RESERVE BANK OF FIJI

ECONOMIC REVIEW

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OVERVIEW

Economic prospects for the international economy remain broadly positive, with the trend in economic expansion likely to continue. This is largely supported by resilience in consumer demand, strong labour market conditions, improved business confidence and higher trade flows. In particular, the balance of growth across our major trading partners and selected non-Japan Asian economies is upbeat. While the projection is favourable however, the threat of high and volatile crude oil prices could disrupt global economic activity and hence slow international economic growth.

On the domestic front, economic prospects are generally positive, fuelled by encouraging developments shown in key partial indicators. Electricity generation cumulative to April continued to increase, indicating a steady growth in economic activity. On the downside however, copra production cumulative to March fell by around 4 percent when compared to the same period last year. Furthermore, outlook on the gold and garment industries remains subdued.

Domestic demand remains firm. In particular, the *Net Value Added Tax* (VAT) collections, a partial indicator for consumption, rose by 13 percent in the first three months this year, relative to the same period in 2005. Individual incomes, a driver of consumer spending, also grew over the period as evident by the growth in partial indicators, such as *Pay As You Earn* (PAYE) collections. In addition, investment demand continues to be driven by increased construction activity. Furthermore, lending by commercial banks for investment-related purposes continued to surge and grew by around 60 percent in the year to April.

Inflation in April stood at 1.6 percent compared to 2.0 percent in March. The underlying measure of inflation, the trimmed mean, rose to 1.2 percent. Overall, inflation is beginning to exhibit a declining trend, partly accruing to favourable prices in the domestic market. Additionally, inflationary pressures emanating from abroad have also been favourable. However, global crude oil prices have been on the increase and are showing heightened volatility. If this upward trend is consistent for over 4 to 5 months, it may partially offset the current lower inflation outcomes. For the present, the year-end inflation forecast remains at 3.5 percent.

In line with robust domestic demand, money and credit aggregates remain buoyant with the annual growth in commercial banks' credit recording a new historical high of 27 percent at the end of April. The major contributing sectors were the private individuals, building & construction and the wholesale & retail trade and real estate sectors.

The employment trend improved over the year, as suggested by partial indicators. Cumulative to April, around 4,900 individuals were registered as taxpayers, an annual increase of around 11 percent. On the wages front, Government has signed an agreement with the Fiji Public Service Association[1] (FPSA) under the new 2005/2007 Industrial Relations Framework (IRF) regarding their members' log of claims. The total payout, as confirmed by the Public Service Commission (PSC), is expected to be around $250 million covering claims for 2004-2007. While PSC has yet to confirm the date of the payouts and other details on the implementation of these awards, the payments are expected to begin in the second half

[1] Together with the Fiji Nurses Association (FNA) and the Fiji Teachers Union (FTU).

of the year. The inflationary impact of the increased incomes, therefore, are not expected to be felt until 2007.

On the external front, the latest Overseas Exchange Trade (OET) data showed that cumulative to March this year, merchandise exports fell by around 6.2 percent. The decline in receipts was largely attributed to lower receipts from re-exports of mineral fuels, other re-exports, fish, ginger, timber, textiles, clothing & footwear and mineral water, which more than offset higher inflows from sugar, gold, and other exports. Excluding sugar, merchandise exports fell by around 33.2 percent. During the same period, merchandise imports rose by around 38 percent driven by higher payments for all categories of imports: consumption goods (16.4%), investment goods (13.6%) and intermediate goods (7.9%).

As at the end of April, official reserves are estimated at $744 million, sufficient to cover 3.2 months of imports of goods.

In summary, domestic demand remains resilient and performances across sectors are relatively positive. However, strong credit growth continues to support high consumption which fuel imports. In the coming months, the recent monetary policy tightenings are expected to slow credit growth with expected flow dampening effects on import demand.

SECTORAL DEVELOPMENTS

During the review period, sectoral performances were generally positive. Partial indicators suggest that consumption activity remains favourable, supported by an annual growth in Net VAT collections and income. Electricity generation has been growing at a constant pace indicating a steady growth in economic activity. However, on the downside, copra and garment production were unfavourable.

Consumption

Cumulative to March, consumption remained upbeat. Net VAT collections, a partial indicator of consumer spending, amounted to around $115 million, representing a 13 percent increase during the review period on an annual basis.

This strong performance was underpinned by increases in domestic cash collections (by 14 percent), customs services collections (by 10 percent) and VAT collections from Government departments (6 percent).

Income

In the year to March, net income tax revenue amounted to around $98 million, indicating a 36 percent increase on an annual basis. PAYE collections, a partial indicator of individual incomes, amounted to around $50 million during the first 3 months of the year, representing around 11 percent increase over the comparable period last year.

Copra

Latest statistics from the Coconut Industry Development Authority show that cumulative to March, copra production amounted to around 1,900 tonnes, representing a decline of around 4 percent over the corresponding level in 2005.

In the review period, the minimum mill gate price of copra remained unchanged at $500 per tonne. Government's subsidy towards the mill gate price was $81.06 per tonne.

Electricity

Electricity production continued to remain favourable during the review period. Cumulative to April, total electricity generated was around 263 million kilowatt hours (kwh), an increase of around 9 percent on an annual basis.

Clothing, textile and footwear

The performance of the clothing, textile and footwear industry was weak in 2005 with around $116 million worth of garments produced. Production in the industry is estimated to have declined by 35 percent after 27 percent growth in 2004. The poor output in 2005 was largely due to the exit of the largest garment manufacturer, Ghim Li from the local market.

Looking ahead, the industry is anticipated to record a further decline of around 20 percent this year. The projected contraction is expected to stem mainly from the exit of Ghim Li and local manufacturers finding difficulties in meeting the Local Area Content of 35 percent under the SPARTECA (TCF Provisions) Scheme.

Inflation

Inflation in April stood at 1.6 percent compared to 2.0 percent in March. Over the month, consumer prices fell by 0.4 percent. During April, prices in the food category fell, mainly due to lower prices of bakery and wheat products and other primary produce.

Conversely, prices of miscellaneous items, clothing & footwear, durable household goods and transport rose. The higher prices of durable household goods, clothing & footwear and transport are a result of changes in import duties since November last year. On the other hand, costs of alcoholic drinks & tobacco, housing, heating & lighting and services remained unchanged. The underlying measure of inflation, the trimmed mean, rose to 1.2 percent from 1.1 percent recorded in March.

Overall, inflation is beginning to exhibit a declining trend, partly accruing to favourable prices in the domestic market. Subdued prices of locally produced goods and services are cushioning the price increases of imported goods due to the higher import and excise duties.

Inflationary pressures emanating from abroad have also been favourable. Average trading partner inflation is currently at a comfortable level of 2.6 percent, largely as a result of tightening monetary policy decisions of trading partner central banks. However, global crude oil prices have been on the increase and are showing heightened volatility. If this upward trend is consistent for over 4 to 5 months then it may partially offset current lower inflation outcomes.

The current inflation forecast will not be changed unless a definite trend becomes evident in the next couple of months. The year-end inflation forecast therefore remains unchanged at 3.5 percent.

Labour Market

Labour market conditions improved over the year as suggested by partial indicators. Cumulative to April, around 4,900 individuals were registered as taxpayers, increasing by around 11 percent over the corresponding period last year. The community, social & personal services sector continued to record the largest number of new taxpayers followed by the finance, insurance, real estate & business services; wholesale, retail trade, restaurants & hotels and manufacturing sectors.

On the wages front, Government has signed an agreement under the new 2005/2007 Industrial Relations Framework regarding their members' log of claims. A total of around 30,000 civil servants will receive the following increments amongst other awards:

- 4 percent Cost of Living Adjustment (COLA) increases for years 2005, 2006 and 2007 across the board. The value of this payout is around $108 million for the three years. The unions expect the first payment to be made during the first pay in June;
- 2 percent across the board payment for 2003, effective from 1st January 2006, costing around $18 million; and
- 2 percent merit increase for the year 2004, backdated to 1st January 2005, amounting to $27 million.

The total payout is expected to be around $250 million covering claims for 2004-2007. While the PSC has yet to confirm the date of the payouts and other details on the implementation of these awards, it is expected that the payouts will begin in the second half of this year. The inflationary impact of increased incomes, therefore are not expected to be felt until 2007.

Monetary & Credit Aggregates

Monetary conditions have remained buoyant so far this year, with a sustained pick-up in credit demand from the commercial sector. Banks were able to finance the higher demand for loans through strong growth in deposits.

Total commercial bank deposits rose by 21.6 percent to around $2.5 billion in the year to April 2006, following a growth of 18.8 percent in the preceding month.

Accordingly, commercial banks' credit on a yearly basis, registered a growth of 27.5 percent as at April. This was mainly driven by private individuals and the building and construction, wholesale & retail trade and real estate sectors.

Credit for consumption increased at an annualised rate of 14.5 percent ($85.0m), while lending for investment purposes grew by 59.5 percent ($126.5m) during the review period. On the other hand, new loans disbursed by commercial banks declined by 11.3 percent over the year to $64.5 million.

Interest Rates

Interest rate movements during the April period were generally on an upward trend. Both the commercial bank time deposit and savings deposit rates increased by 91 basis points and 18 basis points, to 4.24 percent and 0.72 percent, respectively. The commercial bank lending rate rose over the month by 7 basis points to 7.01 percent. In addition, interest rates on new deposits also rose by 177 basis points to 6.73 percent, while interest rates on new loans fell to 7.36 percent from 7.99 percent recorded in March.

External sector

On the external front, latest OET data showed that cumulative to March this year, merchandise exports fell by around 6.2 percent, compared with a decline of around 37.2 percent in the corresponding period in 2005. Excluding sugar, merchandise exports fell by around 33.2 percent, compared to a decline of around 31.9 percent in the same period in 2005. The decline in receipts was largely attributed to lower receipts from re-exports of mineral fuels, other re-exports, fish, ginger, timber, textiles, clothing & footwear and mineral water, which more than offset higher inflows from sugar, gold and other exports.

During the same period merchandise imports rose by around 38 percent, compared to a decline of around 4 percent in the corresponding period in 2005. The increase in import payments was due to higher payments for all catergories: consumption goods (16.4 percent), investment goods (13.6 percent) and intermediate goods (7.9 percent). The higher payments for consumption goods was largely attributed to higher outlays for food, beverage & tobacco, transport equipment, duty free goods and other imports which more than offset lower outlays for government imports and merchanted goods. The growth in investment goods payments was largely due to increases in import payments for machinery & electrical equipment[2] and chemicals. The higher payments for intermediate goods was underpinned by the higher outlays for mineral fuels, raw materials and textiles clothing & footwear.

Exchange Rates

Bilateral movements in exchange rates reveal that during the month of April, the Fiji dollar generally strengthened against the US dollar (3.4%), Yen (0.5%) and Euro (0.3%), and depreciated against the Australian (2.5%) and New Zealand (0.1%) dollars during the review period.

The Nominal Effective Exchange Rate[3] (NEER) Index of the Fiji dollar fell by 0.6 percent in the year to April 2006, indicating a depreciation of the Fiji dollar against the basket of currencies.

The Real Effective Exchange Rate[4] (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 1.6 percent in April 2006, while average trading partner inflation was around 2.9 percent during the same period.

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[2] This includes machinery such as power generating machinery & equipment, machinery specialised for particular industries (agriculture, factory, road making, textile etc), and compressors, cranes, woodworking machinery, amongst others.

[3] 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.

[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	Apr-06	Mar-06	Feb-06	Apr-05
1. Money and Credit				
(year-on-year % change)				
Narrow Money	11.74(p)	14.01(p)	18.42	33.64
Currency in Circulation (monthly average)	11.58	10.45	10.22	8.49
Quasi-Money (Time & Saving Deposits)	27.22(p)	18.66(p)	17.58	11.25
Domestic Credit	30.65(p)	29.99(p)	26.75	13.23
2. Consumer Prices [1/]				
(year-on-year % change)				
All Items	1.6	2.0	2.2	1.3
Food	0.0	1.2	3.0	-1.3
3. Reserves				
(end of period)				
Gross Foreign Reserves ($m)*	744.2	793.1	853.6	989.5
Months of Imports (goods)	3.2	3.4	3.7	4.8
4. Liquidity				
(end of period)				
Liquid Assets Margin to Deposit Ratio (%)	7.4	7.2	8.8	9.9
Banks' Demand Deposits ($m)	131.1	99.7	121.2	101.4
5. Interest Rates (% p.a.)				
(monthly average)				
Lending Rate (Excluding Staff)	7.01	6.94	6.63	6.87
Savings Deposit Rate	0.72	0.54	0.47	0.36
Time Deposit Rate	4.24	3.33	2.80	1.80
91-day RBF Note Rate (month end)	3.25	3.25	2.25	1.75
Minimum Lending Rate (MLR) (month end)	3.75	3.75	3.75	2.25
Overnight Inter-bank Rate	4.16	4.24	n.t	1.10
5-Year Government Bond Yield	5.20	5.00	4.00	n.i
10-Year Government Bond Yield	6.83	6.74	6.73	n.i
6. Exchange Rates [2/]				
(mid rates, F$1 equals)				
(end of period)				
US dollar	0.5762	0.5575	0.5708	0.6042
Pound sterling	0.3198	0.3192	0.3281	0.3170
Australian dollar	0.7610	0.7801	0.7743	0.7753
New Zealand dollar	0.9092	0.9102	0.8654	0.8290
Swiss francs	0.7260	0.7233	0.7547	0.7210
Euro	0.4598	0.4584	0.4816	0.4687
Japanese yen	65.77	65.43	66.32	64.12
7. Commodity Prices (US$)				
(monthly average)				
UK Gold Price/fine ounce [2/]	608.26	555.96	555.63	428.56
London Daily Sugar Price/tonne [3/]	426.64	423.59	440.88	253.35
Crude Oil/barrel [4/]	70.64	62.25	59.92	51.81

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*