RESERVE BANK OF FIJI

ECONOMIC REVIEW

The inclusion of news items in this review does not imply endorsement of the accuracy of the information nor agreement with views expressed.

Vol. 23 No. 11 Month Ended. November 2006

OVERVIEW

International economic developments remain largely encouraging for the domestic economy. The growth outlook for all our major trading partner countries and selected non-Japan Asian (China, Hong Kong & Singapore) economies remain positive this year. However, despite the recent downward trend in international crude oil prices, the risk of prices rising again on global economic growth remains. The world crude oil price has fallen from its peak of US$75 per barrel in July of 2006 to current levels of around US$60 per barrel.

Latest developments in key sectors remained mixed, but of notable concern is the cancellation of hotel bookings for the remaining month of this year in the tourism industry. Looking at the components of aggregate demand, consumption expenditure remains upbeat as evident by strong growth recorded in net Value Added Tax (VAT) collections (a partial indicator of consumer spending). In the year to September, net VAT collections amounted to $353 million, an increase of around 16 percent when compared with the same period last year. Investment as a percentage of GDP continues to grow, albeit at a very sluggish pace.

Monetary and credit growth continues its downward trend. Total money supply rose by 15.1 percent on an annual basis in October, from 15 percent recorded in the previous month. Commercial banks' credit slowed to 21.9 percent as at end-October, down from the peak of 29 percent in May. Furthermore, the annual growth rate of credit for consumption purposes continued its downward trend during the review period, recording 10.1 percent in October, declining from 10.3 percent in September and 12.2 percent in the June quarter. Investment lending by commercial banks increased by 54.4 percent, during the review period.

Interest rates continued to rise. Both the commercial banks' time and savings deposit rates increased by 56 basis points and 2 basis points, to 7.19 percent and 0.82 percent, respectively, in October. The commercial bank lending rate also rose over the month by 11 basis points to 7.80 percent. In addition, interest rates on new deposits increased to 9.63 percent from 8.29 percent, and the interest rate on new loans extended by commercial banks also rose by 14 basis points, to 10.13 percent during the current period. Similar trends also emerged from Licensed Credit Institutions (LCIs).

Inflation in October rose to 4.0 percent compared with 2.8 percent in September. On a monthly basis, consumer prices rose by 1.0 percent, driven by higher prices of heating & lighting, food, miscellaneous items and transport. The underlying measure of inflation, the trimmed mean, rose to 2.1 percent on an annual basis.

In the coming months, some upward pressures on prices are likely to remain. Furthermore, several increases in fiscal and excise duties have come into effect immediately, following the recent budget announcement, and are expected to exert additional price pressures. However, after incorporating these developments, the inflation forecast for the year-end remains unchanged at 3.5 percent.

Employment conditions are improving as suggested by partial indicators of employment. Cumulative to October, around 6,700 taxpayers were registered by the Fiji Islands Revenue & Customs Authority (FIRCA), equating to an annualised increase of around 19 percent.

Latest Overseas Exchange Transaction (OET) data shows that cumulative to September this year, merchandise export earnings fell by 6.9 percent, compared with a decline of around 10.8 percent in the corresponding period in 2005. During the same period, merchandise import payments rose by around 9.7 percent, compared to a growth of around 20.1 percent in the corresponding period in 2005.

On the positive side, the world crude oil price has fallen from its peak of US$75 per barrel in July of 2006 to current levels of around US$60 per barrel. Since the pressure on foreign reserves has emanated from our trade gap, which in large part has come about due to higher imports of consumption goods and mineral fuel payments, this current trend is encouraging.[1]

The 2007 national budget is also expected to provide some relief to our balance of payments pressures by dampening domestic demand. While next year's budget will continue to be expansionary, it will be relatively less potent when compared with 2006. Government is expected to consolidate its fiscal position by reducing the deficit to 2.0 percent of GDP, from an estimated underlying deficit of 4.0 percent of GDP in 2006. The reduction in deficit is anticipated to lower debt outcomes in the medium term – Government debt is projected to fall from 52.8 percent of GDP this year to 52.1 percent of GDP in 2007.

Furthermore, the imposition of higher tariffs on several imported items is likely to dampen domestic demand and as a result, slow the growth of imports of consumption goods. In this respect, the 2007 National Budget can be seen as supportive of the current goal of monetary policy.

Official reserves as at the end of September were estimated at $840.2 million, sufficient to cover 3.4 months of goods imports.

SECTORAL DEVELOPMENTS

On the domestic front, sectoral developments were generally positive during the review period. In the year to September, consumption and individual incomes continue to remain firm. Similarly, electricity production grew on an annual basis during the review period. However, output in the gold, cane and sugar industries continue to fall.

Consumption

Consumption continues to remain firm this year, evident by the growth in partial indicators of consumer spending. In the year to September, net VAT collections amounted to $353 million, an increase of around 16 percent when compared with the same period last year.

This strong performance was underpinned by increases in VAT collections from government departments (19 percent), domestic cash collections (11 percent), and customs services collections (7 percent).

Income

Cumulative to September, net income tax collections amounted to around $288 million, an 18 percent increase on an annual basis. In addition, Pay As You Earn collections, a partial indicator of individual incomes, amounted to around $155 million in the year to September, representing an increase of around 15 percent on an annual basis.

Total customs revenue in the first nine months of this year, amounted to around $221 million, representing an increase of around 3 percent when compared to the corresponding level in 2005.

Looking at the major components of customs revenue, there was an increase in excise duty collections (12 percent), no growth was noted in fiscal collections and other collections declined (3.3 percent) on an annual basis.

Electricity

Electricity production remains favourable. Cumulative to October, total electricity generated by the Fiji Electricity Authority was around 615,292 mega watt hours (Mwh), an increase of 9.3 percent on an annual basis.

Cane and Sugar

Weak performance continues to be registered within the cane industry. Mill reports have indicated that that around 2,409,000 tonnes of cane has been crushed up to October this year. This represents a decline of 4.5 percent on an annual basis. Furthermore, the annual Tonnes Cane to Tonnes

[1] It may be noted that the quantity of mineral fuel imported has largely been constant over the years. Thus, the current drop in crude oil prices should provide some relief to mineral fuel payments.

Sugar ratio has remained around 10:1, indicating no change in the quality of cane.

In line with the cane harvest, around 244,000 tonnes of sugar was produced by the Fiji Sugar Corporation Limited up to October, representing a deterioration of 8.4 percent year-on-year.

The frequent mill breakdowns and unfavourable climatic conditions experienced earlier in the season have resulted in lower cane being crushed. In addition, land tenure issues and the burning of cane have compounded the problems faced by this industry.

Gold

Production in the gold industry remains subdued. Cumulative to October, total gold output amounted to 39,300 ounces, 49 percent lower than the corresponding period in 2005. Poor production is mainly the result of mining disruptions due to the restructure program undertaken at the mill.

Similarly, gold earnings for the same period totalled approximately $40 million, representing a decline of 29 percent on an annual basis.

Inflation

Inflation in October rose to 4.0 percent compared with 2.8 percent in September. On a monthly basis, consumer prices rose by 1.0 percent.

During the month, prices of heating & lighting, food, miscellaneous items and transport rose while costs of alcoholic drinks & tobacco, durable household goods and clothing & footwear fell. Costs of housing and services remained unchanged. The higher costs of food was primarily a result of increases in prices of bakery and dairy products as well as market items, while the increase in price of heating & lighting was due to the electricity fuel surcharge. The rise in prices of miscellaneous items was underpinned by higher prices of toiletries, laundry and other household items. Likewise, the rise in costs of transport emanated largely from the increase in prices of oil and grease. The lower price of alcoholic drinks & tobacco on the other hand, was due to a fall in the price of cigarettes. Furthermore, the decline in costs of durable household goods was largely a result of lower prices of furniture and non-electrical appliances.

The underlying measure of inflation, the trimmed mean, rose to an annual 2.1 percent. The consistent increase in underlying inflation since mid-year reflects that core prices are beginning to pick up in line with the increase in headline inflation. Aside from the domestic fuel price increases, this is also the result of higher prices of basic food items in the Consumer Price Index basket, of both domestic and imported items. As anticipated, inflation picked up. This was largely due to a rise in the price of items in the food category emanating from an earlier increase in prices of flour/ sharps and edible oil coupled with the impact of adverse weather conditions on the prices of market items.

In the coming months, some upward pressures on prices are likely to remain. Furthermore, several increases in fiscal and excise duties have come into effect immediately, following the recent budget announcement and are expected to exert additional price pressures.

However, after incorporating these developments, the inflation forecast for the year-end remains unchanged at 3.5 percent.

Labour Market

Employment conditions are improving as suggested by partial indicators of employment. Cumulative to October, around 6,700 taxpayers were registered by the FIRCA, equating to an annualised increase of around 19 percent.

The community, social & personal services sector continued to record the largest number of new taxpayers followed by the wholesale, retail trade, restaurants & hotels; finance, insurance, real estate & business services; manufacturing; transport, storage & communications and construction sectors.

Money and Credit Aggregates

Money supply rose by 15.1 percent on an annual basis in October. This increase was attributed to expansions in both time deposits and domestic credit, notably private sector credit.

Growth in domestic credit continues to be driven largely by increased lending to the private sector. In the year to October domestic credit rose by 25.4 percent compared with the same period last year. Over the same period credit to the private sector expanded by 25.5 percent, to F$2.3 billion.

Commercial banks' credit slowed to 21.9 percent as at end-October, down from the peak of 29 percent in May. Furthermore, the annual growth rate of credit for consumption purposes continued its downward trend during the review period, recording 10.1 percent in October, declining from 10.3 percent in September and 12.2 percent in the June quarter. Investment lending by commercial banks increased by 54.4 percent during the review period.

In line with the slowdown in credit by commercial banks, lending by LCIs also slowed in October. The annual growth rate of loans stood at 17.2 percent in October, after recording 17.6 percent in the previous month.

Interest Rates

Interest rates continued to rise in October. Both the commercial banks' time and savings deposit rates increased by 56 basis points and 2 basis points, to 7.19 percent and 0.82 percent, respectively, in October. The commercial bank lending rate also rose over the month by 11 basis points to 7.80 percent. In addition, interest rates on new deposits increased to 9.63 percent from 8.29 percent, and the interest rate on new loans extended by commercial banks also rose by 14 basis points, to 10.13 percent during the current period.

Similar trends emerged from LCIs. The interest rate on new time deposits rose to 9.52 percent, an increase of 66 basis points over the month, and the interest rate on new loans increased to 15.82 percent, from 15.12 percent recorded in September.

External sector

Latest OET data shows that cumulative to September this year, merchandise export earnings fell by 6.9 percent, compared with a decline of around 10.8 percent in the corresponding period in 2005. The decline in receipts was due to lower earnings from sugar, ginger, mineral water, fish and re-exports other than mineral fuels, which more than offset the higher inflows from gold, textiles, clothing & footwear, timber, copra, merchanted goods and other exports.

During the same period, merchandise import payments rose by around 9.7 percent, compared to a growth of around 20.1 percent in the corresponding period in 2005, with the increase evident across all categories. The higher outlays for investment goods (4.3 percent) was largely made up of increases in import payments for machinery & electrical equipment, while the growth in consumption goods payments (2.7 percent) was largely attributed to the increase in spending for duty free goods and transport equipment. For intermediate goods, the increase (2.7 percent) was underpinned by mineral fuels, raw materials and textiles, clothing & footwear.

Exchange Rate Developments

On the domestic front, bilateral movements in exchange rates reveal that during the month of October, the Fiji dollar generally strengthened against the US dollar (1.3%), Euro (1.1%) and Yen (1.0%), while the local currency weakened against the Australian (1.4%) and New Zealand (0.1 %) dollars.

The Nominal Effective Exchange Rate[2] (NEER) Index of the Fiji dollar fell by 0.1 percent in the year to October 2006, indicating a depreciation of the Fiji dollar against the basket of currencies, while the Real Effective Exchange Rate[3] (REER) Index of the Fiji dollar, a gauge of our international competitiveness, rose by 0.6 percent during the same period.

RESERVE BANK OF FIJI

---

[2] 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.

[3] 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

KEY INDICATORS	Oct-06	Sep-06	Aug-06	Oct-05
1. Money and Credit				
(year-on-year % change)				
Narrow Money	-7.59	-4.36	-4.78	24.96
Currency in Circulation (monthly average)	9.34	9.44	11.50	11.73
Quasi-Money (Time & Saving Deposits)	35.74	32.47	36.08	12.41
Domestic Credit	25.39	27.42	26.74	23.20
2. Consumer Prices [1/]				
(year-on-year % change)				
All Items	4.0	2.8	2.9	1.9
Food	4.5	1.6	1.9	0.3
3. Reserves				
(end of period)				
Gross Foreign Reserves ($m)*	840.2	817.2	593.3	878.0
Months of Imports (goods)	3.4	3.3	2.5	4.3
4. Liquidity				
(end of period)				
Liquid Assets Margin to Deposit Ratio (%)	4.0	3.3	4.6	8.5
Banks' Demand Deposits ($m)	48.3	39.2	53.6	107.0
5. Interest Rates (% p.a.)				
(monthly average)				
Lending Rate (Excluding Staff)	7.8	7.69	7.65	6.70
Savings Deposit Rate	0.82	0.80	0.81	0.33
Time Deposit Rate	7.19	6.63	6.23	1.81
91-day RBF Note Rate (month end)	4.25	n.i.	n.i	1.75
Minimum Lending Rate (MLR) (month end)	5.25	5.25	5.25	2.75
Overnight Inter-bank Rate	5.36	5.30	5.15	1.35
5-Year Government Bond Yield	n.i.	n.i.	n.i	2.82
10-Year Government Bond Yield	9.94	9.60	n.i	5.44
6. Exchange Rates [2/]				
(mid rates, F$1 equals)				
(end of period)				
US dollar	0.5861	0.5785	0.5816	0.5838
Pound sterling	0.3081	0.3083	0.3054	0.3306
Australian dollar	0.7611	0.7723	0.7622	0.7792
New Zealand dollar	0.8792	0.8797	0.8967	0.8300
Swiss francs	0.7315	0.7215	0.7144	0.7456
Euro	0.4605	0.4554	0.4532	0.4837
Japanese yen	68.81	68.15	68.12	67.53
7. Commodity Prices (US$)				
(monthly average)				
UK Gold Price/fine ounce [2/]	586.76	599.54	633	469.88
London Daily Sugar Price/tonne [3/]	12.07	12.45	13.58	299.09
Crude Oil/barrel [4/]	58.36	62.77	73.61	58.56

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*