



# RESERVE BANK OF FIJI

## ECONOMIC REVIEW

Vol. 22

No 08

Month August 2005

### OVERVIEW

The continued global expansion provides a favorable backdrop to the Fiji economy, with an above-average growth of around 4.3 percent forecasted for the year. Robust growth in the U.S. and Chinese economies is predicted to sustain the growth momentum. The outlook for Fiji's major trading partners also remains positive, with most predicting solid growth for the year. However, the continued hike in oil prices remains a concern, with prices recently reaching a record high of US\$66.79 (on 15/08/05). Though not predicted to have a significant dampening effect on the current global expansion, the continued upward trend in oil prices is an indicator of the demand pressures arising from it.

The domestic economy, contrary to world trends, is slowing. The momentum of the good economic performance post 2000 appears to have stalled. The economy is expected to grow by 1.4 percent this year, an upward revision from the earlier forecast of 1.2 percent. A growth of 0.8 percent is still forecast for next year. These projections compare with the average growth of around 3.5 percent recorded for period 2001-2004.<sup>1</sup> In the medium term, reforms are needed to push the growth rates higher and closer to the potential level for Fiji.

Aggregate supply analysis - namely the production performance - is largely in agreement with the lower economic performance due to the slowdown in garments, gold and sugar. On the other hand, consumption and investment demand, backed by favorable financial conditions continues to surge ahead. At the very least, they are maintaining the pace seen for recent past years. However, the negative contribution of net exports is dragging down aggregate demand.

Consumption continued to grow strongly during the first 7 months of the year. Partial indicators such as Net Value Added Tax (VAT) collections rose at a measured pace of 1.2 percent during the review period, on an annual basis. However, cash collections from domestic activities (seen as a better indicator of consumer spending), grew more robustly. For the first 7 months of the year, cash collections amounted to around \$119 million, representing a 10.9 percent increase over the comparable period last year.

Financial conditions throughout the first six months have remained expansionary, despite the low expected economic activity. Broad money continues to grow strongly, expanding by 13.7 percent over the year to June, largely on the back of sustained increase in narrow and quasi money. The monetary expansion has been aided by the continued growth in credit in the banking system, largely made up of borrowings by private individuals and tourism related sectors.

The growth in credit has also supported the downward movement in interest rates. Over the month of June, the weighted average lending rates of both commercial banks and Licensed Credit Institutions (LCIs) declined by 5 and 6 basis points to 6.77 percent and 11.48 percent, respectively. Time deposit rates of commercial banks also fell by 2 basis points to 1.78 percent, although savings deposit rate rose marginally to 0.42 percent.

On external trade, the continuing decline in Fiji's real sector exports remains a concern. Latest Overseas Exchange Trade data showed that cumulative to June, merchandise exports fell by around 22 percent, while merchandise imports grew by 4 percent in the same period. The growing commodity trade deficit is largely attributed to the declines in gold and garment

<sup>1</sup> The growth rates for 2003 (3 percent) and 2004 (4.1 percent) are still estimates.

exports, as well as the lower than expected growth in sugar exports.

The domestic inflation rate picked up in July, rising by 0.7 percentage points over the month to 2.8 percent. Despite this, the inflation rate throughout the first half of the year has been relatively mild, generally remaining below 3 percent. Looking ahead however, the year-end inflation forecast remains at 4.5 percent. This is largely due to inflationary pressures arising from the hike in oil prices in recent months.

At the end of July, foreign reserves stood at around \$955 million, sufficient to cover 4.0 months of imports of goods and non-factor services or 5.4 months of imports of goods only. Of these reserves, NBFI's foreign asset holdings account for around \$265 million. The decline in our net export receipts, as well as the current hike in imported mineral fuel costs, remain the major downside threats to future reserve levels. On the other hand, factors that are sustaining reserve levels are the continued buoyant growth in tourism receipts, as well as the emergence of personnel remittances.

## **SECTORAL DEVELOPMENTS**

Sectoral performances were mixed during the review period. Electricity generation, copra and sugar production all recorded favorable growth during the period. However, gold production remained weak for the seventh consecutive month. Growth in consumption spending, while still strong, also appears to be decelerating, in line with the economic slowdown expected for the year.

### **Income**

Cumulative to July, net income tax revenue amounted to around \$176 million, indicating a 6.0 percent increase over the corresponding period last year. In addition, despite sentiments of a slow down, labour market conditions remain firm. Pay As You Earn collections, a partial indicator of individual incomes, amounted to around \$102 million during the first 7 months of the year, representing around 3 percent increase over the comparable period last year.

### **Inflation**

The inflation rate in July was 2.8 percent, compared with 2.1 percent in June. Over the month, consumer prices increased by 0.2 percent, underpinned by higher prices of heating & lighting, transport, alcoholic drinks & tobacco, food and miscellaneous items. The underlying measure of inflation, the trimmed mean, was 1.3 percent in July, up from 1.1

percent in the previous month.<sup>2</sup>

Looking ahead, factors that are expected to influence domestic inflation levels are the possible rises in prices of primary produce and taxi fares. On the international front, stronger oil prices are also expected to exert some upward price pressure. In view of this, the year-end inflation forecast is maintained at 4.5 percent.

### **Labour Market**

Conditions in the labour market have been relatively "soft" over the year, given the slowdown in certain sectors of the economy. Cumulative to July, around 5,100 individuals were registered as new taxpayers with the Fiji Islands Revenue and Customs Authority (FIRCA).<sup>3</sup> This equates to a fall of around 20 percent over the year. Registrations in most of the sectors fell, except for the construction, electricity & water and mining & quarrying sectors. Community, social and personal services sector recorded the most new taxpayers followed by the finance, insurance, real estate & business services; wholesale, retail trade, restaurants & hotels sector; manufacturing; construction and transport, storage & communication sectors.

On the wages front, the Public Service Commission recently approved an increment to the starting salary of graduate nurses by around 6.5 percent. In addition, an increased shift and supervisory allowance was approved.

### **Cane and Sugar**

The cane and sugar industries have been performing well. Recent data from the Fiji Sugar Corporation (FSC) suggests that total cane produced during the first 2 crushing months amounted to around 966,000 tonnes, around 37 percent more than the level recorded during the comparable period last year. The strong growth is partly due to the early start of the crushing season this year, when compared with the previous year.

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<sup>2</sup> The underlying measure of inflation removes substantial increases or decreases in prices of items present in the CPI basket, from its calculations. These extreme price movements may reflect seasonality patterns and/or government policy changes.

<sup>3</sup> From this year, FIRCA has been providing a breakdown of taxpayers, since as the aggregate total includes companies as well as those who register for tax and customs clearance. Private individuals refer to those joining the labour force. This will enable the tracking of the movement in private individuals. In total, cumulative to July, around 6,600 new taxpayers have been registered this year, which represented a decline of 20 percent from the corresponding period.

In line with good cane harvest, total sugar output totalled over 90,000 tonnes, representing 27 percent growth over the corresponding period last year. According to FSC, reasonable performance was noted across all the mills except for the Labasa Mill, which experienced plant breakdown. However, the tonnes cane to tonnes sugar (TCTS) ratio deteriorated slightly due to higher incidence of burnt cane during the review period.

### **Copra**

Copra production continued its rising trend. Latest statistics from the Coconut Industry Development Authority show that cumulative to June, copra production amounted to around 5,600 tonnes, representing an increase of almost 14 percent over the corresponding period in 2004.

In May, the minimum mill gate price of copra remained unchanged at \$500 per tonne. Government's subsidy towards the mill gate price was \$56.26 per tonne.

### **Electricity**

Cumulative to July, total electricity generated was around 404 million kilowatt hours, an increase of 5 percent over the same period last year. The steady growth in electricity generated for the year to date, is a partial indication of the steady growth in economic activity in the country.

### **Gold**

Cumulative to June, total gold output amounted to almost 46,000 ounces, 28 percent lower than the corresponding level in 2004. Gold earnings for the same period totaled \$32.6 million representing a decline of 26 percent over the comparable period last year.

### **Monetary Aggregates**

During the month of June, broad money continued to rise but at a slower rate of 13.7 percent (14.5% in May) to \$2.3 billion. The outturn was largely attributed to increases in narrow (19.5%) and quasi money (9.0%), which in turn was driven by higher demand and savings deposits.

The monetary expansion has been aided by the continued growth in credit in the banking system. Domestic credit grew by 17.0 percent during the review period to around \$2 billion, underpinned by higher credit to the private sector, which rose by 20.8 percent. Higher private sector credit was in turn largely influenced by the expansion in commercial bank lending. In the year to June 2005, the total value

of outstanding loans in the banking system increased by 20.6 percent to \$1.8 billion. This growth was largely driven by increased lending to private individuals (20.2%), wholesale & retail, hotels & restaurant (19.0%), real estate sectors (75.2%), followed by manufacturing (11.3%) and building & construction sectors (22.0%). Moreover, new loans by commercial banks stood at around \$88.5 million in June 2005, an increase of 36.8 percent and 29.8 percent over the month and year respectively.

Total loans and advances of LCIs grew at an annual rate of 16.4 percent during the review period to \$251 million, with more loans extended mainly to private individuals (mainly for consumption purposes).

On the supply side, total deposits with commercial banks totaled \$2.2 billion, an annual increase of 14.7 percent. This was largely due to higher demand deposits placed by private business enterprises and individuals. Movement in interest rates generally remained conducive to borrowing. At the end of June, the weighted average lending rate of commercial banks and LCIs declining by 5 basis points and 6 basis points to 6.77 percent and 11.48 percent, respectively. The time deposit rate also fell by 2 basis points to 1.78 percent, while the savings deposit rate rose marginally to 0.42 percent.

Similarly, interest rates on new deposit rate offered by commercial banks increased by 2 basis points to 1.53 percent, while the new lending rate fell by 77 basis points to 7.09 percent. This result was caused by extension of large amount of loans at lower lending rates. For LCIs, their interest rates offered on new loans and advances declined from 12.34 percent to 11.81 percent over the month and the new time deposit rates fell by 16 basis points to 3.49 percent at the end of June 2005.

### **External sector**

On the external front, latest Overseas Exchange Trade (OET) data showed that cumulative to June, merchandise exports fell by around 22 percent, compared with an increase of around 10 percent in the corresponding period last year. The decline in receipts was largely attributed to negative contributions from, textiles, clothing & footwear, sugar, merchanted goods, fish, other exports, gold and timber, which more than offset positive contributions from ginger, other re-exports and mineral water.

During the same period, merchandise imports rose by around 4 percent, compared to a growth of around 16 percent in the corresponding period in 2004. The

increase in import payments was due to positive contributions from investment goods (3.7 percent) and intermediate goods (2.1 percent). The growth in investment goods was largely made up of increases in imports of machinery & electrical equipment and chemicals, while the rise in mineral fuels payments underpinned the growth in intermediate goods. The growth in these particular imported goods more than offset the fall in consumption goods (-1.8 percent), which was largely made up of declines in other imports, food, beverages & tobacco and transport equipment.

In the revised trade forecast<sup>4</sup> released by the Macroeconomic Policy Committee, domestic exports (excluding aircraft) for 2005 are expected to grow by a slow pace of 1.9 percent, which is considerably lower than the 4.9 percent growth envisioned earlier for the year. The downward revision was mainly due to the larger-than-expected decline in garment receipts, coupled with negative contributions from gold. Imports growth for the year, was also revised downwards by 0.5 percentage points to 6.6 percent.

This was underpinned by the lower-than-anticipated growth in imports of consumption and investment goods.

### **Exchange Rates**

In July 2005, the performance of the Fiji dollar was mixed against the major currencies. Bilateral movements in the exchange rate showed that the Fiji dollar strengthened against the New Zealand dollar (1.7%) and the Yen (1.0%), but weakened against the Euro (1.1%), US (0.5%) and Australian dollars (0.3%).

The Nominal Effective Exchange Rate (NEER)<sup>5</sup> index of the Fiji dollar rose by 0.3 percent in the year to July, indicating an appreciation of the Fiji dollar against the basket of currencies. The Real Effective Exchange Rate (REER)<sup>6</sup> index of the Fiji dollar (a measure of our international competitiveness) rose by 0.9 percent during the review period, implying a deterioration in competitiveness of our exports. The rise in REER was largely attributed to the higher domestic inflation expectations.

## **RESERVE BANK OF FIJI**

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<sup>4</sup> The assumptions for the trade projections are based on the available accrual trade data (cumulative to March 2005), released by the Fiji Islands Bureau of Statistics. Exports rose by around 26 percent cumulative to March this year, compared to a decline of around 3 percent in the corresponding period last year. On the other hand, Imports increased by around 12 percent, compared to a 5 percent increase during the same period last year.

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<sup>5</sup> 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.

<sup>6</sup> 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.

## FIJI: FINANCIAL STATISTICS

<b>KEY INDICATORS</b>	<b>Jul-05</b>	<b>Jun-05</b>	<b>May-05</b>	<b>Jul-04</b>
<b>1. Money and Credit</b> (year-on-year % change)				
Narrow Money	n.a.	19.48	22.77	29.35
Currency in Circulation (monthly average)	9.14	-0.36	8.33	13.21
Quasi-Money (Time & Saving Deposits)	n.a.	8.97	7.84	9.90
Domestic Credit	n.a.	16.99	15.19	11.63
<b>2. Consumer Prices</b> <sup>1/</sup> (year-on-year % change)				
All Items	2.8	2.1	2.5	2.8
Food	3.3	1.5	1.4	5.2
<b>3. Reserves</b> (end of period)				
Gross Foreign Reserves (\$m)*	954.6	991.6	990.8	980.7
Months of Imports (goods & non factor services)	4.0	4.2	4.2	4.4
Months of Imports (goods)	5.4	5.6	5.6	6.6
<b>4. Liquidity</b> (end of period)				
Liquid Assets Margin to Deposit Ratio (%)	n.a.	10.4	11.5	13.3
Banks' Demand Deposits (\$m)	n.a.	107.7	127.6	87.0
<b>5. Interest Rates (% p.a.)</b> (monthly average)				
Lending Rate (Excluding Staff)	n.a.	6.77	6.82	7.13
Savings Deposit Rate	n.a.	0.42	0.38	0.35
Time Deposit Rate	n.a.	1.78	1.80	1.73
91-day RBF Note Rate (month end)	1.75	1.75	1.75	1.75
Minimum Lending Rate (MLR) (month end)	2.25	2.25	2.25	2.25
Overnight Inter-bank Rate	1.00	1.16	n.t.	0.82
5-Year Government Bond Yield	2.74	2.74	2.71	2.55
10-Year Government Bond Yield	5.30	5.27	5.23	4.66
<b>6. Exchange Rates</b> <sup>2/</sup> (mid rates, F\$1 equals) (end of period)				
US dollar	0.5848	0.5876	0.5927	0.5579
Pound sterling	0.3330	0.3255	0.3250	0.3073
Australian dollar	0.7692	0.7715	0.7793	0.7971
New Zealand dollar	0.8546	0.8401	0.8326	0.8798
Swiss francs	0.7517	0.7541	0.7341	0.7144
Euro	0.4818	0.4871	0.4752	0.4633
Japanese yen	65.56	64.94	64.00	62.49
<b>7. Commodity Prices (US\$)</b> (monthly average)				
UK Gold Price/fine ounce <sup>2/</sup>	424.86	429.96	422.61	398.29
London Daily Sugar Price/tonne <sup>3/</sup>	266.60	258.84	252.99	225.01
Crude Oil/barrel <sup>4/</sup>	57.58	54.34	48.55	38.37
<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>				