RESERVE BANK OF FIJI

ECONOMIC REVIEW

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OVERVIEW

The global economic outlook remains favourable, particularly with growth prospects for all our major trading partners and selected non-Japan Asia (China, Hong Kong & Singapore) expected to be strong this year. Resilient domestic conditions in the US, Australia, New Zealand and Japan continue to support the growth prospects for these economies. However, rising energy costs are slowly beginning to depress consumer and business confidence in some of these economies, and hence pose some downside risks to their outlook

On the domestic front, the 2005 National Budget is one that is 'less expansionary', when compared to the 2004 fiscal year. Government has announced a smaller underlying deficit of 4.3 percent of GDP, compared to 4.8 percent of GDP in 2004. Despite the reduction in the deficit, expenditure is higher compared to 2004. The reduction in the deficit has been achieved by higher revenue measures. However, for the first time in the past 4 years, Government is expected to record a small savings in 2004, which is expected to strengthen next year to around $32 million.

Sectoral developments over the month were generally favourable. The tourism industry continued to perform strongly. Production was higher on an annual basis in the gold, copra and electricity industries. Domestic cement sales, a partial indicator for the construction sector also registered strong growth, supporting the strong outlook for the construction sector.

In the labour market, recent developments suggest further improvements. The number of newly registered taxpayers, a partial indicator for employment, rose by 5 percent in October, compared with the corresponding period last year.

Inflationary pressures remain subdued with inflation at 2.8 percent in October, against 3.4 percent recorded for September. The year-end inflation is projected at 3.5 percent.

The outlook for investment is also positive. Preliminary estimates suggest that Government's investment next year will amount to 5 percent of GDP. Coupled with the surge in private construction activity and continuing investment by statutory bodies, next year's total investment is anticipated to step up to 17 percent of GDP, the highest in the last 17 years.

Consistent with developments in the real sector, money and credit aggregates continued to improve in the year to September. Broad money growth stemmed mainly from significantly higher growth in narrow money[1] and private sector credit. Additionally, as at September-end, the total value of outstanding loans in the banking system increased by 15.8 percent on an annual basis underpinned mainly by higher lending to private individuals, real estate, manufacturing, public enterprises, wholesale, retail, hotels & restaurants and building & construction sectors. On commercial banks' interest rates, the weighted average lending rate was 7.11 percent and the savings deposit rate was 0.35 percent, marginally lower than the level in the previous month. The time deposit rate remained at 1.77 percent. In contrast, weighted average interest rates on new lending continued its upward trend in the review period.

On the external front, recent Overseas Exchange Trade data showed that cumulative to September, merchandise exports rose by around 2.4 percent, when

[1] 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.

compared with a decline of around 7.3 percent in the corresponding period last year. The increase in exports was largely attributed to positive contributions from textiles, clothing & footwear, merchanted goods, gold, and timber, which more than offset the negative contributions from sugar, other exports, copra and fish. Merchandise imports rose by around 16 percent, in the review period, when compared with a growth of around 13 percent in the corresponding period last year. The increase was credited to higher import payments for all categories of goods.

As at the end of October, foreign reserves were around $747 million, sufficient to cover 3.3 months of imports of goods and non-factor services or 5.1 months of imports of goods only.

SECTORAL DEVELOPMENTS

The domestic economy continued to show signs of increased economic activity over the month, supported by favourable outcomes in the major sectors of the economy. Strong growth in visitor arrivals has continued. Additionally, annual increases were noted for gold, copra and electricity production and domestic cement sales.

Tourism

The tourism industry has been registering record-breaking monthly arrivals since the start of the year. Available data suggests that visitor arrivals cumulative to October this year amounted to around 417,000, representing a significant increase of around 17 percent over the comparable period last year.

Gold

Cumulative to October, total gold production amounted to nearly 110,000 ounces, 18 percent higher than last year's level. On a monthly basis, gold production amounted to over 11,000 ounces, which represents an annual increase of 11 percent. The strong growth in gold production supports EGM's intention of gradually increasing its production level towards an annual production target of 180,000 ounces by 2006. Accordingly, earnings increased on an annual basis by 21 percent to $76 million, during the review period.

Copra

For the first time in 9 months, copra production improved on an annual basis. Latest statistics from the Coconut Industry Development Authority showed that cumulative to September, copra production amounted to around 8,100 tonnes, representing an increase of around 3 percent over the comparable period last year. The minimum mill gate price of copra for the month of September stood at $500 per tonne. Government's subsidy towards the mill gate price was $42.08 per tonne.

Electricity Production

Electricity production remained favourable. Cumulative to October, total electricity generated was around 537 million kilowatt hours (kwh). This represented an increase of 2.5 percent on an annual basis.

The outlook for the electricity industry is encouraging, with a number of major new energy projects lined up for the next five years. In the 2005 National Budget, Government announced allocating an additional $6 million to Government's rural electrification schemes. In the last three years, this scheme has made 400 new connections and with this additional $6 million allocation it is expected to cover more rural communities in 2005.

Public Finance

In announcing the 2005 National Budget, Government has since revised its projected underlying deficit for this year to 4.8 percent of GDP ($220.5 million) from the originally envisaged 3.9 percent of GDP target ($183.6 million). The higher deficit is a result of the two additional appropriations by Government, totalling $50.9 million, to meet costs related to the flash floods in April and expenditure overruns by three prominent Government Ministries. As such, the earlier-anticipated annual reduction in Government expenditure for this fiscal year, which was the basis for Government's contractionary fiscal stance, will not be achieved. However, on a positive note, the provisional underlying deficit for 2004 is an improvement from the 2003 underlying deficit of 5.9 percent of GDP ($255.9 million).

For 2005, Government's total expenditure is expected to increase by 4 percent while revenue collections (excluding asset sales) are projected to increase by 7 percent. Nevertheless, the expected revenues will not be able to offset the expenditure, resulting in an expected underlying deficit of $207.1 million, equivalent to 4.3 percent of GDP. Including asset sales of $40 million, the net headline deficit is projected at $167.1 million, or 3.5 percent of GDP.

In terms of the Government's operating-capital expenditure mix for next year, the ratio is projected to be 82:18, not very different from the mix for this year. The allocation for capital expenditure is expected to rise by 6 percent, driven mainly by a strong increase in capital purchases, while operating expenditure is also anticipated to rise by 4 percent.

Inflation

Inflation stood at 2.8 percent in October, compared to 3.4 percent in September. Over the month, consumer prices fell by 0.4 percent, as prices of food, alcoholic drinks & tobacco, housing and durable household goods declined. The fall in food items was largely due to lower prices of spices, fruits and vegetables. These were partially offset by rises in the prices of clothing & footwear, miscellaneous items, and transport. The prices of heating & lighting and services remained unchanged over the month.

The underlying measure of inflation, the trimmed mean, was 1.2 percent in October, unchanged from the previous month.

Inflation is anticipated to pick up slightly by the year-end. This is largely due to an increase in the prices of alcoholic drinks & tobacco and an anticipated rise in domestic fuel prices. The forecast for year-end inflation is 3.5 percent.

Labour Market

Conditions in the labour market improved over the month, as indicated by partial indicators of employment as well as survey data. Cumulative to October, around 9,300 new taxpayers were registered with the Fiji Islands Revenue and Customs Authority. This is an increase of around 5 percent over the corresponding period in 2003. Additionally, new active membership with the FNPF in the September quarter totalled around 4,900, an increase of around 10 percent over the year.

On the supply side, cumulative to August, around 3,900 people took up residence abroad, representing a decline of 4 percent. During the review period, fewer workers under the professional & technical and clerical, sales & services categories migrated relative to last year. However, this was partially offset by an increase in the number of agriculture & production and administrative workers leaving Fiji.

Financial Aggregates and Interest Rates

Broad money continued to grow in the year to September, rising by 13.4 percent following an expansion of 20.5 percent in the previous month. The determinants of broad money, comprising domestic credit and net foreign assets, recorded annual growth rates of 11.2 percent and 15.5 percent respectively. The increase in the former was spurred by higher credit to official entities and private sector credit, which rose by 27.9 percent and 14.7 percent respectively, over the year. New and renewed loans represented an increase of around 20.2 percent ($11.7 million) over the previous month, largely due to higher lending to the manufacturing, followed by agriculture, and the public enterprises sector.

Total loans and advances of licensed credit institutions (LCIs) also grew at an annual rate of 22.8 percent in September, with loans extended mainly to private individuals (mainly for housing purposes), real estate, with impetus also coming from building & construction, wholesale & retail trade and manufacturing sectors. The weighted average lending rate of LCIs was 11.83 percent during the review period compared with 11.82 percent in the previous month.

Also, during the review period, total outstanding deposits of commercial banks increased by around $31 million over the month to record an annual growth rate of 8.9 percent, following a growth of 13.3 percent in the year to August. Higher deposits by private sector business enterprises and private individuals contributed mainly to the increase in total deposits.

The weighted average lending rate of commercial banks declined by 6 basis points to 7.11 percent at end-September. The weighted average commercial bank time deposit rate remained at 1.77 percent, while the saving deposit rate fell by 1 basis point to 0.35 percent.

Meanwhile, interest rates offered by LCIs on outstanding loans and advances rose over the month by 1 basis point to 11.83 percent. Similarly, interest rate on new loans and advances increased to 14.28 percent at end-September (13.09 percent at end-August). However, the same cannot be said for new time deposit rates as it fell over the month by 14 basis points to 3.00 percent, underpinned by lower rates offered on the 6-12 month category of new time deposit.

Recent data also indicate upward movement in the interest rates offered on money market and capital market securities.

Exchange Rates

The Nominal Effective Exchange Rate[2] index of the Fiji dollar rose by 0.1 percent in the year to October, indicating an appreciation of the Fiji dollar against the basket of currencies.

The Real Effective Exchange Rate (REER)[3] Index of the Fiji dollar, a gauge of our international competitiveness, rose by 0.7 percent during the review period. The increase in the REER Index over the year reflects deterioration in our international competitiveness and was largely due to higher domestic inflation outcomes. Domestic inflation increased to 2.8 percent in October, while average trading partner inflation was around 2.3 percent during the same period.

External sector

On the external front, recent Overseas Exchange Trade data showed that cumulative to September, merchandise exports rose by around 2.4 percent, when compared with a decline of around 7.3 percent in the corresponding period last year. The increase in exports was largely attributed to positive contributions from textiles, clothing & footwear, merchanted goods, gold, and timber, which more than offset the negative contributions from sugar, other exports, copra and fish. Cumulative to September, merchandise imports rose by around 16 percent, when compared with a growth of around 13 percent in the corresponding period last year. The increase was credited to higher import payments for all categories of goods. The increase in intermediate goods was led by higher payments for mineral fuels, raw materials and textiles, clothing & footwear, while machinery & transport equipment and chemicals led the increase in investment goods. The positive contributions from merchanted and duty free goods underpinned the increase in payments for consumption goods.

RESERVE BANK OF FIJI

[2] 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. 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.

[3] 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.