RESERVE BANK OF FIJI

ECONOMIC REVIEW

Vol. 27 No. 7 Month Ended. July 2010

The International Monetary Fund (IMF) revised upwards its 2010 world growth forecast in July following a strong global recovery during the first half of this year. The world economy is now expected to grow by 4.6 percent in 2010, before slowing to 4.3 percent next year. Despite improved expectations, the IMF has cautioned that surrounding sovereign and financial sector risk in the Euro Area could pose difficulties for both financial stability and the economic outlook. On a positive note, however, the well-coordinated polices undertaken recently are expected to gradually rebuild confidence and stabilise financial market conditions in Europe.

On the domestic economy, positive sector performances were noted. Visitor arrivals in the first five months of 2010 rose strongly by 21.4 percent over the same period last year. Improved global recovery coupled with package deals offered by tourism stakeholders have contributed positively towards this outcome. The introduction of new air routes and the reduction in fiscal duty for Jet Skis in the recent 2010 Revised Budget are also favourable for the industry.

Gold production cumulative to June showed a substantial improvement over the same period last year. Investment in new capital machinery and equipment by Vatukoula Gold Mines and the venture into surface mining contributed to this growth. The industry has also benefited from extremely favourable gold prices in the world market.

Electricity production rose by 8.1 percent over the same period, reflecting increased energy demand from industrial and commercial users.

Consumer spending remained buoyant during the first five months of the year as suggested by partial indicators. Cumulative to May, net Value Added Tax (VAT) collections rose annually by 11.8 percent while commercial banks' outstanding lending for consumption purposes increased by 3.3 percent.

Partial indicators of income also reflect rising income levels supporting consumption. Cumulative to May, Pay As You Earn (PAYE) collections rose by 1.2 percent on an annual basis. Inward personal remittances rose strongly in the first half of this year. Employment conditions have also improved over the same period, evidenced by increases in partial indicators of employment and survey data.

On the other hand, cumulative to June, new vehicle sales declined by 27.6 percent. However, the recent reduction in import duties is expected to stimulate demand for new vehicles, further supporting economic activity.

Partial indicators for investment reveal subdued activity in the first five months of the year. Commercial banks outstanding lending for investment purposes slowed on an annual basis, to a growth of 7.4 percent in May, against a growth of 9.7 percent in the previous year. In addition, imports of investment goods fell annually by 3.3 percent in March.

On the banking sector, yearly growth in broad money slowed further to 8.4 percent in May, from 9.9 percent in April. The deceleration in broad money growth was underpinned by the slowdown in both time and savings deposits. Commercial bank credit expanded marginally by 0.3 percent, in the year to May, a slowdown from a growth of 8.2 percent a year ago.

Liquidity conditions in the banking system remain stable despite a decline of around $25 million in

July to current levels of around $219 million. The decline in bank liquidity is attributed to an increase in the statutory reserve deposits (SRD), following an increase in the SRD requirement from 8.5 percent to 10 percent, effective 7 July.

Both the new and outstanding weighted average lending rates of commercial banks rose over the month by 24 and 3 basis points to 8.38 and 7.54 percent, respectively in May. Savings deposit rates rose by 8 basis points to 1.06 percent over the same period while both new and existing time deposit rates fell by 39 and 23 basis points to 5.83 and 5.63 percent, respectively.

Inflation slowed to 5.5 percent in June from 9.4 percent in May. On a monthly basis, consumer prices fell by 0.7 percent, due to relatively lower prices for heating & lighting, transport and some food items. The inclusion of VAT on certain insurance products, as announced in the 2010 Revised Budget, is expected to have a minimal impact on inflation while the increase in electricity tariff for commercial and industrial users poses an upside risk. On balance, the year-end inflation forecast remains intact at 5.0 percent.

On the external front, the merchandise trade deficit narrowed significantly cumulative to March, by around 21 percent, to $358 million. Domestic export earnings grew by 16.6 percent in the same period. The increase was led by fish, mineral water, timber, gold and biscuits which more than offset the decline in export earnings from sugar. Including re-exports, total export earnings rose by 11.1 percent, compared to a 13.0 percent decline in the same period last year.

Over the same period, import payments (excluding aircraft) fell by around 9.6 percent, compared with a small decline of 0.2 percent in the same period last year. The decline was led by lower payments for all categories of imports: consumption goods (-12.4 percent), intermediate goods (-11.1 percent) and investment goods (-3.3 percent).

As at 30th July 2010, foreign exchange reserves were around $1,139 million, equivalent to around 3.6 months of imports of goods and non-factor services.

Over the month of June, the Fiji dollar gained strength against the Euro (1.3%), the US dollar (0.7%) and the Australian dollar (0.2%) but weakened against the Japanese Yen (2.0%) and the New Zealand dollar (1.4%). As a result, the Nominal Effective Exchange Rate (NEER)[1] index rose marginally by 0.1 percent in June, reflecting a marginal appreciation of the Fiji dollar against our major trading partner currencies. Similarly, on an annual basis, the NEER index rose by 1.2 percent.

The Real Effective Exchange Rate (REER)[2] index fell over the month of May by 1.3 percent, indicating an improvement in our international competitiveness relative to the major trading partner currencies. The decrease in the REER index is largely attributed to a fall in domestic inflation over the month, when compared with the average inflation of our trading partners. However, on an annual basis, the REER index rose by 4.6 percent.

RESERVE BANK OF FIJI

[1] The NEER index is the sum of the indices of each trading partner country's currency against the Fiji dollar, adjusted by their respective weights in the basket. 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.

[2] 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. The index measures the competitiveness of the Fiji dollar against the basket of currencies. A decline in REER index indicates an improvement in Fiji's international competitiveness.

FIJI: FINANCIAL STATISTICS

	Jun-10	May-10	Apr-10	Jun-09
KEY INDICATORS				
1. Money and Credit				
(year-on-year % change)				
Narrow Money	n.a	2.1	2	-26.8
Currency in Circulation (monthly average)	n.a	9.5	10.1	2.9
Quasi-Money (Time & Saving Deposits)	n.a	12.5	15.3	14.6
Domestic Credit	n.a	2.9	3.9	4.5
2. Consumer Prices *				
(year-on-year % change)				
All Items	5.5	9.4	10.5	2.3
Food	3.3	6.5	8.6	5.4
3. Reserves				
(end of period)				
Foreign Reserves ($m) [1/]	1138.8(p)	1090.8(p)	1083.9(p)	650.0
4. Liquidity				
(end of period)				
Liquid Assets Margin to Deposit Ratio (%)	n.a	n.a	12.0	5.8
Banks' Demand Deposits ($m)	301.4	301.4	349.0	146.9
5. Interest Rates (% p.a.)				
(monthly average)				
Lending Rate (Excluding Staff)	n.a	n.a	7.51	8.30
Savings Deposit Rate	n.a	n.a	0.98	0.73
Time Deposit Rate	n.a	n.a	5.86	4.77
14-day RBF Note Rate (month end)	2.88	2.88	n.i.	n.i.
Minimum Lending Rate (MLR) (month end) [2/]	3.00	3.00	2.10	3.00
Overnight Inter-bank Rate	1.00	1.00	0.10	1.00
5-Year Government Bond Yield	n.i.	n.i.	n.i.	8.15
10-Year Government Bond Yield	n.i.	n.i.	n.i.	10.52
6. Exchange Rates **				
(mid rates, F$1 equals)				
(end of period)				
US dollar	0.5003	0.4970	0.5215	0.4871
Pound sterling	0.3319	0.3448	0.3404	0.2940
Australian dollar	0.5894	0.5880	0.5622	0.6027
New Zealand dollar	0.7229	0.7330	0.7209	0.7488
Swiss francs	0.5412	0.5761	0.5652	0.5275
Euro	0.4105	0.4054	0.3942	0.3459
Japanese yen	44.32	45.20	49.06	46.78
7. Commodity Prices (US$) **				
(monthly average)				
UK Gold Price/fine ounce	1231.80	1202.94	1145.50	948.02
CSCE No. 11 Sugar Spot Price/Global (US cents/Pound)	21.24	19.59	19.87	16.94
Crude Oil/barrel	74.88	76.25	84.95	65.56

n.a. - Not available/No activity

n.i. - No issues

n.t. - No trading

[1/] Foreign reserves includes monetary gold, Special Drawing Rights, reserve position in the Fund and foreign exchange assets consisting of currency and deposits actually held by the Reserve Bank, as at 30 July 2010.

[2/] With the introduction of the new Monetary Policy Framework on 17 May 2010, the minimum lending rate was set at 50 basis points above the Overnight Policy Rate.

Sources: [*] *Fiji Islands Bureau of Statistics*

[**] *Bloomberg*