying measure of inflation, the trimmed mean, fell to 1.1 percent from 1.2 percent recorded in April.

Inflation continues to be benign despite the persistent volatility in international crude oil prices. This favourable outcome is partly a result of the monetary policy tightenings by the central banks of our major trading partners. Domestically, the higher interest rates which are raising the debt servicing of local firms are not expected to fully translate into higher prices. At this point in time it appears that firms may absorb this added cost as the rate hikes are expected to also dampen demand. In addition, some of the items in the CPI basket are subject to various price controls, further tempering inflationary measures.

However, upside risks to inflation remain as global

crude oil prices continue to be volatile with the gradual appreciation of the US dollar. For the present, however, the year-end inflation forecast remains at 3.5 percent.

### **Labour Market**

Employment conditions improved over the year as suggested by partial indicators. Cumulative to May, around 5,000 individuals were registered as taxpayers, increasing by around 9 percent over the corresponding period last year. The largest number of new taxpayers was recorded from the community, social & personal services sector followed by the finance, insurance, real estate & business services; wholesale, retail trade, restaurants & hotel sectors and manufacturing sectors.

### **Monetary & Credit Aggregates**

Domestic credit continued to grow as evident in commercial banks' credit growth of 29 percent in the year to May, following a growth of 27.5 percent in the preceding month. This was mainly driven by private individuals and the building and construction, wholesale & retail trade, manufacturing and real estate sectors.

Credit for consumption increased at an annualised rate of 15.4 percent (\$90.4m), while lending for investment purposes grew by 62 percent (\$133.8m) during the review period. In addition, new loans disbursed by commercial banks also rose by 59.1 percent over the year to \$102.9 million.

Similarly, lending by LCIs rose by 21.3 percent (\$52.6 million) to \$300.1 million during the review period. The increase was largely due to higher lending to private individuals and to the real estate sector.

Banks were able to finance the higher demand for loans through strong growth in deposits. Total commercial bank deposits rose by 19.6 percent to around \$2.5 billion in the year to May 2006, following a growth of 21.6 percent in the preceding month.

### **Interest Rates**

Interest rate movements during the May period were generally on an upward trend. The commercial bank time deposit rate increased by 104 basis points to 5.28 percent while the savings deposit rate fell over the month by 1 basis point to 0.71 percent. The commercial bank lending rate rose over the month by 10 basis points to 7.11 percent. In addition, interest rates on new deposits rose by 70 basis points to 7.43

percent and on new loans rose to 7.87 percent from 7.36 percent recorded in April.

In addition, the weighted average LCI time deposit rate increased significantly to 7.80 percent from 5.89 percent recorded in April while the lending rate on new loans fell to 10.81 percent, a decline of 118 basis points from the previous month.

### **External sector**

Latest accrual trade data showed that cumulative to March 2006, merchandise exports rose by around 4 percent, compared with a growth of around 9.6 percent in the same period last year. The increase in receipts was largely attributed to the higher inflows from sugar, mineral water, fish and gold, which more than offset the decline in earnings from coconut oil, footwear, textiles yarn & fabrics, garments and timber.

During the same period, merchandise imports rose by around 24 percent, compared with a growth of around 1.6 percent in the corresponding period in 2005. The increase in import payments was due to positive contributions from all categories: intermediate goods (16%), investment goods (6%), and consumption goods (3%). The increase in import payments for intermediate goods was led by higher imports of mineral fuels and crude materials, while the growth in investment goods payments was largely due to increases in payments for machinery and chemicals, and the increase in payments for consumption type imports was due to higher outlays for food and manufactured goods.

### **Exchange Rates**

Bilateral movements in exchange rates reveal that during the month of May, the Fiji dollar generally strengthened against the US (0.9%) and Australian dollars (0.3%) and depreciated against the Euro (1.8%), Yen (0.9%) and New Zealand (0.1%) dollars.

The Nominal Effective Exchange Rate<sup>3</sup> (NEER) Index of the Fiji dollar fell by 0.5 percent in the year to May, indicating a depreciation of the Fiji dollar against the basket of currencies.

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<sup>3</sup> 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.

The Real Effective Exchange Rate<sup>4</sup> (REER) Index of the Fiji dollar, a gauge of our international competitiveness, also fell by 1.6 percent during the review period. The decline in the REER Index reflects an improvement in our international

competitiveness and was largely due to the better domestic inflation outcome. Domestic inflation was around 1.5 percent in May 2006, while average trading partner inflation was around 2.9 percent during the same period.

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<sup>4</sup> 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

<b>KEY INDICATORS</b>	<b>May-06</b>	<b>Apr-06</b>	<b>Mar-06</b>	<b>May-05</b>
<b>1. Money and Credit</b> (year-on-year % change)				
Narrow Money	0.23	11.74(p)	14.01(p)	22.77
Currency in Circulation (monthly average)	10.53	11.58	10.45	8.33
Quasi-Money (Time & Saving Deposits)	31.68	27.22(p)	18.66(p)	7.84
Domestic Credit	30.34	30.65(p)	29.99(p)	15.19
<b>2. Consumer Prices</b> <sup>1/</sup> (year-on-year % change)				
All Items	1.5	1.6	2.0	2.5
Food	0.1	0.0	1.2	1.4
<b>3. Reserves</b> (end of period)				
Gross Foreign Reserves (\$m)*	692.9	744.2	793.1	990.8
Months of Imports (goods)	3.0	3.2	3.4	4.8
<b>4. Liquidity</b> (end of period)				
Liquid Assets Margin to Deposit Ratio (%)	3.4	7.4	7.2	11.5
Banks' Demand Deposits (\$m)	40.3	131.1	99.7	127.6
<b>5. Interest Rates (% p.a.)</b> (monthly average)				
Lending Rate (Excluding Staff)	7.11	7.01	6.94	6.82
Savings Deposit Rate	0.71	0.72	0.54	0.38
Time Deposit Rate	5.28	4.24	3.33	1.80
91-day RBF Note Rate (month end)	3.25	3.25	3.25	1.75
Minimum Lending Rate (MLR) (month end)	4.25	3.75	3.75	2.25
Overnight Inter-bank Rate	4.25	4.16	4.24	n.t.
5-Year Government Bond Yield	8.80	5.20	5.00	2.71
10-Year Government Bond Yield	9.08	6.83	6.74	5.23
<b>6. Exchange Rates</b> <sup>2/</sup> (mid rates, F\$1 equals) (end of period)				
US dollar	0.5814	0.5762	0.5575	0.5927
Pound sterling	0.3085	0.3198	0.3192	0.3250
Australian dollar	0.7629	0.7610	0.7801	0.7793
New Zealand dollar	0.9083	0.9092	0.9102	0.8326
Swiss francs	0.7040	0.7260	0.7233	0.7341
Euro	0.4516	0.4598	0.4584	0.4752
Japanese yen	65.20	65.77	65.43	64.00
<b>7. Commodity Prices (US\$)</b> (monthly average)				
UK Gold Price/fine ounce <sup>2/</sup>	673.56	608.26	555.96	422.61
London Daily Sugar Price/tonne <sup>3/</sup>	393.00	426.64	423.59	252.99
Crude Oil/barrel <sup>4/</sup>	70.18	70.64	62.25	48.55
<p>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</p> <p>Sources: <sup>1/</sup> Fiji Islands Bureau of Statistics  <sup>2/</sup> Bloomberg and Reserve Bank of Fiji  <sup>3/</sup> Fiji Sugar Marketing Company Limited  <sup>4/</sup> Bloomberg</p>				