RESERVE BANK OF FIJI

ECONOMIC REVIEW

Vol. 22 No. 09 Month Ended September 2005

OVERVIEW

Despite soaring crude oil prices, the global economy maintains a reasonable pace of expansion. Against this backdrop, growth prospects for our trading partners and selected non-Japan Asian Countries (China, Hong Kong and Singapore) remains favourable. Preliminary assessment by international commentators suggests that hurricane Katrina is not expected to seriously dampen the growth projection for the US.

Developments on the domestic front have remained mixed. Consumer demand has gathered pace, supported by strong credit, despite indications of a softening in labour market conditions this year. Lower interest rates and a strong tourism sector have continued to bolster investment levels. In addition, inflation remains low due to the abundance of locally produced goods in the market. Conversely, exports have remained depressed, whilst record high crude oil prices continue to fuel the imports bill.

Sectoral performances were largely unchanged during the first eight months of the year. The wholesale and retail trade industry recorded strong sales growth, evident by the 13 percent rise in domestic Value Added Tax (VAT) collections[1]. Optimism in the sector remains high, as indicated by the Bank's recent June Retail Sales Survey. Sugar production also improved over the year. Electricity production continues to show positive growth, and remains a positive indicator of economic activity in the country.

Labour market conditions however have continued to ease. A partial indicator, new individual taxpayer registrations with the Fiji Islands Revenue and Customs Authority (FIRCA), showed a decline in registrations by around 19 percent over the year.

Inflation in August stood at 2.2 percent, compared with 2.8 percent in July. The underlying measure of inflation, the trimmed mean, was 1.3 percent. The effects of higher fuel prices have to some extent been offset by lower prices of domestically produced goods and services. As such, the year-end inflation is now forecast at around 3 - 4 percent.

On the fiscal front, contemporary figures released by the Ministry of Finance indicates that cumulative to July, Government's underlying deficit was around $64.2 million (1.3 percent of GDP), compared with $191.2 million (4.6 percent of GDP) that was budgeted for the period. The deficit position was underpinned by a 6.6 percent increase in net expenditure and 1.6 percent deterioration in net revenue. Cumulative to August, total Government debt was around $2.4 billion, or around 49 percent of GDP.

Monetary and credit aggregates also rose during the review period. Broad money increased by 16.2 percent in the year to July, following an annual growth of 13.7 percent in June. The outturn was largely attributed to higher demand, savings and time deposits. Similarly, domestic credit recorded an annual growth rate of 20 percent, spurred by higher credit to the private sector and government. The increase in private sector borrowings arose largely from lending for housing purposes, which recorded a strong annual growth of 22 percent. New loans provided by commercial banks also grew strongly by 33 percent. In addition, total loans and advances of licensed credit institutions (LCIs) grew by around 15 percent, the majority of which were extended to private individuals for consumption purposes.

Interest rates movements were mixed in July. Interest rates on time deposits rose slightly to 1.81 percent, the

[1] Percentages are reported as annual growth rates, unless stated otherwise.

savings deposit rates fell to 0.40 percent, while the weighted average lending rate remained unchanged at 6.77 percent. During the period, there were some upward pressures on new deposits and lending rates. Interest rates on new time deposits increased marginally to 1.54 percent, while the new lending rate increased by 35 basis points to 7.44 percent.

On the external front, the Overseas Exchange Transactions data showed that cumulative to July, merchandise exports fell by around 19 percent. Conversely, merchandise imports rose by around 11 percent, spurred by increases in inflows of intermediate, investment and consumption goods.

Foreign reserves are expected to remain at adequate levels this year. Official reserves at the end of September stood at around $940 million, sufficient to cover 3.9 months of imports of goods and non-factor services, or 5.3 months of imports of goods only.

SECTORAL DEVELOPMENTS

On balance, developments on the domestic front generally remained positive during the review period. In the real sector, cane & sugar output, and electricity production recorded good growth. In terms of aggregate expenditure, consumption spending grew robustly during the first 8 months of the year. This is in line with the findings of the Bank's recent June Retail Sales Survey, which projects growth in retail sales this year by around 8.0 percent. Provisional statistics on public finance suggests a lower than expected underlying government deficit for the first 8 months of the year.

Consumption

Consumption remained buoyant, as evident by the growth in partial indicators of consumer spending. Cumulative to August, net VAT collections amounted to $264 million, an increase of around 3.0 percent compared with the same period last year. However, cash collections from domestic activities (viewed as a better indicator of consumer spending) grew by 13 percent during the review period, to around $140 million. From the basis of these partial indicators, consumer spending appears to have regathered momentum, following the relatively slower pace seen in the last few months.

Income

Total income tax collections rose over the year. According to FIRCA, total income tax revenue amounted to around $201 million, around 8.0 percent higher than the level recorded during the comparable period last year. PAYE tax collections, a partial indicator of individual incomes, totalled around $118 million, representing a 5 percent increase over the previous comparable period.

Inflation

The inflation rate in August was 2.2 percent, compared with 2.8 percent in July. Over the month, consumer prices declined by 0.7 percent, underpinned by lower prices of food and alcoholic drinks & tobacco. The underlying measure of inflation, the trimmed mean, was 1.3 percent in August, up from 1.2 percent in the previous month.

The effects of higher fuel prices have to some extent been offset by lower prices of domestically produced goods and services. As such, the year-end inflation is now forecast at around 3-4 percent.

Labour Market

Labour market conditions, although positive, is showing signs of a slowdown. Cumulative to August, individuals registered as new taxpayers with the Fiji Islands Revenue and Customs Authority (FIRCA) totalled about 5,300. This represents a fall of around 19 percent over the year. However, registrations were high in the construction; mining & quarrying; electricity & water; transport, storage & communication and finance, insurance, real estate & business services sectors.

Cane and Sugar

The cane and sugar industries recorded good outturn during the season to August. According to the Fiji Sugar Corporation (FSC), total cane harvested amounted to around 1.5 million tonnes, which was 30 percent more than the level recorded during the comparable period last year. In line with good cane production, total sugar output amounted to around 147,000 tonnes, representing a 25 percent rise over the corresponding period last year. According to FSC, the growth was largely underpinned by consistent supply of cane to the mills. However, the relatively higher rainfall in August coupled with increased incidences of burnt cane led to a slight deterioration of the tonnes cane to tonnes sugar (TCTS) ratio.

Electricity

Electricity production held up well during January to August. Total electricity generated was around 455 million-kilowatt hours (kwh), an increase of around 4 percent on an annual basis during the review period.

The consistent growth in electricity production serves as a positive indicator of economic activity in the country.

Business Expectations Survey

The Reserve Bank of Fiji conducted its latest Business Expectations Survey (BES) in June this year. The prospects for general business conditions in the short term remained relatively encouraging; with a net[2] 40 percent of respondents expecting business to pick up in the quarter ahead. The tourism, finance and non-garment manufacturing industries and the building & construction sector largely underpinned the positive growth outlook. As for the 12-month outlook, sentiments were downcast by 17 percentage points. However, a net 33 percent of respondents remained optimistic about the medium-term outcome. Relatively stronger expectations were noted from the building & construction sector and the insurance, non-garment manufacturing and tourism industries.

Retail Sales Survey

The June 2005 survey results suggest that retail sales this year will increase by around 8.0 percent, slightly higher than the projection indicated in the December 2004 survey (6.0 percent). The improved outlook for sales this year is underpinned by better sales prospects in the duty free retailing; food, drinks & tobacco; building materials & hardware; household goods & appliances; motor cars & other transport equipment and clothing & textile categories.

The revised forecast for this year is consistent with growth in some of the partial indicators of retail sales and consumer spending. Domestic VAT cash collections, for instance, grew by almost 13 percent cumulative to August. Imports of consumption items also rose marginally (1 percent) while currency in circulation increased by around 10 percent in the year to July. Increase in retail sales this year is likely due to expansion in local demand reflected in good consumption trends, increased tourism activity and the growth in construction activities

Public Finance

The Government underlying balance remained low during the January to July period this year. Recently released data by the Ministry of Finance indicates that the cumulative to July, the underlying deficit was around $64.2 million, equivalent to 1.3 percent of GDP. The deficit position was mainly underpinned by a 7.0 percent increase in net expenditure and 1.6 percent deterioration in net revenue. On a brighter note, the deficit outturn was well below the target of $191.2 million, or 4.6 percent of GDP for the same period. In addition, the capital/operating mix was 11:89 during the review period, with Government incurring lower-than-budgeted level of capital expenditure, aimed mainly at capital transfers and purchases.

Government Debt

Total outstanding Government debt continued to expand during the first 8 months of the year. At the end of August this year, total Government debt totalled around $2.4 billion, or around 49 percent of GDP. Total outstanding domestic debt constituted 93 percent of government debt, while the balance represented borrowings from external parties. The year-end forecast for total Government debt stands at 51 percent of GDP.

Monetary Aggregates

Broad money rose in the year to July, expanding by 16.2 percent following an annual growth of 13.7 percent in June. The outturn was largely attributed to increases in narrow and quasi money, which in turn was influenced, by rises in demand, savings and time deposits. The demand for funds also rose during the review period, with domestic credit recording an annual growth rate of 20 percent. The outturn was spurred by higher credit to the private sector and government, which rose by 22 percent and 19 percent respectively, over the year. The increase in the former was in turn underpinned by higher commercial bank lending which continued to grow strongly in the year to July, increasing by 21 percent to around $1.8 billion. This outcome was largely due to increased lending for the housing purposes of private individuals (22 percent), professional & business services (77 percent), manufacturing (14 percent) and building & construction (14 percent) sectors.

The value of loans outstanding for housing purposes increased by around $88 million to $475 million, over the year, at the end of July. Additionally, new loans provided by commercial banks during the same period totalled $71.4 million. Although this was a 19 percent decline over the month, it still represented 33 percent increase over the corresponding period last year. The growth was largely driven by higher credit to private individuals and, to a smaller extent, the transport & storage, agricultural and building & construction sectors.

[2] Net is calculated by subtracting the number of respondents expecting a decrease from the number of respondents expecting an increase.

On a cumulative basis, the total value of new loans disbursed by commercial banks in the first 7 months of this year equated to $500 million, a 28 percent increase over the same period in 2004. Moreover, total loans and advances of licensed credit institutions (LCIs) grew by 15.2 percent in the year to July to $255.3 million, with more loans extended mainly towards consumption purposes of private individuals. Collectively, the value of loans outstanding to commercial banks and LCIs in the financial system is around $2 billion. The outturn can be attributed to various factors, chief among which is the high demand for loans and low interest rates prevailing in the market.

On the supply side, commercial bank deposits in the year to July grew at an annual rate of 16.6 percent to $2.2 billion. There was a general increase across all types of deposits, with significant expansion noted in the value of demand and savings deposits of private business enterprises and private individuals.

Interest Rates

Movement in outstanding commercial bank interest rates were generally mixed during the review period. The commercial bank weighted average time deposit rate rose by 3 basis points to 1.81 percent while the savings deposit rate declined by 2 basis points to 0.40 percent. The weighted average lending rate remained unchanged at 6.77 percent. In contrast, the outturn in commercial bank weighted average interest rates on new deposits and loans reveal an upward trend. Interest rates on new bank time deposit increased marginally to 1.54 percent, while the new lending rate increased by 35 basis points to 7.44 percent.

Interest rates offered by LCIs on outstanding loans and deposits declined during the review period. The average lending rate and time deposits rate both fell by 5 basis points to 11.43 and 4.14 percent respectively. The new time deposit rate of LCIs was also down by 47 basis points to 3.02 percent. Conversely, the new lending rate rose by 15 basis points to 11.96 percent.

External sector

On the external front, latest Overseas Exchange Trade (OET) data showed that cumulative to July, merchandise exports fell by around 19 percent, compared with an increase of around 9 percent in the corresponding period last year. The decline in receipts was largely attributed to negative contributions from textiles, clothing & footwear, sugar, fish, merchanted goods, other exports, gold and timber. This more than offset growth in exports of ginger, re-exports of mineral fuel and mineral water.

During the same period, merchandise imports rose by around 11 percent, compared to a growth of around 23 percent in the corresponding period in 2004. The increase in import payments was due to positive contributions from intermediate goods (5.4 percent), investment goods (4.7 percent) and consumption goods (0.5 percent). The increase in imports of intermediate goods was largely made up of increases in mineral fuels and textiles, while the rise in investment goods was underpinned by the increase in payments for machinery & electrical equipment and chemicals. The higher payment for consumption goods was largely attributed to the increase in contribution from duty free goods, government imports and merchanted goods.

Exchange Rates

Bilateral movements in exchange rate reveal that the Fiji dollar generally weakened against major trading partner countries in August. With the exception of the Aussie dollar, against which the Fiji Dollar strengthened by 1.3 percent, the domestic currency fell against the Yen (1.0 percent), Euro (1.0 percent), NZ (1.0 percent), and US dollar (0.3 percent).

In August, the Nominal Effective Exchange Rate (NEER) index of the Fiji dollar fell by 0.3 percent over the previous month. Similarly, the Real Effective Exchange Rate (REER) Index of the Fiji dollar, a gauge of our international competitiveness, fell by 1.1 percent during the same period. The decline in the REER Index over the month reflects an improvement in our international competitiveness and was largely due to a general depreciation in the domestic currency.

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FIJI: FINANCIAL STATISTICS

KEY INDICATORS	Aug-05	Jul-05	Jun-05	Aug-04
1. Money and Credit				
(year-on-year % change)				
Narrow Money	n.a.	23.47	19.48	39.49
Currency in Circulation (monthly average)	n.a.	9.14	-0.36	14.20
Quasi-Money (Time & Saving Deposits)	n.a.	10.10	8.97	7.45
Domestic Credit	n.a.	20.00	17.01	12.17
2. Consumer Prices 1/				
(year-on-year % change)				
All Items	2.2	2.8	2.1	2.9
Food	1.8	3.3	1.5	3.1
3. Reserves				
(end of period)				
Gross Foreign Reserves ($m)*	958.7	954.6	991.6	1002.6
Months of Imports (goods & non factor services)	4.0	4.0	4.2	4.5
Months of Imports (goods)	5.4	5.4	5.6	6.8
4. Liquidity				
(end of period)				
Liquid Assets Margin to Deposit Ratio (%)	n.a.	11.4	10.4	13.9
Banks' Demand Deposits ($m)	n.a.	127.0	107.7	92.6
5. Interest Rates (% p.a.)				
(monthly average)				
Lending Rate (Excluding Staff)	n.a.	6.77	6.77	7.17
Savings Deposit Rate	n.a.	0.40	0.42	0.36
Time Deposit Rate	n.a.	1.81	1.78	1.77
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	1.27	1.00	1.16	0.80
5-Year Government Bond Yield	2.73	2.74	2.74	2.57
10-Year Government Bond Yield	5.34	5.30	5.27	4.76
6. Exchange Rates 2/				
(mid rates, F$1 equals)				
(end of period)				
US dollar	0.5831	0.5848	0.5876	0.5613
Pound sterling	0.3264	0.3330	0.3255	0.3125
Australian dollar	0.7794	0.7692	0.7715	0.8023
New Zealand dollar	0.8461	0.8546	0.8401	0.8625
Swiss francs	0.7398	0.7517	0.7541	0.7178
Euro	0.4771	0.4818	0.4871	0.4656
Japanese yen	64.89	65.56	64.94	61.69
7. Commodity Prices (US$)				
(monthly average)				
UK Gold Price/fine ounce 2/	437.74	424.86	429.96	399.75
London Daily Sugar Price/tonne 3/	264.22	266.60	258.84	216.22
Crude Oil/barrel 4/	64.09	57.58	54.34	43.03

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