RESERVE BANK OF FIJI

QUARTERLY REVIEW

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QUARTERLY REVIEW OF THE ECONOMY & FINANCIAL CONDITIONS

OVERVIEW

Global growth for 2008 has been downgraded following the recent financial market turmoil and the associated weakening of the United States (US) economy. The International Monetary Fund (IMF) estimates that world economic growth for this year will slow to 3.7 percent, from an estimated 4.9 percent expansion last year.

While central banks in the developed countries have co-ordinated their efforts to calm financial markets, down side risks to world growth remain. At the forefront of this are potential inflationary pressures stemming from the volatile oil market and rising prices of various other commodities.

However, growth in emerging economies, in particular China, India and Brazil, remain robust. These economies continue to perform well and contribute close to two-thirds of world economic growth.

Monetary policy actions by our major trading partner countries varied during the quarter. On the one hand, the US Federal Reserve reduced interest rates three times so far this year to help the economy recuperate, complemented by a fiscal stimulus package. On the other hand, the Reserve Bank of Australia hiked interest rates twice, as inflationary pressures persisted. The central banks of Fiji's other major trading partners kept their key interest rates unchanged.

On the domestic front, the economy is now estimated to have contracted by 4.4 percent in 2007 due to weaker-than-expected performances in the manufacturing, agriculture, forestry, fishing & subsistence, community, social & personal services and building & construction sectors.

Although a turnaround in economic activity is anticipated this year, it is now expected to be more modest than earlier anticipated. The economy is now forecast to grow by 1.7 percent, lower than the 2.2 percent growth forecast earlier. Growth in 2008 is expected to be almost broad based, with all sectors of the economy growing, except finance, insurance, real estate & business services and community, social and personal services.

In line with the slower growth expected this year, partial indicators of consumer demand posted small gains in the first quarter. Imports of consumption goods rose, while lending for consumption purposes recorded a small growth. In addition, Value added Tax (VAT) collections grew by just over a percent, on an annual basis. Positive outcomes were also recorded in the tourism, mining and electricity sectors.

The annual inflation rate peaked at a 10-year high of 7.5 percent in March 2008. The increase was led by a number of factors, including soaring oil and food prices, higher bus fares and flag fall rate for taxis and an increase in the electricity fuel surcharge. Looking ahead, inflationary pressures are expected to remain, given the rising commodity and volatile crude oil prices.

According to revised data from the Ministry of Finance, the Government recorded a deficit of $71.6 million or 1.3 percent of GDP in 2007, compared with a deficit of 2.9 percent in 2006. For 2008, a budget deficit of 2.0 percent of GDP has been projected.

Although Fiji's trade imbalance remained large, it narrowed by 12.6 percent in 2007. The improvement in the trade deficit was largely due to a reduction in imports; exports also rose, albeit marginally. The decline in import payments mirrored the weak domestic economy and was reflected in lower payments for investment, intermediate as well as consumption goods.

Cumulative to February 2008, both exports and imports rose over the same period last year.

At the end of March 2008, gross foreign reserves were $908.7 million, sufficient to cover 3.8 months of import payments for goods.

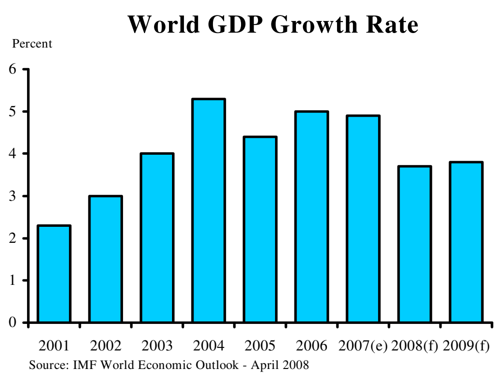
The monetary policy stance was unchanged throughout the quarter with open market operations remaining suspended and the credit ceiling still in place.

THE INTERNATIONAL ECONOMY

International Economic Conditions

The global economic expansion has been losing momentum since the beginning of the year, mainly due to the effects of the financial turmoil and the associated economic slowdown in the US. Growth in emerging and developing economies, however, remained robust despite signs of slowing economic activity in some countries. The IMF has revised the growth forecast for the world economy downwards to 3.7 percent this year from 4.1 percent envisaged earlier. Growth next year is projected at 3.8 percent (Graph 1).

Graph 1



Tightening financial conditions in the developed world, particularly in the US and the European countries, have led to a co-ordinated effort by their central banks to provide adequate liquidity to their banks. This is expected to calm financial markets and ease the dampening effects on housing and other corporate sectors in these economies.

Risks to the world growth outlook are on the downside, with the potential effect of a further slowdown in economic activity. This is underpinned by the uncertainty associated with the full-blown effects of the financial market crisis on the world economy. Moreover, inflationary pressures stemming from the volatile oil market and, to a lesser extent, the persistent large global imbalances, could also derail global growth.

Monetary policy actions were mixed during the quarter as central banks were faced with the challenge of balancing downside risks to growth against upside risks to inflation. The US Federal Reserve cut its key interest rate three times during the quarter, by a total of 200 basis points, to mitigate the risks to economic activity and to promote moderate growth over time. However, persistent inflationary pressures have led the Reserve Bank of Australia (RBA) to raise rates twice by 25 basis points each time, while interest rates in New Zealand and the Euro zone remained unchanged. The Bank of Japan kept its policy interest rate at 0.5 percent while it continues to monitor developments closely.

In the international financial markets, equities generally fell over the March quarter this year while bond markets recorded mixed performances. In the foreign exchange market, the US dollar weakened against all of Fiji's major trading partner currencies.

Fiji's major trading partner countries are expected to achieve positive growth rates in 2008, however at a slower pace relative to the previous year. In the US, the housing market has deteriorated and its impact has been felt on other areas of spending. Domestic economic conditions in Japan appear to have softened, with business sentiments weakening and household sector conditions deteriorating. Furthermore, in the Euro zone, tight banking standards and an appreciating Euro are expected to weigh on the region's economic growth prospects. The Australian economy has remained robust in recent periods, notwithstanding a more difficult international environment, while the New Zealand economy is also expected to remain healthy (Graph 2).

Graph 2

In the fourth quarter of 2007, the Australian economy grew by only 0.6 percent compared with a revised 1.1 percent growth recorded during the third quarter. Overall, the economy expanded strongly in 2007, by 3.9 percent, fuelled by a surge in construction activity and retail sales.

Economic indicators over the current quarter show a mixed performance. An expansion in Australia's construction industry accelerated in December, boosted by new infrastructure projects and commercial property building. Retail sales continued its increase in December, supported by the lowest unemployment rate in 33 years and rising wages.

On a negative note, an index of Australia's leading economic growth indicators fell in January, for a second month, signalling the nation's 16-year expansion may be cooling. Moreover, Australia posted its second-largest trade deficit in January, as imports rose and floods disrupted exports of coal. Inflation also surged to 4.0 percent in March from a year earlier, breaching the 3.0 percent limit of the RBA's target range. Consumer confidence fell in March, for a third month, after the central bank raised interest rates and the share market tumbled on concerns of slowing global economic growth.

The RBA increased its benchmark interest rate in February this year by 25 basis points and by another 25 basis points in March to 7.25 percent to contain inflation over the medium term.

The economy is forecast to grow by 3.2 percent this year, from an estimated 3.9 percent growth last year, driven by business investment and retail sales. For 2009, the Australian economy is expected to slow to 3.1 percent. Consumer prices are expected to pick up in 2008 from an estimated 2.3 percent last year to 3.5 percent, beyond the RBA's target band of 2-3 percent. For 2009, consumer prices are forecast at 3.3 percent.

For New Zealand, recent economic indicators showed that retail sales rose in January driven by higher food and fuel prices. In addition, the annual trade deficit narrowed in January, underpinned by soaring prices for dairy products which buoyed export earnings. Furthermore, New Zealand's unemployment rate fell to a record low of 3.4 percent in the December quarter, from 3.5 percent in the third quarter.

On the downside, business confidence fell to a 17-year low in March, led by retailers and home builders' expectations of slowing growth this year. Inflation also surged to 3.2 percent in the fourth quarter from a year earlier as travel and food costs increased, while consumer confidence fell to an 18-month low in the fourth quarter.

The Reserve Bank of New Zealand (RBNZ) kept its key interest rate unchanged at 8.25 percent throughout the March quarter, on expectations that slowing economic growth would abate inflationary pressures.

This year the New Zealand economy is projected to grow by 2.0 percent, from an estimated 3.0 percent expansion in 2007. A 2.1 percent growth is envisaged for 2009. Year-end inflation is expected at 3.4 percent this year, up from 2.4 percent recorded in 2007. In 2009, inflation is expected to be 2.7 percent.

The US economy slowed in the last quarter of 2007 growing at an annualised rate of 0.6 percent compared to 4.9 percent in the third quarter, weakened by a deepening housing mortgage crisis.

Latest economic indicators for the quarter were weak. The index of leading US economic indicators fell in February, for a fifth straight month, reflecting signs of a recession. In addition, US consumer confidence fell in February, to the lowest level in five years while the service industries contracted in January, at the fastest pace since 2001. Moreover, consumer prices rose in January, led by increases in food and energy costs, rents and apparel prices.

The Federal Reserve cut its benchmark interest twice in January (75 basis points on the 22^{nd} and 50 basis points on the 30^{th} of the month) to 3.0 percent from 4.25 percent. The action was taken in view of the weakening economic outlook. The Federal Reserve further cut its benchmark interest rate on 18th March by 75 basis points to 2.25 percent. The action was taken, combined with those earlier, to promote moderate growth over time and to mitigate the risks to economic activity.

The economy is expected to grow by 0.5 percent this year, after an estimated 2.2 percent growth last year, largely attributed to anticipated declines in consumer spending and residential and business investment. In 2009, growth is expected to pick-up slightly to 0.6 percent. Inflation is estimated at 3.0 percent in 2008, from 2.9 percent in 2007. In 2009, inflation is expected to slow to 2.0 percent.

Economic growth in the Euro zone slowed to 0.4 percent in the fourth quarter of 2007 compared with 0.7 percent in the third quarter. The slowdown was a result of weakening retail sales and consumer confidence, together with decelerating service and manufacturing industries.

Latest economic indicators suggest mixed performances in Germany and France, the two largest economies in the region.

European industrial production rose for the first time in three months in January, boosted by Germany. German business confidence rose for a third month in March while retail sales rose in January, for the first time in four months. Moreover, French business confidence also rose in March, spurred by consumer spending and export orders while retail sales growth slowed in March as inflation picked up.

On a negative note, European inflation accelerated in March, to the fastest rate in almost 16 years. Furthermore, Euro zone retail sales fell in March and consumer confidence dropped across the region as inflation, higher credit costs and declining house prices weakened spending. Growth in Europe's service and manufacturing industries also slowed in March, as the Euro's appreciation vis-à-vis the US dollar and high oil prices are restraining economic growth.

The European Central Bank (ECB), however, kept its benchmark interest rate unchanged at a 6-year high of 4.0 percent throughout the March quarter to curb inflation, even as the Euro's appreciation and a possible US recession threatened Euro-zone growth.

Growth in the Euro-area is projected to decelerate to 1.4 percent in 2008 from an estimated 2.6 percent growth in 2007. The lower growth is largely underpinned by a slowdown in investment and private consumption. Growth in 2009 is expected to slow further to 1.2 percent. Year-end inflation for 2008 is forecast at 2.8 percent while for 2009 inflation is forecast at 1.9 percent.

Japan's economy expanded by 0.9 percent in the fourth quarter of last year, up from a revised 0.3 percent growth in the third quarter of 2007, buoyed by an increase in retail sales and exports.

Recent data, however, painted a mixed picture of the Japanese economy. Retail sales rose in January, from a year ago, due to higher gasoline prices and increasing car sales. In addition, Japan's export growth accelerated in February due to high demand from other Asian economies.

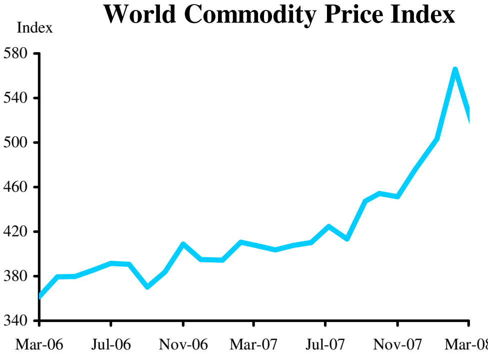
On the downside, consumer confidence and manufacturing production fell in February, attributed to rising energy costs and weak demand from the US. Moreover, consumer prices rose at the fastest pace in a decade and the unemployment rate increased for the first time in five months in January, as declining profits prompted companies to reduce hiring.

The Japanese economy is projected to slow to a growth of 1.4 percent in 2008 from a 2.1 percent expansion in 2007. In 2009, economic growth is expected at 1.5 percent. Inflation for 2008 is forecast at 0.6 percent. For 2009, inflation is expected to pick-up to 1.3 percent.

World commodity prices rose by 8.5 percent over the March quarter, led by increases in crude oil, gold, and sugar prices (Graph 3).

Graph 3

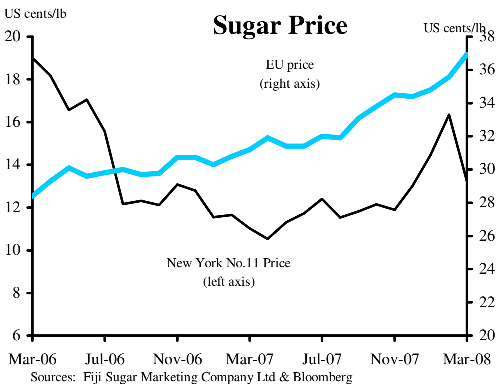
World Commodity Price Index



Source: Bloomberg

Over the March quarter, world market sugar prices increased by 1.6 percent (Graph 4). World market sugar prices rose in January and February on speculation that demand for fuel made from sugar will increase. However, prices declined in the last month of the quarter, on expectations that India[1] will boost exports this year, and speculation that high taxes will reduce shipments to Russia (the largest importer of sugar).[2]

Graph 4



Sugar prices, however, are expected to remain high in the coming months as higher energy costs increase expectations that demand for ethanol, an alternative fuel produced from sugar, will rise.

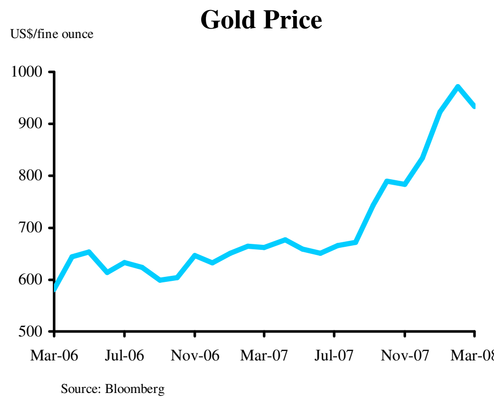
At the end of March, the European Union (EU) sugar price was around US36.9 cents per pound, having risen by 7.3 percent over the quarter.

Gold prices rose by around 12.0 percent over the fourth quarter (Graph 5). Prices rose in the first two months of the quarter, after the depreciating US dollar increased the appeal of gold as an alternative investment and as a hedge against inflation. However, prices fell in March, after expectations that the Greenback will rebound, reducing the demand for bullion by European buyers.

[1] Exports from India may rise to 5 million tonnes in the year ending September 30th from an earlier forecast of 3.5 million tonnes.

[2] Russia, the largest importer of sugar will impose a seasonal duty on raw-sugar imports at US$220 a metric tonne. The tax previously was US$140 a tonne.

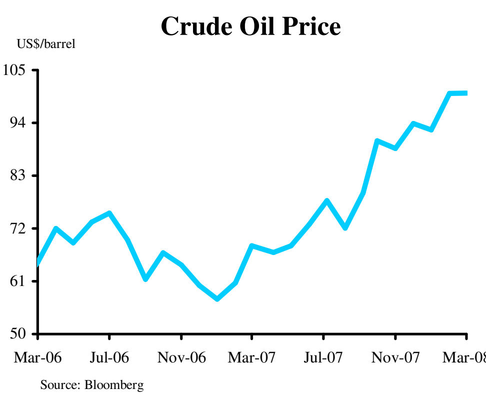
Graph 5



In the approaching months, gold prices are anticipated to remain high as fears of a US economic recession are likely to boost the appeal of the precious metal as an alternative investment.

At the end of March, the Brent crude oil price was around US$100 per barrel, 13.1 percent higher than at the end of the previous quarter (Graph 6).

Graph 6



Crude oil prices rose in January and again in March, after the weakening US dollar increased demand for commodities priced in the US currency.

However, oil prices fell mid-quarter, on expectations that the slowing US economy may reduce demand from the world's largest energy consumer, after US domestic crude oil stockpiles rose.

In the coming months, crude oil prices are anticipated to remain around US$100 per barrel, as exports from the Organisation of Petroleum Exporting Countries (OPEC) to the world market is anticipated to be unchanged.

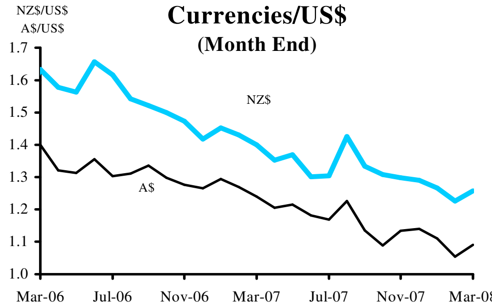
International Financial Markets

Over the March quarter, the US dollar generally weakened against all of Fiji's major trading partner currencies. The New Zealand and Aussie dollars moved in tandem against the Greenback throughout the quarter, strengthening in the early part of the quarter and depreciating in the final month. Likewise, the Yen tracked the Euro closely, appreciating against the US dollar throughout the period.

The Aussie and Kiwi dollars (Graph 7) strengthened against the US dollar in the first two months of the quarter, after the US Federal Reserve lowered its benchmark interest rate by two percentage points, further widening the two countries' interest rate advantage over the US. However, the US dollar strengthened against both currencies in March, after reports that 2007 fourth quarter consumption spending in the US exceeded estimates, prompting a higher demand from investors for US dollar denominated assets.

Graph 7

Exchange Rate - Selected Currencies/US$
(Month End)

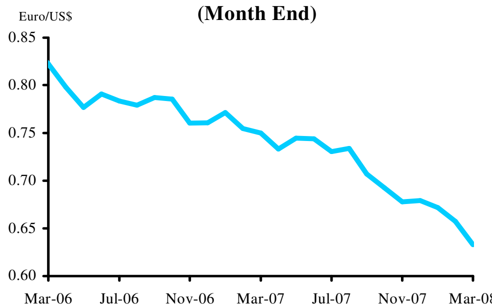


Sources: Reuters & Bloomberg

The Euro (Graph 8) strengthened against the US dollar over the quarter, on expectations that the Euro zone's interest rate advantage over the US will remain. With the acceleration of inflation in Euro zone, the ECB is expected to keep interest rates unchanged, while the US Federal Reserve lowered borrowing costs.

Graph 8

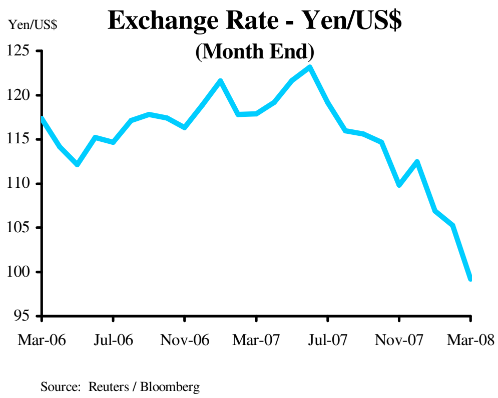
Exchange Rate - Euro/US$
(Month End)



Sources: Reuters & Bloomberg

The Yen (Graph 9) appreciated against the Greenback over the quarter, as speculation that the US sub-prime mortgage losses are deepening, prompted investors to switch from US dollar denominated assets to Yen denominated assets.

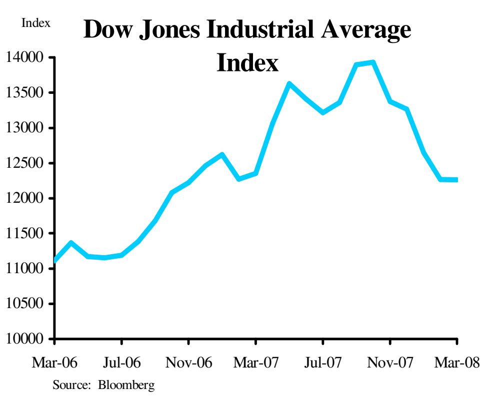
Graph 9



Equity prices fell during the three months to March.

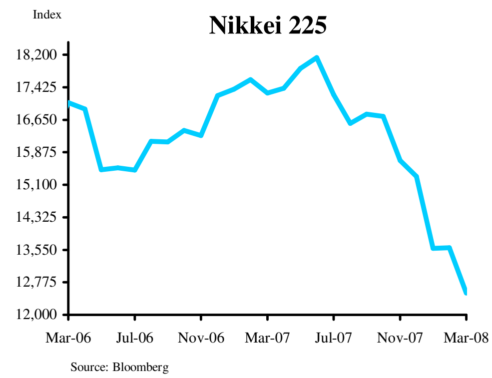
The Dow Jones Industrial Average Index fell by around 7.6 percent (Graph 10). The Dow fell in all three months of the quarter, as fears of an economic slowdown in the US led investors to switch to the safety of government debt assets, dampening the appeal of US stocks.

Graph 10



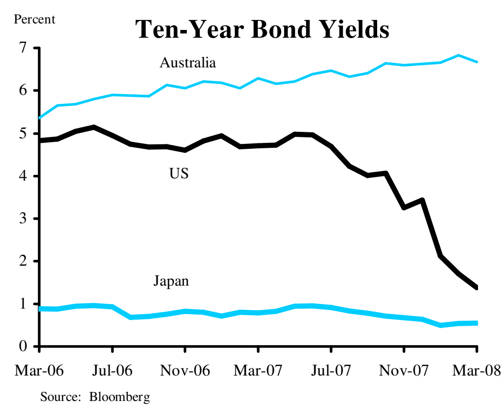
Over the three months to March, the Nikkei 225 Stock Average Index fell by 18.2 percent (Graph 11). The decline in Japanese equities came in the wake of weak US growth prospects, which depressed the profit outlook for export related firms.

Graph 11



Over the March quarter, bond yields for the US and Japan fell, while yields in Australia rose (Graph 12).

Graph 12



US bond yields fell in the three months of the quarter, as investors traded off stocks for the safety of government debt instruments, following widespread expectations of an economic slowdown in the US.

Japanese bond yields fell over the March quarter, as investors switched from holding equities to the safety of fixed-return government debt assets, amid uncertainties about the US economy, one of its major trading partners.

Over the March quarter, Australian 10-year bond prices fell, as inflationary pressures reduced the appeal of fixed-income[3] debt assets.

[3] Inflation erodes the real return on fixed income securities such as bonds.

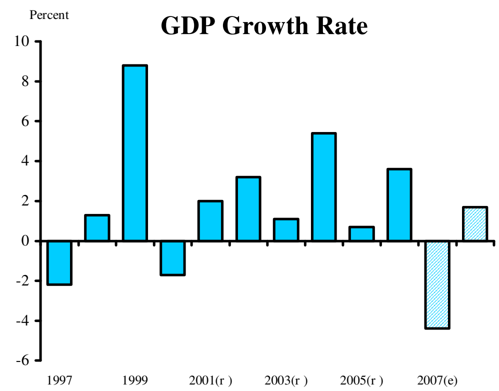
THE DOMESTIC ECONOMY

Domestic Economic Conditions

Fiji's economy is now estimated to have contracted by 4.4 percent in 2007, when compared with the 3.9 percent decline projected in October 2007 (Graph 13). The downward revision is mainly due to weaker-than-expected performances in the cane and sugar industries, which have underpinned downward revisions in the manufacturing and agriculture sectors. Similarly, the forestry, fishing & subsistence and building & construction sectors also contributed to the deeper contraction.

Graph 13

GDP Growth Rate



Sources: Fiji Islands Bureau of Statistics & Macroeconomic Committee

The estimated decline for 2007 is broad-based with the electricity & water sector being the only one estimated to have grown.

For 2008, the economy is now forecast to grow by 1.7 percent, lower than the 2.2 percent projected earlier. The main sectors underpinning this downward revision are the community, social, & personal services; manufacturing; and agriculture, forestry, fishing & subsistence sectors. The decline in these sectors largely offset the positive revision for the mining & quarrying sector.

Growth in 2008, is forecast to be mainly driven by the mining & quarrying; agriculture, forestry, fishing & subsistence; transport & communication and wholesale & retail trade, hotels & restaurants sectors.

Consumer Spending

Partial indicators of consumer spending indicate that consumption activity picked-up in the first quarter of the year.

In the first three months of 2008, net VAT receipts increased by 1.3 percent when compared with the corresponding period in 2007. In addition, imports of consumption goods increased by 18.2 percent cumulative to February 2008, while lending for consumption purposes noted a slight monthly increase in February this year.

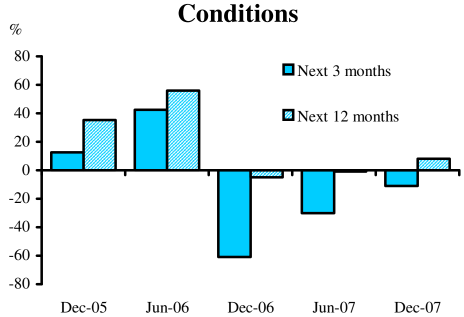
The results of the December 2007 Business Expectations Survey suggest prospects for general business conditions in the short-term will remain relatively negative, with a net[4] 11 percent of respondents expecting business activity to

[4] The net figure is calculated by subtracting the number of respondents expecting a decrease from the number of respondents expecting an increase.

decline in the first three months of 2008 (Graph 14). However, this represents a much smaller decline from expectations expressed in the previous survey. Negative expectations of general business conditions from the garment, insurance, communication, tourism, finance, wholesale & retail trade and transport sectors more than offset the positive expectations from the real estate, manufacturing and other sectors.

Graph 14

Outlook for General Business Conditions



Source: Reserve Bank of Fiji

Sentiments for general business conditions for the medium-term also improved. A net 8 percent of respondents now expect better business conditions in the medium-term. In the June 2007 survey, a net 1 percent of respondents expected business conditions to deteriorate. The relatively more optimistic outlook in the recent survey is underpinned by positive sentiments expressed by the manufacturing, communication, building & construction, real estate, tourism and transport sectors which more than offset the negative sentiment in the garment, insurance and wholesale & retail trade sectors. Generally, the sentiments expressed in this survey are consistent with a modest economic recovery expected in 2008.

Production

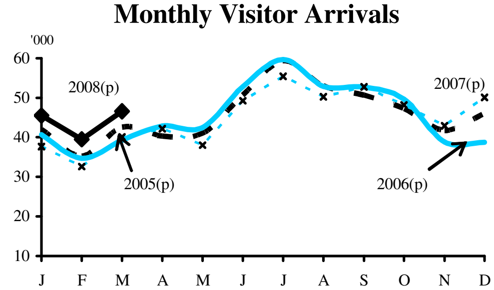
On a sectoral basis, the overall economic performance during the review period was generally mixed.

Positive performances were noted in the tourism, mining and electricity industries. However, the performance in the copra, timber and building & construction industries was subdued.

Looking at the tourism industry, provisional data indicate that visitor arrivals totalled 131,576 in the first quarter of 2008, an annual increase of 19.3 percent (Graph 15).

Graph 15

Monthly Visitor Arrivals



Sources: Fiji Islands Bureau of Statistics & Reserve Bank of Fiji estimates

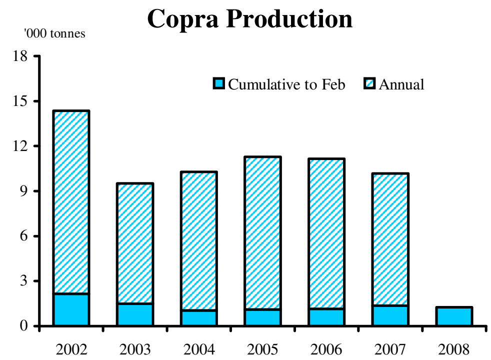
The Fiji Islands Visitors Bureau (FIVB) expects visitor arrivals for this year to total 571,260, 5.9 percent higher than the 2007 level. While an improvement in visitor arrivals is expected to continue, sentiment concerning the industry is still subdued as earnings are expected to remain sluggish due to the continued discounts offered by hoteliers compounded by lower lengths of stay of tourists. However, the recent decision by Pacific Blue to increase flights from Australia into Fiji bodes well for the industry's growth prospects.

For 2007, total garment export earnings (on an accrual basis) totalled around $109.5 million, a growth of 0.3 percent over the 2006 level. However, in January 2008, exports of the textiles, clothing and footwear industry registered a decline of 26.5 percent (to $4.3 million) over the corresponding period in 2007.

On the mining & quarrying sector, Westech Gold Fiji Limited took over the operations of Emperor Gold Mining Company Limited in March 2007 and commenced with rehabilitation and maintenance work to facilitate mining operations at Vatukoula. Recent data received from the company indicates close to 1,000 ounces of gold was produced in 2007. While this represents only a small amount, in terms of gold production, output is expected to be higher in 2008 as mining operations will be carried out over the full year. The re-opening of the mine has also resulted in the re-employment of around 526 people, with employment expected to increase as operations at the mine gain momentum.

The copra industry performed unfavourably in the first two months of 2008. Cumulative to February this year, copra production totalled 1,267.7 tonnes (Graph 16), a decline of 7.8 percent when compared with the corresponding period last year.

Graph 16



Source: Coconut Industry Development Authority

The minimum mill gate price of copra was $692.16 per tonne, higher than the Government support price ($500.00). The high price reflected a combination of high demand as well as low supply of copra. No subsidies have been provided to producers since February 2007.

Electricity output continues to grow. In the first two months of 2008, total electricity generated by the Fiji Electricity Authority totalled 130,596 mega watt hours (Mwh), representing an annual increase of 1.1 percent.

Annual trade statistics suggests that total fish export earnings totalled $101.3 million in 2007, a 3.4 percent rise over the previous year. Growth continued in January 2008, with fish exports amounting to $8.9 million representing a substantial growth of 16.8 percent over the same period last year.

The timber industry is estimated to have grown by 5 percent in 2007, largely driven by a rise in mahogany log production of 72,000 cubic meters in contrast to 46,000 cubic meters recorded in 2006. Export receipts for the timber industry for 2007 totalled $47.7 million, a growth of 27.0 percent over 2006.

Cumulative to February 2008, timber export receipts were around $7.3 million, 21.3 percent lower than the same period in 2007. Despite the weak February result, the forestry industry is projected to grow by 10.0 percent this year.

The building & construction sector performed poorly in 2007. The Quarter 4 Building and Construction Survey Report revealed that the total value of work put-in-place in 2007 totalled $230.3 million. This indicates a significant decline of 27.3 percent on an annual basis.

By categories, the value of work put-in-place in 2007 by the private sector registered a substantial decline of 23.1 percent (from $256.7m realised in 2006 to $197.4m in 2007). Similarly, the public sector recorded a fall of 45.4 percent (to $32.8m from $60.0m recorded by the public sector in 2006).

Looking at leading indicators, provisional building statistics released by the Fiji Islands Bureau of Statistics (FIBOS) for 2007 show that the total number of building permits issued (1,357) declined on an annual basis by 26.8 percent. In line with the lower number of permits issued, the *value* of building permits also declined over the year (58.0 percent), underpinned by a decline in both building permits issued for other building[4] and private dwellings categories.

In addition, the total number of building completion certificates issued (559) declined on an annual basis by 8.4 percent. However, the *value* of building completion certificates issued increased over the year by 12.7 percent.

Overall investment levels are expected to remain subdued in 2008 as major projects were either completed in 2007 or are nearing completion this year. Major projects which were completed last year include the Radisson Hotel, Port Denarau Retail & Commercial Center, Stage 1 of Carpenters Tower, Likuliku Bay Resort and Kadavu House. Those nearing completion this year are the Great Council of Chief's Complex and the Fiji National Provident Fund building in Nasese, Suva. Some major projects, such as those at Momi Bay, are still on hold. As a result only a marginal growth is projected for the building & construction sector (1.2 percent) this year. Overall, investment in 2008 is projected at 15 percent of GDP, a similar level to 2007.

In terms of investment related data for 2008, imports of investment type goods fell by 11.7 percent cumulative to February, when compared with the corresponding period in 2007. As regards loans, lending to private individuals for housing purposes and to the construction sector slowed in the review period.

Public Finance

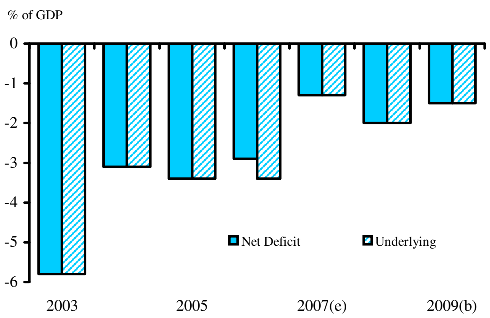
For 2007, both the headline and underlying deficit is estimated at $71.6

[4] Includes permits for hotels, educational buildings, commercial and all other buildings apart from private.

million (1.3% of GDP). This compares with an underlying deficit of 2.9 percent of GDP in 2006. The lower deficit in 2007 is largely due to lower operating and capital expenditures and to buoyant collections in indirect taxes and non-tax revenues, when compared to 2006 (Graph 17).

Graph 17

Government Balance



Source: 2008 National Budget Supplement

Total underlying revenue collections as at 31 December 2007 stood at $1,288.1 million, $28.5 million above collections at end 2006[5]. This is due to higher collections in Indirect Taxes (Fiscal duty; Import excise duty; Excise duty; VAT and Hotel Turnover Tax) and Non-Tax revenue (Fees, Fines, Charges & Penalties; Reimbursements and Recoveries and Other Revenue and Surpluses) compared with 2006. A total of $46.8 million was also collected during the Tax Amnesty period from 15 October 2007 to the end of the year.

Total Government expenditure in 2007 amounted to $1,359.7 million, $85.2 million below 2006 levels. Lower operating expenditures in most expenditure categories were mainly attributed to Government's tight fiscal stance for the 2007 fiscal year.

Total operating expenditure for 2007 stood at $1,179.8 million compared to $1,232.2 million in the previous year. According to Ministry of Finance, stringent control of spending was maintained in 2007.

Total investment related expenditure last year was $179.9 million, lower than the $212.6 million in 2006. The delay in capital project implementation was largely due to the revision of the 2007 Budget in March 2007, as most of the major projects were put on hold pending finalisation of the revised Budget.

For 2008 and 2009, the fiscal deficit is forecast at 2.0 percent of GDP and 1.5 percent of GDP, respectively.

Government's outstanding debt for 2007 was estimated at $2,734.8 million, equivalent to 49.1 percent of GDP. This compares with the 2006 estimated debt level of $2,863.1 million, equivalent to 52.2 percent of GDP.

For this year, Government debt is projected at $2,919.9 million (48.6% of GDP).

Inflation

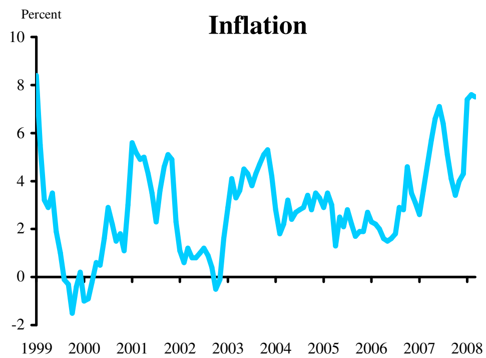
Inflation rose to 7.5 percent in March from 4.3 percent recorded in December 2007 and 4.7 percent in March last year (Graph 18). Over the quarter, consumer prices grew by 4.1 percent.

Imported inflation has added around 5.0 percentage points to the March 2008 inflation rate, with the remainder coming from domestic sources.

[5] Total revenue, on the other hand, grew only by $0.5 million, with asset sales of $28 million in 2006.

During the March quarter, higher prices in the food category was the major contributor to inflation accounting for more than half of the increase in prices. This is followed by higher costs of transport, heating & lighting, durable household goods and miscellaneous items. Prices in other categories remained unchanged over the quarter.

Graph 18



Source: Fiji Islands Bureau of Statistics

Higher prices of vegetables & root crops, wheat, dairy, cereal products and fresh fish led the increase in the food category. In addition, higher costs of licences & fares and petrol & diesel, in the transport category, underpinned the rise in the inflation rate.

The trimmed mean, a measure of underlying inflation, rose from 3.2 percent in the December 2007 quarter to 3.8 percent in the March quarter. The gradual increase in core inflation is partly a reflection of second-round effects of oil price hikes in recent years.

Recently, Fiji's inflation rate has risen due to rising crude oil and wheat prices. Soaring crude oil prices have not only affected fuel prices but also electricity charges, bus & taxi fares and a more pronounced second-round effect on other goods and services. Likewise, higher wheat prices have resulted in wheat, bakery, cereal and dairy product price increases.

While some easing in prices is expected against the backdrop of a weaker US dollar, trading partner inflation is likely to be higher given a similar scenario of higher energy and food prices, in the respective countries.

Looking ahead, surging energy and non-energy commodity prices - a current global phenomenon - are expected to drive prices higher. Currently, the year-end inflation projection is 5.0 percent; however, risks are on the upside given the volatile nature of global crude oil and wheat prices.

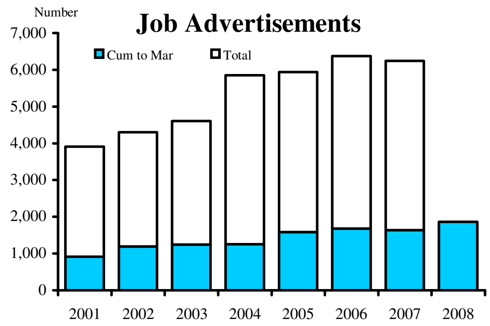
Labour Market

In the year to March 2008, employment conditions have weakened in certain sectors of the economy. However, in the coming months, labour market conditions are expected to improve based on the turnaround in economic activity.

In the first three months of the year, the number of taxpayer registrations, a partial indicator of employment, has fallen by around 16.0 percent over the corresponding period in 2006. Sectors which recorded declines include the manufacturing sector, followed by the mining and quarrying and the community, social & personal services sector.

However, some improvement is expected in the coming months, based on positive recruitment intentions. Cumulative to March, the number of jobs advertised rose by around 13.9 percent (to 1,866) over the corresponding period last year (Graph 19).

Graph 19



Source: The Fiji Times

The community, social & personal services sector registered the highest positive recruitment intentions. This was followed by the wholesale & retail trade, restaurants & hotels; finance, insurance, real estate & business services; construction, and manufacturing related firms. This outturn can be partly attributed to some improvement in business confidence and general optimism that economic activity will pickup somewhat this year and also possibly to fill vacant positions due to emigration.

The External Sector

In 2007, the trade balance improved by 12.6 percent as merchandise export receipts rose by 0.7 percent, while import payments declined by 7.5 percent. Leading the increase in export receipts were mineral water, timber, fish, fruits & vegetables, sweet biscuits, flour, uncooked pasta, other domestic exports and re-exports, while the decline in import payments was a result of lower outlays for all categories of goods, investment, intermediate and consumption.

Cumulative to February this year, merchandise export earnings (excluding aircraft) rose by around 16.4 percent when compared with the same period in 2007. The increase was largely attributed to higher earnings from mineral water, fish, flour, coconut oil, molasses and re-exports.

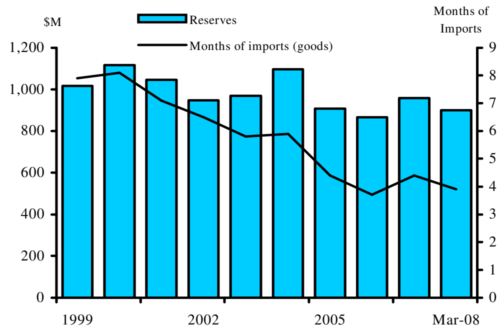
Import payments (excluding aircraft) increased by 16.2 percent during the year to February 2008, when compared with the same period in 2007. The rise was underpinned by higher payments for intermediate goods (10.1 percent) and consumption goods (6.6 percent). Payments for investment goods fell marginally, led by lower imports of chemicals and machinery and transport equipment.

Personal remittances fell significantly in 2007, by 20.5 percent, to around $256.0 million. A similar trend was noted in January 2008 with total inflows declining by 44.9 percent to around $10.3 million, compared with the same period last year. Remittances, like other services inflows, are volatile and sensitive in nature to a number of factors, such as labour market conditions in source countries.

Foreign reserves at the end of March were provisionally around $898.8 million, sufficient to cover 3.9 months of import payments of goods (Graph 20).

Graph 20

Gross Foreign Reserves



Source: Reserve Bank of Fiji

Domestic Financial Conditions

Money Markets

The Reserve Bank of Fiji's monetary policy stance remained unchanged during the first quarter of 2008. The credit ceiling remained in place, while open market operations remained suspended. Given that the outlook on the Balance of Payments was for continued pressures on foreign reserves, the monetary policy stance was considered appropriate and left unchanged.

Since June 2007 the interbank money market remained dormant, until a total of $33.7 million was traded in March 2008. This was due to a significant deterioration in the balance of one market participant for a few days during the month. The weighted average interbank lending rate was 1.53 percent compared with 4.22 percent in May 2007, when activity was last recorded.

In the March quarter, Treasury Bills (T-Bills) issued by Government declined to $117.5 million when compared with $159.6 million allotted in the December 2007 quarter. The weighted average 91-day T-Bill rate was down by 15 basis points to 0.15 percent when compared with the preceding quarter.

Capital Markets

Total bonds issued by the Government amounted to $80.0 million during the March quarter, compared with $20.0 million allotted in the previous quarter. The maturities issued ranged from 3 to 20 years. Bond yield movements were mixed, with rates declining at the short end of the maturity spectrum and rising on the long-end.

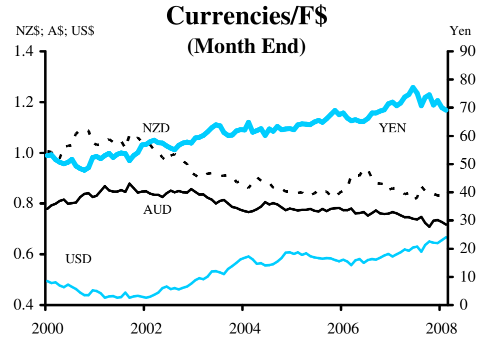
There were no bonds issued by statutory corporations in the first quarter of 2008, compared with $107.4 million issued in the previous quarter.

Foreign Exchange Markets

Exchange rate movements between the Fiji dollar and our trading partners' currencies were mixed (Graph 21). The Fiji dollar strengthened against the US (3.7 percent) and New Zealand (1.1 percent) dollars over the quarter to March, but weakened against the Japanese Yen (8.6 percent), Euro (3.4 percent) and the Australian dollar (0.8 percent).

Graph 21

Exchange Rates - Selected Currencies/F$
(Month End)

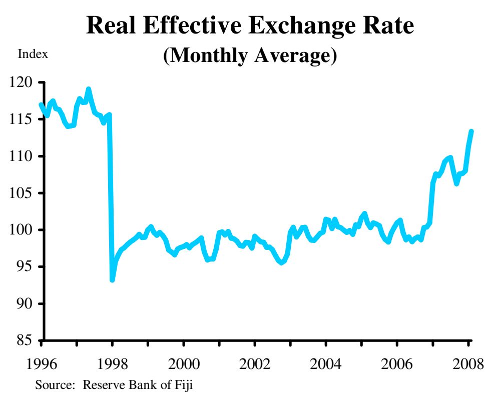


Source: Reserve Bank of Fiji

In March, the Nominal Effective Exchange Rate (NEER) Index, which reflects aggregate exchange rate movements between the Fiji dollar and currencies of our major trading partners, rose by 0.1 percent over the quarter. This indicated a marginal appreciation of the Fiji dollar against the basket of currencies.

During the same period, the Real Effective Exchange Rate (REER) Index of the Fiji dollar, which adjusts the NEER for inflation differentials across Fiji's major trading partners, rose by 4.6 percent (Graph 22).

Graph 22

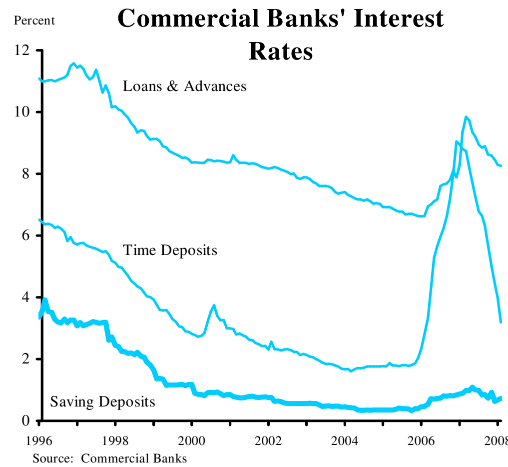


The rise in the REER reflects a deterioration in Fiji's international competitiveness, and was underpinned by higher domestic inflation; 7.5 percent in March.

Financial Intermediaries

Reflecting high liquidity conditions during the review period, commercial banks' interest rates generally fell. The time deposit rate declined from 4.45 percent in December to 3.20 percent in February (Graph 23).

Graph 23



In the same period, the new time deposits rate declined to 1.85 percent in February from 3.78 percent. The savings deposit rate, however, rose by 9 basis points to 0.73 percent.

The weighted average lending rate on outstanding loans declined to 8.25 percent in February from 8.46 percent in December. Similarly, the interest rate on commercial banks' new loans fell by 164 basis points to 8.05 percent in the review period.

Movements in interest rates offered by Licensed Credit Institutions (LCIs)[7] were mixed in the review period. The weighted average lending rate rose by 5 basis points to 13.09 percent in February, while the interest rate on time deposits declined to 4.82 percent in February from 5.23 percent recorded in December.

Broad money supply rose by 10.4 percent in December 2007, a weaker growth than the 16.6 percent in the September quarter. The slowdown was due to a decline in

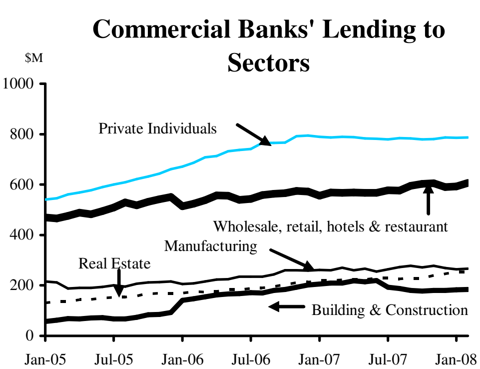
[7] LCIs include Merchant Finance Investment Company Limited, Credit Corporation (Fiji) Limited and Home Finance Company Limited.

quasi money over the year, by 9.8 percent, underpinned by a 17.6 percent contraction in time deposits. With excess liquidity in the financial system and declining interest rates, there has been a shift in funds from time to demand deposits. Consequently, demand deposits rose by 59.5 percent in the review period.

Domestic credit growth slowed further to 3.2 percent in December, after rising by 8.4 percent in the third quarter. The outturn was largely influenced by a substantial slowdown in private sector credit as a result of subdued levels of economic activity as well as due to the credit ceiling.

In February, commercial banks' outstanding credit grew by 3.2 percent, a marginal increase from 2.2 percent recorded in December. Lending to the wholesale and retail trade, manufacturing, real estate, building and construction sectors and to private individuals (mainly for housing and other purposes), continued to drive credit demand (Graph 24).

Graph 24



Source: Commercial Banks

Lending by LCIs declined in February by 6.6 percent, compared to a decline of 5.8 percent recorded in December. This decline is attributed to a fall in lending to private individuals.

Banking Industry Quarterly Condition Report –December 2007

Overview – Commercial Banks

The Banking industry's performance was assessed as satisfactory for the December quarter. The satisfactory assessment is a result of the continued strong Capital levels registered by commercial banks and improvements in Earnings and Liquidity levels to satisfactory positions. In addition, Asset Quality remained at marginal level.

Capital adequacy ratios of all banks were above the minimum prudential requirement of 8.0 percent, and the overall banking industry recorded a strong ratio of 14.3 percent.

Asset quality continued to weaken and was assessed as marginal over the December quarter. Past due levels rose to $95.3 million and classified exposures rose by $33.6 million over the quarter to $153.8 million. The classified to gross loans ratio increased to 6.0 percent from 4.7 percent in September 2007.

Management was assessed as satisfactory with earnings performance improving to satisfactory levels. Management also took a proactive approach in implementing preventative measures to improve their asset quality levels.

Earnings of banks' were assessed as satisfactory for the December quarter with an improvement in return on assets (3.3 percent), return on equity (29.9 percent) and efficiency ratio to 48.3 percent.

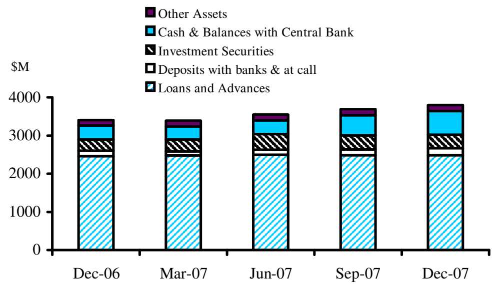
Liquidity levels were high and adequately managed with no institution engaging in short-term borrowing or lending. Banks' liquidity position improved to a satisfactory level over the quarter, characterised by an improvement in coverage ratios.

Balance Sheet

As at December 2007, total assets of the banking industry stood at $3.8 billion, an increase of $108.4 million (2.9 percent) over the quarter and $388.4 million (11.4 percent) over the year (Graph 25).

Graph 25

Structural Change and Growth in Bank Assets



Source: Commercial Banks

The rise in assets was led by a 24.2 percent increase in the cash & settlement account over the quarter to $428.7 million. In addition, deposits with Banks and at call rose by $35.5 million to $184.7 million. The increase in these liquid assets was mainly due to a lack of avenues to invest these funds amid dampened consumer demand for funds. A similar growth was noted on an annual basis.

Investments decreased by $15.9 million over the quarter to $352.2 million. The decline was mainly due to a institutions failing in the tender bids for Government bonds this quarter. However, on an annual basis, investments grew by $60.9 million as excess funds were invested in Fiji Government Bonds.

On the liabilities side, total deposits grew by $109.3 million (3.4 percent) to $3.3 billion. The growth is a result of an increased placement of demand deposits by non-bank financial institutions with the banks.

Capital and Reserves increased by $19.7 million due to Banks recording profits while balances due to other Banks declined by $11.5 million over the quarter to $28.1 million.

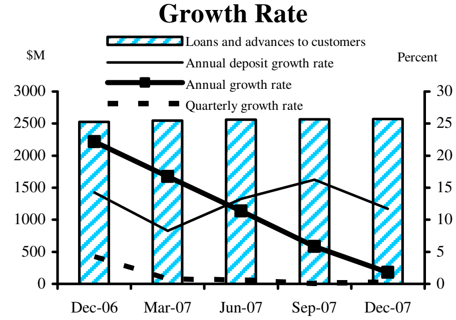
Lending

Loans recorded a sluggish growth of $7.0 million or 0.3 percent over the quarter to $2.6 billion. This is in comparison to a growth rate of 4.2 percent in December 2006 (Graph 26).

The significant slowdown in loan growth was a result of the credit ceiling which was put in place in December 2006, and also a general decline in consumer demand for loans, given the economic environment.

Graph 26

Banking Industry's Loans and Growth Rate

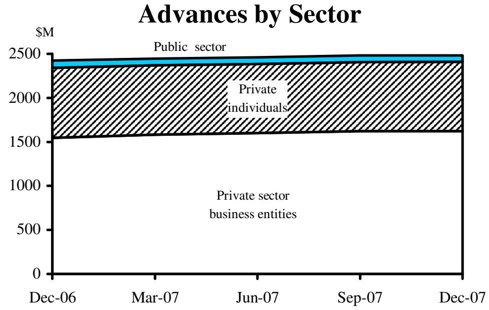


Source: Commercial Banks

Lending to priority[8] sectors, recorded a reduction over the quarter with borrowing by the electricity, gas & water and manufacturing sectors falling by $21.6 million and $8.2 million, respectively (Graph 27). However, lending to non-priority sectors rose led by real estate ($16.4 million), professional business services ($4.6 million) and private individuals ($4.8 million).

Graph 27

Commercial Banks' Loans and Advances by Sector



Source: Commercial Banks

Capital Adequacy

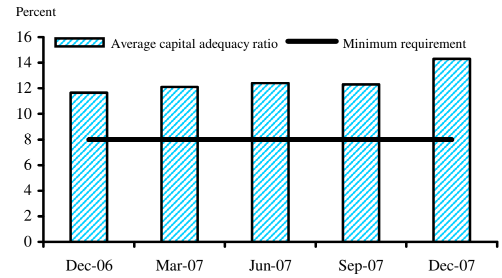
As at December 2007, the industry recorded a strong capital adequacy ratio of 14.3 percent. This was an improvement of 210 basis points over the quarter and 260 basis points over the year. All commercial banks maintained capital adequacy levels well above the minimum requirement of 8.0 percent.

The improvement in capital adequacy was underpinned by a higher rate of growth in capital (17.2 percent) compared with risk-weighted assets which grew by 0.3 percent (Graph 28).

[8] As set out by the RBF Lending Guidelines to banks in early 2006.

Graph 28

Capital Adequacy Ratio of Commercial Banks



Source: Commercial Banks

The expansion in total capital over the quarter was a result of an increase in retained profits and a slight rise in general provisions in tier 2 capital. Risk-weighted assets recorded an increase in all risk categories, except 100 percent risk weighting, as the level of loans declined.

Asset Quality

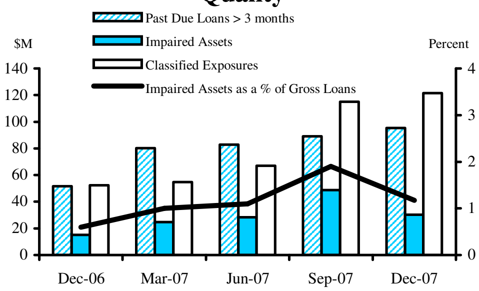
Asset quality worsened further, characterised by an increase in classified accounts and growing past due levels. Although the level of classified accounts recorded a significant increment, it remained at marginal level while compared against the level of gross loans and individual banks' tolerance capacity.

Banks had made efforts to restructure customer accounts by offering them interest only repayments, with some customers taking this offer in the December quarter. In view of the rising past due levels, Banks have also allocated additional resources to collection departments with one Bank forming a Watch List Committee.

The level of classified exposures rose by $33.6 million over the quarter to $153.7 million. Notwithstanding the continuous rise in classified accounts, the ratio of classified to gross loans of the overall industry remains marginal at 6.0 percent (Graph 29).

Graph 29

Commercial Banks' Asset Quality



Source: Commercial Banks

The rise in classified loans mainly stemmed from the wholesale and retail sector which increased by $20.7 million. These were mainly tourism related accounts, which were affected by low occupancy rates in the tourism industry. However, the private individuals category improved by $4.0 million over the quarter to $66.5 million.

Banks past due levels escalated to $95.3 million in the December quarter. The rise was mainly in the 1-3 months category indicating an increase in new accounts hitting past due status. It is noted that past dues in the latter stages are increasing over time (Graph 30).

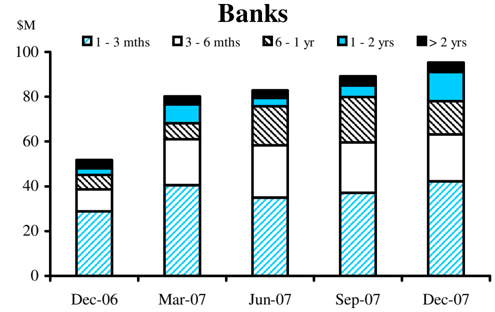
Worsening asset quality was evident from the rise in the number of demand notices issued during the quarter (1,466 notices) and mortgage sales (166 in process and 15 completed) during the quarter.

Banks raised their general provisions over the quarter to $52.9 million, in anticipation of the rise in classified exposures. General provisions were at 2.6 percent of gross loans and advances and considered satisfactory. Specific provisions were also raised by $2.5 million over the quarter. The overall level of specific provisions ($15.7 million) in comparison to $153.7 million of classified assets (10.2 percent coverage) is assessed to be low, as banks also consider security values while allocating provisions on classified accounts.

Recently, banks have put in place short-term relief measures to cushion the impact of the current economic environment on Asset Quality. This included the two major banks announcing interest free payments for 3 months after the impact of Cyclone Gene.

Graph 30

Past Due Status of Commercial Banks



Source: Commercial Banks

Earnings

Over the December 2007 quarter, the earnings performance of the banking industry was assessed as satisfactory. Banks' pre-tax profit was $30.5 million, an improvement from that recorded in the previous quarter as well as the same quarter of 2006.

The satisfactory level of earnings is a result of improvement in net interest income.

Table 1: Commercial Banks' Combined Income Statement

	Dec 06	Sep 07	Dec 07	% Change Over Qtr	% Change Over Dec 06
Interest Income	63.5	68.1	64.5	-5.4	1.5
Interest Expense	28.8	26.2	18.5	-29.3	-35.5
Net interest income	34.8	41.9	46.0	9.6	32.1
Add: **Non interest income**	22.0	24.2	23.8	-1.7	8.4
Income from overseas exchange transactions	9.2	11.3	11.1	-1.8	20.7
Commission	3.5	-0.7	2.2	-443.9	-36.9
Fee Charges	8.8	13.1	10.7	-18.6	21.0
Other income	0.5	0.5	-122	-123.2	-126.1
Total operating income	56.8	66.2	69.8	5.5	22.9
Less: Operating expenses	28.7	33.0	33.7	2.2	17.4
Less: Bad Debts & provisions	0.4	11.3	5.5	-51.0	1312.8
Profit before tax	27.6	21.8	30.5	39.7	10.4
Less: Tax	8.2	5.1	9.2	81.7	12.9
Net profit after tax	19.5	16.8	21.3	27.0	9.4

Source: Commercial Banks

Following the decrease in carded interest rates by banks for the past few quarters, interest income declined by $3.7 million (5.4 percent) over the quarter. However, this decline was cushioned by a higher rate of decline ($7.7 million or 29.3 percent) in interest expenses which led to the overall improvement in net interest income.

Fees income, one of the major components of non-interest income, declined over the quarter, underpinned by lower income earned from loans. Income from foreign exchange dealings also reduced over the quarter due to the decrease in foreign exchange transactions.

The rise in operating expenses was mainly due to an increase in personnel expenses by 9.2 percent. Two institutions increased the number of their management staff which led to the increase in personnel expenses.

Banks booked $5.5 million as bad and doubtful debt expenses over the quarter, 51 percent less than the previous quarter but in excess of the December 2006 levels.

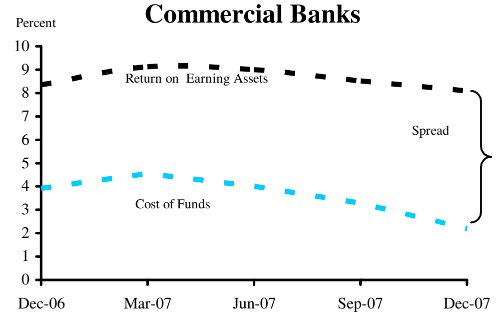
As a result of an increase in pre-tax profits, the pre-tax return on assets (annualised) of the banking industry rose to 3.3 percent from 2.4 percent in the previous quarter matching the December 2006 levels. Similarly, Return on Equity (after tax profits) rose to 29.9 percent from 24.5 percent in the last quarter; however this remained below the December 2006 level (31.2 percent).

Interest Margin and Spread

Return on earnings assets and cost of funds both continued its downward trend in the review quarter. The cost of funds reduced at a faster rate (108 basis points) than the return on monetary assets (42 basis points) causing the overall spread to widen further (Graph 31).

Graph 31

Interest Rate Spread of Commercial Banks



Source: Commercial Banks

The return on earning assets was 8.0 percent, down from 8.5 percent in the previous quarter and 8.4 in December 2006. The cost of funds was recorded at 2.2 percent compared to 3.3 percent in September 2007 and 3.9 percent in December 2006.

Prior to the monetary policy tightening in early 2006, the Banking industry maintained a return on earning assets at an average of 6.0 percent and a cost of funds at 0.9 percent.

Efficiency

The efficiency ratio improved to 48.3 percent in the December 2007 quarter. This compares to 49.9 percent recorded in the September quarter and 50.6 percent in December 2006. The improvement was due to a faster rate of growth in operating income than in operating expenses.

Liquidity and Funding

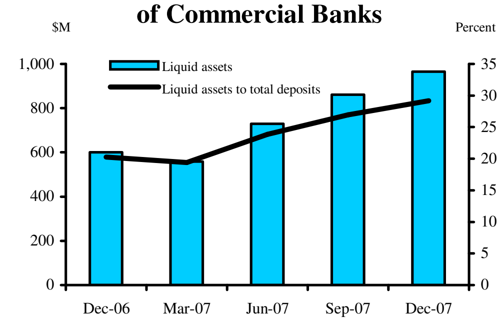
Banks' liquidity position improved to a satisfactory level over the quarter, characterised by an improvement in coverage ratios.

Banks' liquid assets level rose to $965.7 million, an increase of $103.0 million over the quarter and $366.0 million over the year. The rise mainly stemmed from funds held in settlement accounts and in deposits with banks and at call (Graph 32).

As noted in the previous quarter, the build up in liquidity was indicative of a stable reserves position, the credit ceiling and the reduction in Statutory Reserve Deposits (SRD) requirement in the second quarter of 2007.

Graph 32

Liquid Assets to Total Deposits of Commercial Banks



Source: Commercial Banks

The rise in liquid assets, led to an improvement in liquid assets to total assets ratio, which increased to 25.4 percent from 23.4 percent in the previous quarter. The liquid assets to deposits ratio also rose to 29.2 percent from 27.0 percent in September 2007 and 20.2 percent in December 2006.

The ratio of loans to deposits also improved to 77.7 percent over the quarter from 80.1 percent in September 2007 and 80.5 percent in December 2006.

Maturity analysis of banks showed a significant decline in short-term negative maturity mismatches. There are cash inflows of $237.7 million in the less than 1 month category followed by cash outflows of $301.4 million over the next 12 months. The level of liquid assets would easily be able to meet these outflows.

Large depositors gained prominence over the December quarter with large depositors as a percentage of total deposits increasing to 30.1 percent from 28.3 percent.

Overview – Credit Institutions

Credit institutions' operations were assessed to be satisfactory over the quarter. Loans reduced and improvements were noted in profitability and asset quality. Liquidity was adequately managed and capital levels were maintained above the minimum requirement by all institutions at all times.

The combined credit institutions' capital adequacy ratio remained strong at 22.7 percent.

Although the asset quality of credit institutions improved over the quarter, it remained marginal. There was a large decline in classified exposures ($9.9 million) causing a reduction in the classified exposures to gross loans ratio to 4.7 percent from 7.7 percent. Despite this, the level of past due loans increased.

The management of credit institutions was assessed as satisfactory considering an improvement in asset quality position and earnings performance. Cash flow was satisfactorily managed despite marginal liquidity levels. Measures were taken by management to prevent deterioration in the asset quality.

Earnings performance improved over the quarter and was assessed as satisfactory with an improvement in returns on assets (5.6 percent), return on equity (26.7 percent) and an outstanding efficiency ratio of 29.8 percent. Total profits before tax was $4.9 million, 32.7 percent higher than the previous quarter.

Credit institutions' liquidity continues to be rated as marginal. There was a drop in the level of liquid assets ($9.1 million), impacting on the liquidity ratios and maturity mismatch remained unfavourable (negative mismatch of $102.6 million). Concentration in 15 large depositors also increased in December 2007.

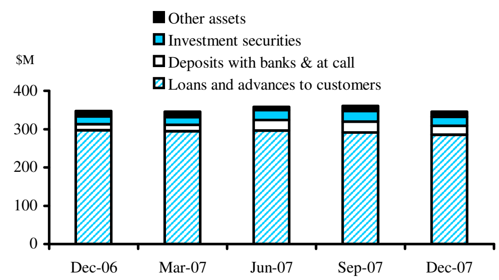
Balance Sheet

Combined assets of credit institutions declined once again by 3.7 percent ($13.4 million) to $347.5 million. The decline mainly stemmed from a decrease in total loans. Annual comparisons showed a marginal increase of 0.1 percent (Graph 33).

On the liabilities side, amounts owing to parent companies, dropped by 21.9 percent to $53.5 million over the quarter. The level of deposits also dropped by $1.6 million to $224.0 million contributing to the overall decline in liabilities.

Graph 33

Structural Change and Growth in Credit Institutions' Assets



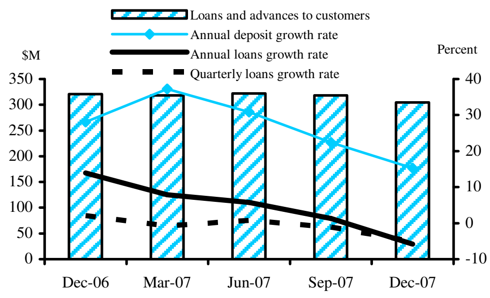
Source: Credit Institutions

Lending

A negative growth is noted in the credit institutions' loan book for the second consecutive quarter. Credit levels declined substantially by $16.3 million over the December quarter to $301.8 million (Graph 34).

Graph 34

Credit Institutions' Loans and Growth Rate

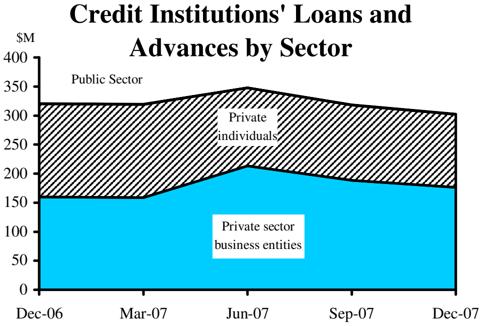


Source: Credit Institutions

The drop in credit institutions' loans was led by a decrease in loans to private sector business entities, which fell by $12.0 million to $176.5 million. Loans to private individuals also declined by $4.0 million to $125.5 million, the majority being for home mortgages (Graph 35).

Graph 35

Credit Institutions' Loans and Advances by Sector



Source: Credit Institutions

Capital Adequacy

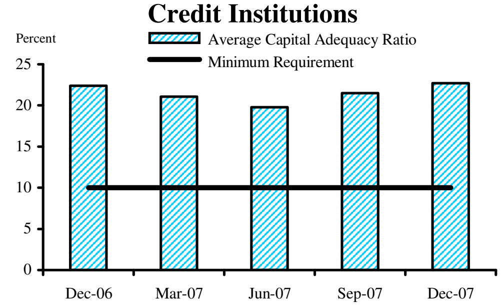
Credit institutions recorded a strong capital adequacy ratio of 22.7 percent for the December 2007 quarter. This was 121 basis points higher than in the previous quarter and 27 basis points higher than that recorded in December 2006. All credit institutions maintained their capital adequacy levels well above the minimum requirement of 10.0 percent.

The rise in the capital adequacy ratio was attributed to the decrease in risk weighted assets by $1.6 million, coupled with an increase in unaudited profits by $3.0 million on the total capital side (Graph 36).

The increase in capital adequacy over the year was due to a 12.5 percent growth in total capital, while risk weighted assets grew by only 11.3 percent. Similar to banks, it is expected that asset quality movements may affect future capital levels of credit institutions.

Graph 36

Capital Adequacy Ratio of Credit Institutions



Source: Credit Institutions

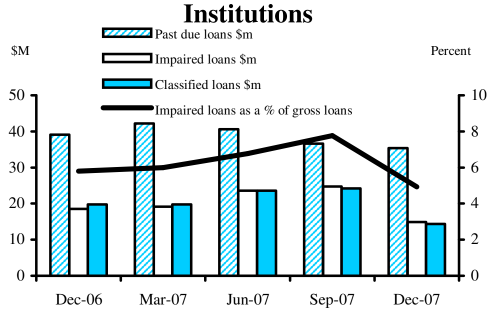
Asset Quality

Contrary to banks, credit institutions' Asset Quality improved over the quarter, but remained marginal. The improvement was mainly a result of a large decline in one institution's classified assets. However, past due levels rose, indicating a possible deterioration in the quality of loans.

Total classified loans declined by $9.9 million to $14.3 million. This was mainly due to the writing-off of several long-standing impaired accounts against interest suspended and specific provisions (Graph 37).

Graph 37

Asset Quality of Credit Institutions



Source: Credit Institutions

Despite the write-offs, past due loans showed a rise of $1.3 million over the quarter within the 1-3 months category. As such, there was a rise in the number of demand notices issued during the quarter (203) and mortgage sales (15 in process and 7 completed during the quarter).

Credit institutions have been gradually increasing their general provisions since December 2006 in view of the economic situation. A further increment of $0.6 million was booked for the December quarter and total general provisions rose to $11.8 million, representing 3.9 percent of gross loans and advances.

Specific Provisions declined by $2.6 million to $4.1 million, a direct result of a decrease in classified exposures.

Earnings

Credit institutions' earnings improved to a satisfactory level over the December quarter. Total profits before tax of $4.9 million was recorded over the quarter. This was 32.7 percent higher than the previous quarter and 20.7 percent higher than December 2006.

This was attributed to institutions recording higher interest income, a drop in interest expenses and a decline in operating expenses.

Favourable net interest income recorded this quarter was mainly due to a drop in interest expense (12.8 percent) and a slight rise in interest income (1.9 percent). The decrease in interest expenses reflected the impact of falling market interest rates on deposits.

Table 2: Credit Institutions' Income Statement

	Dec 06	Sep 07	Dec 07	% Change	
				Over Qtr	Over Dec 06
Interest Income	11.2	11.9	12.1	1.9	8.4
Interest Expense	4.4	4.9	4.3	-12.8	-2.2
Net interest income	6.8	7.0	7.8	12.2	15.2
Add: **Non interest income**	0.7	0.9	0.9	3.1	21.2
Commission	0.1	0.1	0.06	-41.4	-38.0
Fee Charges	0.5	0.3	0.5	62.6	-1.6
Other income	0.1	0.4	0.3	-30.4	218.7
Total operating income	7.5	7.8	8.7	11.2	15.7
Less: Operating expenses	2.7	2.9	2.6	-9.6	-3.7
Less: Bad Debts & provisions	0.8	1.3	1.2	-5.0	58.3
Profit before tax	4.1	3.7	4.9	32.7	20.7
Less: Tax	0.7	0.6	0.9	49.4	41.5
Net profit after tax	3.4	3.1	4.0	29.4	16.7

Source: Credit Institutions

With increasing levels of service fees and charges, non-interest income also improved over the quarter.

In an effort to improve profitability, all institutions reduced their operating expenses. This mainly stemmed from a reduction in personnel expenses due to a decrease in employee numbers.

Bad debt expenses dropped by 5.0 percent over the quarter mainly due to recoveries during the review period.

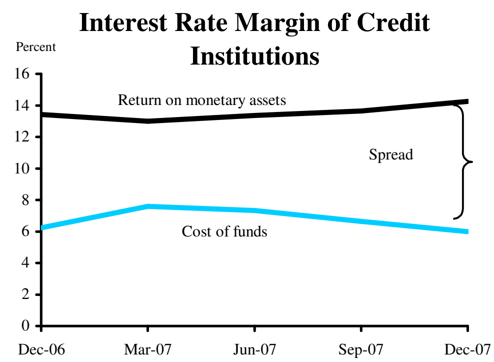
An improvement in profits earned for the quarter improved the profitability ratios. The return on assets before tax improved to 5.6 percent from 4.1 percent in the previous quarter (Dec 2006: 4.7 percent). Return on equity rose to 26.7 percent from 21.8 percent and 24.3 percent over the year.

The increase in operating income and decline in operating expenses led credit institutions to record a superior efficiency ratio (operating cost to operating income) of 29.8 percent in the December quarter, the lowest recorded since June 2002.

Return on monetary assets began to improve while cost of funds trended downwards since March 2007. In the December quarter, the interest spread widened further as a result of an increased level of interest income and a reduction in the cost of funds.

Return on monetary assets increased to 14.3 percent from 13.6 percent in the previous quarter and 13.4 percent in December 2006. Cost of funds dropped to 6.0 percent from 6.6 in September 2007 and 6.2 percent in December 2006 (Graph 38).

Graph 38



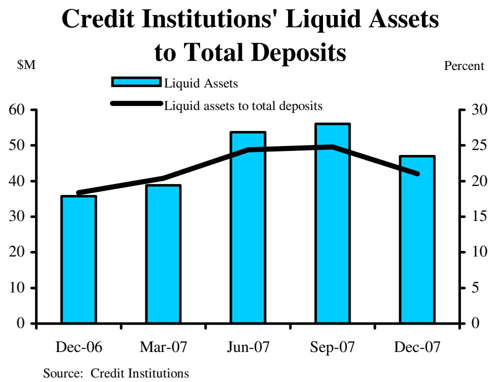
Source: Credit Institutions

Liquidity

Liquidity of credit institutions was assessed as marginal in the December quarter considering unfavourable coverage ratios and negative mismatches in the short-term.

Liquid assets reduced by $9.1 million (16.2 percent) over the quarter, or $11.2 million (31.4 percent) over the year, to $47.0 million. Reduction in liquid assets caused a decline in liquidity ratios as the liquid assets to deposits ratio declined to 21.0 percent from 24.8 percent and the liquid assets to total assets ratio decreased to 13.5 percent from 15.5 percent (Graph 39).

Graph 39



Liquidity was utilised to reduce debts to shareholders during the quarter. Owings to shareholders have been steadily declining since March 2006 with a decrease of $30.8 million recorded since December 2006.

The maturity profile analysis of combined credit institutions shows negative mismatches for the next 12 months totalling $107.6 million.

Credit institutions have marginal ability to pay for these maturing obligations without increasing their level of borrowings. This is due to deposits mainly being short-term while the majority of loans are long term with a longer maturity period.

Credit institutions' deposits are concentrated in the 15 largest depositors, representing 45.8 percent (totalling $102.6 million) over the quarter. It was also noted that the largest depositor alone accounted for 25.9 percent of total deposits of credit institutions.

Insurance Industry Quarterly Condition Report – September 2007

Overview

The insurance industry's performance continued to be assessed as satisfactory indicated by the combined industry solvency surplus, positive growth in the balance sheet, adequate level of liquid funds and improvement in profitability indicators.

The growth in insurers' underwriting performance continues with strong operating results recorded for both the life and general sectors.

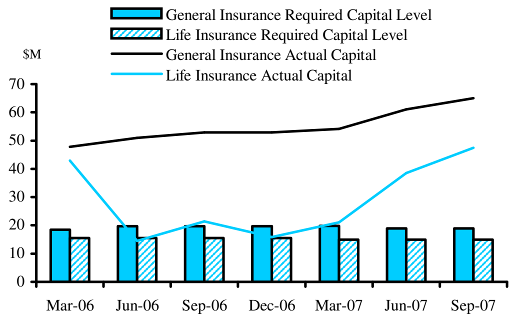
All licensed insurers met the solvency requirements under the Insurance Act, 1998.

Licensed Insurers

The capital requirement for the insurance industry was assessed as satisfactory for the quarter under review. Total capital available for the industry was $112.4 million, well above the required capital level of $33.8 million, with the growth in the life insurance industry's admissible assets contributing to the sound capital position (Graph 40).

Graph 40

Insurance Industry Actual Capital & Required Capital Levels



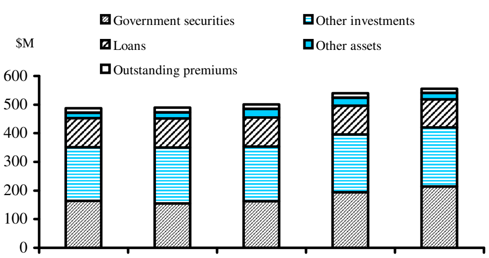
Source: Insurance Companies

Combined assets rose by 12.0 percent to $787.4 million with the growth attributed to the increase in assets for both sectors. The life insurance sector which accounted for a larger part of the increase, continued to hold the larger market share accounting for 70.5 percent of total industry assets.

Total life insurers' assets grew by 14.0 percent in 2007 to $555.5 million (2006: $487.3 million). Investments and loans continued to be the major categories accounting for 93.0 percent of the total (Graph 41).

Graph 41

Distribution of Assets of Life Insurance Companies



Source: Insurance Companies

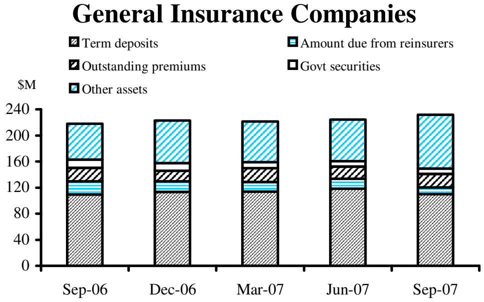
The asset distribution pattern remained unchanged over the year. Government securities continued to dominate the asset base of life insurers at 38.6 percent of total assets, followed by loans to policyholders (17.5 percent) and property (11.6 percent). Of total loans, 99.0 percent are reported as secured.

Holdings of Government securities grew by 31.0 percent to $214.6 million over the year and also up 10.0 percent from the previous quarter, while loans declined by 4.0 percent over the year to $97.3 million. Other notable movements included deferred reinsurance expense and sundry debtors both increasing significantly by 463.0 percent and 119.0 percent, respectively. Cash on hand declined by 25.0 percent to $4.9 million whilst bank deposits increased to $43.9 million from $42.0 million in the previous quarter.

Consolidated assets of non-life insurers' increased marginally by 7.0 percent over the year to $231.9 million (2006: $217.1m) (Graph 42).

Graph 42

Distribution of Assets for General Insurance Companies



Source: Insurance Companies

The majority of the insurance industry's assets continued to be comprised of investments, at 63.1 percent of total assets, or $146.3 million. In the investment category, bank deposits continued to be the largest holding at

$109.8 million followed by equity investments with related and non-related persons totaling $14.0 million.

Current assets increased by 17.0 percent to $70.7 million over the year due to a significant increase in cash on hand by $19.4 million to $28.7 million.

Other major assets included outstanding premiums, amounts due from reinsurers, Government securities, shares in related persons and land & building.

All insurers satisfactorily complied with required reinsurance arrangements, which were assessed to be adequate.

The industry's total liabilities (excluding shareholders funds) increased over the year to $649.2 million. This was underpinned by growth in life insurance liabilities which resulted from the continued increase in balance of revenue account which forms the bulk of the industry's liabilities, at $481.0 million.

The overall after tax profit was reported at $20.5 million, a considerable increase over the corresponding 2006 period. Positive underwriting results by the general insurance sector, coupled with the favourable investment performance in the life insurance sector, contributed to the overall growth.

The industry's liquidity position is considered satisfactory as the major assets are concentrated in bank deposits and Government securities. These can be easily liquidated should the need arise.

Insurance Brokers

The insurance broking industry's total earnings for the quarter under review slightly fell by 10.0 percent to $3.1 million.

The overall after tax profit was reported at $1.0 million, a reduction of 32.0 percent from the same period in 2006. The result is mainly attributed to the decline in revenue and a marginal increase in expenses.

The increase in expenses adversely affected the efficiency ratio (total expenses-to-total revenue) of the broking industry, raising it from 52.2 percent a year ago, to 60.2 percent.

Brokerage earned as commission continued to be the major revenue earner for the industry despite declining by 13.0 percent for the quarter to $2.9 million (2006: $3.3 million).

Total expenses increased by 4.0 percent to $1.9 million. All expenses except for directors' fees and other expenses recorded an increase when compared with the same quarter last year.

The aggregate amount outstanding in the Insurance Broking Account for the review quarter was $6.3 million, up by 54.7 percent from $4.1 million in the same quarter of 2006. The increase was due to the decline in total withdrawal during the quarter.

A total of 118 applications worth $4.5 million were approved in the third quarter of 2007 compared to 111 applications amounting to $5.2 million in the same period in 2006.

For the Record

MEMORANDUM OF AGREEMENT SIGNED BETWEEN THE FIJI POLICE FORCE AND THE FINANCIAL INTELLIGENCE UNIT

Statement by the Director Financial Intelligence Unit, Reserve Bank of Fiji, 24 January 2008

A Memorandum of Agreement (MOA) was signed today between the Fiji Police Force and the Financial Intelligence Unit (FIU).

The MOA will enable the two agencies to exchange intelligence and financial information and to work together to detect, investigate and prosecute money laundering and proceeds of crime cases.

The Commissioner of Police Commodore Esala Teleni said that there is a greater need in Fiji to maximize exchanges of information and effective cooperation among law enforcement authorities. Commissioner Teleni said that the Fiji Police Force has had a close working relationship with the Financial Intelligence Unit since 2003 by placing a Police Officer on fulltime secondment with the FIU office at the Reserve Bank of Fiji. He said that this arrangement will now enable the Fiji Police Force to quickly access financial transaction information and will also allow its investigators to trace movements of funds of suspects involved in money laundering and other financial crimes.

Commissioner Teleni added that police investigators have been working on more than 60 cases that were referred by the FIU. As a result of FIU's intelligence and case disseminations, a number of money laundering, proceeds of crime and other serious offence cases were successfully investigated by the Police and are now with the Office of the Director of Public Prosecutions and the Courts.

The Director of the Financial Intelligence Unit, Mr. Razim Buksh said that this arrangement will further strengthen the cooperation and networking between relevant domestic agencies in Fiji in the fight against serious criminal activities including money laundering offences.

All financial institutions in Fiji are now required under the Financial Transactions Reporting Act to report certain transactions to the FIU and these include reporting of suspicious transactions, all international electronic funds transfer transactions and cash transactions of F$10,000 or more. In addition to this, all inbound and outbound travelers are now required to declare and report if they are carrying F$10,000 or more in currency or negotiable bearer instruments.

Mr Buksh said that this information is extremely beneficial when investigating complex crimes such as money laundering. Therefore, networking and timely exchanges of information and financial intelligence with FIU's partner agencies such as the Fiji Police Force becomes crucial.

Mr Buksh added that although a lot more needs to be done in Fiji to combat such crimes, the FIU was happy with the progress so far particularly with the implementation of measures under the Financial Transactions Reporting Act and the level of networking with relevant law enforcement authorities.

A Police Officer will continue to be seconded to the FIU under the MOA.

Mr. Buksh said similar MOAs were signed last year with the Director of Immigration and the Fiji Islands Revenue and Customs Authority. Discussions are continuing with the Ministry of Justice, Fiji Islands Trade and Investment Bureau and other Government departments and agencies to finalize similar arrangements.

The FIU has powers under the Financial Transactions Reporting Act to enter into arrangements with Government institutions and agencies for the exchange of information subject to strict confidentiality and protection of information requirements.