



RESERVE BANK OF FIJI

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OVERVIEW

Prospects for a stronger global economy have firmed, with the International Monetary Fund recently increasing its 2006 world growth forecast to 5.1 percent, from 4.9 percent projected earlier in the year. Stronger-than-expected performances in most regions during the first half of the year largely underpinned the improved outlook. In particular, solid expansions from the US economy, Japan, the Euro-zone and key emerging markets were the underlying source of optimism. The growth outlook for Fiji's trading partner economies remain encouraging, however, persistent high crude oil prices pose a potential drag on economic activity.

Domestically, partial and forward-looking indicators continue to present an encouraging growth scenario. Consumption and investment spending remain resilient. In addition, surveys conducted by the Reserve Bank on various macroeconomic indicators point to an optimistic outlook over the short to medium term. The pattern of economic growth, however, is disproportionately spread across the real sector. Furthermore, the external sector remains weak. Nevertheless, overall, growth prospects across the economy is generally optimistic.

Partial indicators of consumer spending continue to show sustained resilience in consumption patterns. Both net Value Added Tax (VAT) and net income tax collections rose in the year to August. Furthermore, lending by commercial banks for consumption purposes also grew during the same period. Employment expectations obtained through the Reserve Bank's main surveys point to higher recruitment intentions for the medium term. The building and construction sector, tourism-related industries and the finance sector appear to be the common key sectors with major positive influence.

Investment demand continues to rise. The total value

of work put in place by the private sector dominated the overall growth in building activity over the first six months, rising by 38 percent. Additionally, lending by commercial banks for investment purposes rose further in the year to August by around 64 percent. Looking ahead, the June Business Expectations Survey revealed optimistic investment plans in plant & machinery and new buildings. In addition, sentiment on the outlook for general business conditions is quite favourable, with optimism from the manufacturing, tourism, building & construction and the wholesale & retail trade sectors.

The real sector continues to under-perform. Both cane and sugar output levels fell on an annual basis by the end of September, with the quality of cane remaining unchanged. Copra and gold production also fell in the first eight months of this year. Electricity production continued to increase, depicting both higher household consumption and economic activity.

On balance, monetary and credit growth slowed further in August. Total money supply grew at 16 percent, around the same rate of growth in July, driven largely by further expansion in time deposits. Since peaking at a growth rate of 29 percent in May, total commercial bank credit has since slowed and was around 24 percent at the end of August. Compared with end July, lower contributions to growth in lending emanated from the electricity & water sector, and the hotels and restaurants sub-sector of the wholesale, retail trade & hotels and restaurants sector. A slowdown in overall lending was also noted for Licensed Credit Institutions (LCIs).

Interest rates continued to rise, with commercial banks' time and savings deposit rates at 6.23 percent and 0.81 percent, respectively, at the end of August. Similarly, the weighted average lending rate rose by 5

basis points to 7.65 percent. Similar trends emerged from LCIs, with both the time deposit rate and interest rates on new loans increasing further.

Inflation in September was 2.8 percent compared with 2.9 percent in August. Over the month, consumer prices rose by 0.1 percent driven by higher prices of housing, heating & lighting, clothing & footwear, miscellaneous items and transport. The underlying measure of inflation, the trimmed mean, rose to 1.8 percent on an annual basis. Overall, the year-end inflation forecast remains unchanged at 3.5 percent.

Conditions in the labour market are improving. Cumulative to September, an annual increase of around 16 percent was recorded for taxpayers registered with Fiji Islands Revenue & Customs Authority (FIRCA). Looking ahead, both the Bank's September Survey of Job Advertisements and the Fiji Employers Federation (FEF) indicated optimism in hiring intentions over the medium-term.

On the external front, latest Overseas Exchange Transactions (OET) data show that cumulative to August, merchandise export earnings fell by 12.3 percent due to lower receipts from the major commodities. During the same period, merchandise import outlays rose by around 9.3 percent due to higher payments on all import categories.

The official reserves level has increased significantly as a result of international borrowings by the Fiji Government to meet Budget deficit requirements for 2007, and in particular to finance its capital projects. As at the end of September, official reserves were estimated at \$817.2 million, sufficient to cover 3.4 months of goods imports.

SECTORAL DEVELOPMENTS

During the review period, sectoral performances were generally positive. Partial indicators suggest that consumption activity remained firm, supported by growth in Net VAT collections and income. Activity in the building & construction sector also continued to remain robust. In the year to September, electricity generation continued to post an encouraging trend. On the downside, however, sugar, gold and copra production remained weak.

Consumption

Consumption remained upbeat in the year to August. Net VAT collections, a partial indicator of consumer spending, amounted to around \$309 million, representing a 17 percent annual increase during the review period.

This growth was underpinned by higher VAT collections from domestic sources (12 percent), customs services (9 percent) and collections from government departments (7 percent)¹, when compared with the corresponding period in 2005.

Income

Cumulative to August, net income tax collections amounted to around \$236 million, indicating a 17 percent increase on an annual basis. In addition, Pay As You Earn collections, a partial indicator of individual incomes, totalled around \$138 million during the first 8 months of the year, representing a 17 percent increase over the comparable period last year.

Electricity

Electricity production continued to hold up well during the review period. In the year to September, electricity generated by the Fiji Electricity Authority totalled 557 mega watt hours (Mwh), an increase of around 10 percent over the corresponding review period last year.

Building & Construction

The building & construction sector also performed strongly in the second quarter of this year, evident by the value of work put-in-place. According to the 2006 Quarter 2 Building and Construction Survey² report released by the Fiji Islands Bureau of Statistics, \$156 million was spent on capital works during the first half of the year, an increase of 34 percent on an annual basis.

By categories, cumulative to June 2006, the total value of work put-in-place by the private sector rose by around 38 percent (to \$125m), followed by the public sector, which recorded an increase of 19 percent (to \$31m) during the review period.

Cane and Sugar

Up to September this year, the sugarcane industry is

¹ VAT from the Customs Services, Government Departments and Domestic collections are 3 separate categories of net VAT collections.

² The survey covers all private sector enterprises operating in the private and public sectors of the construction sector.

estimated to have contracted by 5.9 percent on an annual basis, with around 1,976,000 tonnes of cane crushed. Unfavourable climatic conditions experienced earlier in the crushing season, frequent mill breakdowns and land tenure issues saw slower transportation of cane to the mills and poorer performance when compared with the same period in 2005.

Consistent with the industry problems mentioned, cumulative to September sugar production was estimated at 199,000 tonnes, registering a deterioration of 8.6 percent on annual basis. The Tonnes Cane to Tonnes Sugar ratio was 10:1, this was around the same as that in the comparable period last year.

Copra

Latest statistics from the Coconut Industry Development Authority show that in the year to August, copra production amounted to around 7,500 tonnes, representing a decline of 6 percent over the corresponding period in 2005.

In the review period, the minimum mill gate price of copra remained unchanged at \$500 per tonne with Government's subsidy towards the mill gate price being \$83.45 per tonne.

Gold

Production in the gold industry also continues to remain subdued. Cumulative to August, total gold output amounted to almost 29,000 ounces, 53 percent lower than the corresponding level in 2005. Poor production is mainly resulting from mining disruptions due to the restructure program being undertaken at the mill.

Similarly, gold earnings for the same period totalled \$29 million representing a decline of 34 percent over the comparable period last year.

Business Expectations Survey (BES)

According to the results of the June 2006 BES, the outlook for general business conditions is optimistic with a net 42 percent of respondents expecting business to pick up in the three months to September. This is an increase of around 30 percentage points (pp) when compared to the December 2005 survey response. This improved outcome is underpinned by stronger than anticipated expectations from the manufacturing, tourism, building & construction, wholesale & retail trade sectors/ industries.

For the medium term (over the next 12 months), the net majority of respondents (56%) anticipate general business conditions to improve. Encouragingly, this sentiment is higher (by 21 pp) than in the December 2005 survey. The major impetus is stemming from the communication, insurance, manufacturing, real estate and wholesale & retail trade industries.

On production, stronger medium term sentiment was expressed when compared with the previous surveys. A net 43 percent of respondents anticipate production to rise in the coming 12 months to June 2007. Underpinning this outlook are the manufacturing, building & construction, insurance, tourism and garments industries/ sectors.

Similarly, expectations for employment over the medium term also strengthened (by 7 pp) with a net 38 percent of the respondents anticipating employment to increase. The higher expectation for recruitment intentions mainly emanated from the communication, real estate, building & construction, manufacturing and tourism industries/ sectors.

In addition, investment prospects also remained optimistic. Over the medium term, a net 48 percent of respondents anticipate increased investment in plant and machinery. This outlook is dominated by the communication, insurance, real estate and tourism industries. Similar positive sentiment was expressed for investment in new buildings, with a net 45 percent of respondents anticipating investment to rise in this category, over the next 12 month period. The outlook for investment in buildings remains the same as that of the December 2005 survey result.

Inflation

Inflation in September was 2.8 percent compared with 2.9 percent in August. Over the month, consumer prices rose by 0.1 percent. During the month, prices of housing, heating & lighting, clothing & footwear, miscellaneous items and transport rose while costs of food and alcoholic drinks & tobacco fell. Costs of durable household goods and services remained unchanged. The higher cost of housing was a result of an increase in private house rent while the rise in cost of heating & lighting was underpinned by the increase in the price of kerosene. Likewise, the rise in cost of transport emanated from the increase in price of petrol and diesel implemented by the Prices & Incomes Board in the month of September. The lower price of food items, on the other hand, was underpinned by a fall in prices of market items, while

the decline in the cost of alcoholic drinks & tobacco was due to a fall in the price of cigarettes and some alcoholic spirits.

The underlying measure of inflation, the trimmed mean, rose to 1.8 percent on an annual basis.

Overall, prices fell slightly. This was largely due to a fall in the price of market items. In terms of the inflation forecast, year-end inflation is expected to remain at 3.5 percent.

Labour Market

Employment conditions are improving. Cumulative to September, around 6,400 taxpayers were registered with the FIRCA, representing an annual increase of around 16 percent. The highest number of new taxpayers so far have been registered in the community, social & personal services sector followed by the wholesale, retail trade, restaurants & hotel; finance, insurance, real estate & business services; manufacturing; transport, storage & communications and construction sectors.

Furthermore, the Reserve Bank's September Survey of Job Advertisements registered a rise of around 20 percent over the comparable period last year. Recruitment intentions were largely noted in the wholesale, retail trade, restaurants & hotels; community, social & personal services; transport, storage & communication; construction; and finance, insurance, real estate & business services sectors.

Looking ahead in the approaching months, employment prospects remain positive, as indicated by the Reserve Bank's FEF expectations survey conducted in September. According to the survey, a net of around 81 percent and 63 percent of the respondents expect an increase in permanent and temporary employment, respectively. On the wages front, the survey noted that around 83 percent of the respondents anticipate wages to rise between 0-5 percent, while the remaining 9 percent expect a rise of between 5-10 percent.

Money and Credit Aggregates

In August, the annual growth rate of credit by commercial banks declined to 24.2 percent from 25.4 percent and 25.9 percent in July and June,

respectively. This was mainly underpinned by a slowdown in lending to the wholesale & retail trade and building & construction sectors.

Furthermore, the annual growth rate of credit for consumption purposes continued its downward trend during the review period. The annual growth rate of commercial bank lending for consumption purposes was 9.4 percent in August. On the investment lending side, the annual growth rate of commercial bank credit for such purpose increased to 63.8 percent in August, from 62.7 percent in July. New loans disbursed by commercial banks rose by 47.1 percent over the month to \$83.3 million in August.

In line with the moderation in credit by commercial banks, lending by LCIs also slowed in August. The annual growth rate of loans stood at 19.3 percent, after recording 20.8 percent growth in the previous month.

Interest Rates

Interest rates continued to increase in August. Commercial banks' time and savings deposit rates were both up by 27 basis points and 7 basis points, to 6.23 percent and 0.81 percent, respectively. The commercial bank lending rate rose over the month by 5 basis points to 7.65 percent. In addition, interest rates on new deposits also increased to 7.86 percent from 7.53 percent in July, while the interest rate on new loans fell by 39 basis points to 8.87 percent during the current period.

Similar trends emerged from LCIs. The interest rates on new loans rose to 15.86 percent, an increase of 130 basis points over the month, while the new time deposit rates also rose to 8.26 percent from 8.14 percent recorded in July.

External sector

Latest OET data shows that cumulative to August this year, merchandise export earnings fell by 12.3 percent, compared with a decline of around 17.4 percent in the corresponding period in 2005. The decline in receipts was due to lower receipts from sugar, ginger, fish, mineral water, textiles, clothing & footwear and re-exports other than mineral fuels. These more than offset the higher inflows from gold, copra, timber, re-exports of mineral fuels and other

exports.

During the same period, merchandise import payments rose by around 9.3 percent, compared to a growth of around 12.3 percent in the corresponding period in 2005, with the increase evident across all categories. The higher outflows for investment goods (4.0 percent) was largely made up of higher payments for machinery & electrical equipments and chemicals, while the growth in consumption goods payments (3.5 percent) was largely attributed to the increase in payments for duty free goods, transport equipment, food, beverage & tobacco. For intermediate goods, the increase (1.7 percent) was underpinned by mineral fuels, raw materials and textiles, clothing & footwear.

Excluding re-exports of mineral fuels, export earnings fell by around 14 percent cumulative to August 2006, after a decline of 20 percent in the same period in 2005. Excluding mineral fuels, merchandise imports rose by around 9 percent cumulative to August 2006, compared to around 7 percent increase in the same

period in 2005.

Exchange Rate Developments

Bilateral movements in exchange rates reveal that during the month of September, the Fiji dollar generally strengthened against the Australian dollar (1.3%), Euro (0.5%) and Yen (0.1%), while the local currency weakened against the New Zealand (1.9 %) and US (0.5%) dollars.

The Nominal Effective Exchange Rate³ (NEER) Index of the Fiji dollar fell by 0.1 percent in the year to September 2006, indicating a depreciation of the Fiji dollar against the basket of currencies.

The Real Effective Exchange Rate⁴ (REER) Index of the Fiji dollar, a gauge of our international competitiveness, also fell by 0.4 percent during the review period. The decline in the REER Index reflects an improvement in our international competitiveness and was largely based on developments in consumer prices.

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³ The NEER index is the sum of the indices of each trading partner country's currency against the Fiji dollar, adjusted by their respective weight in the basket. Each weight reflects a trading partner's contribution to Fiji's total trade in goods and services. This index measures the overall movement of the Fiji dollar against the basket of currencies. An increase in this index indicates a slight appreciation of the Fiji dollar against the basket of currencies and vice versa.

⁴ The REER index is the sum of each component of the NEER index, adjusted by the relative price differential between Fiji and each of Fiji's major trading partners. This index measures the competitiveness of the Fiji dollar against the basket of currencies. A decline in the REER index indicates an improvement in Fiji's international competitiveness and vice versa.

FIJI: FINANCIAL STATISTICS

KEY INDICATORS	Sep-06	Aug-06	Jul-06	Sep-05
1. Money and Credit (year-on-year % change)				
Narrow Money	n.a.	-4.78	-1.73	25.49
Currency in Circulation (monthly average)	n.a.	11.50	11.23	10.41
Quasi-Money (Time & Saving Deposits)	n.a.	36.08	32.59	12.91
Domestic Credit	n.a.	26.74	27.43	22.58
2. Consumer Prices ^{1/} (year-on-year % change)				
All Items	2.8	2.9	1.8	1.7
Food	1.6	1.9	-1.5	-0.1
3. Reserves (end of period)				
Gross Foreign Reserves (\$m)*	817.2	593.3	621.5	939.0
Months of Imports (goods)	3.4	2.5	2.6	4.6
4. Liquidity (end of period)				
Liquid Assets Margin to Deposit Ratio (%)	n.a.	4.6	5.3	10.4
Banks' Demand Deposits (\$m)	n.a.	53.6	82.6	122.6
5. Interest Rates (% p.a.) (monthly average)				
Lending Rate (Excluding Staff)	n.a.	7.65	7.60	6.70
Savings Deposit Rate	n.a.	0.81	0.74	0.39
Time Deposit Rate	n.a.	6.23	5.96	1.79
91-day RBF Note Rate (month end)	n.i.	n.i.	4.25	1.75
Minimum Lending Rate (MLR) (month end)	5.25	5.25	5.25	2.25
Overnight Inter-bank Rate	5.30	5.15	5.21	1.45
5-Year Government Bond Yield	n.i.	n.i.	n.i.	2.77
10-Year Government Bond Yield	9.60	n.i.	9.52	5.39
6. Exchange Rates ^{2/} (mid rates, F\$1 equals) (end of period)				
US dollar	0.5785	0.5816	0.5775	0.5850
Pound sterling	0.3083	0.3054	0.3098	0.3320
Australian dollar	0.7723	0.7622	0.7524	0.7697
New Zealand dollar	0.8797	0.8967	0.9334	0.8467
Swiss francs	0.7215	0.7144	0.7112	0.7563
Euro	0.4554	0.4532	0.4524	0.4858
Japanese yen	68.15	68.12	66.22	66.11
7. Commodity Prices (US\$) (monthly average)				
UK Gold Price/fine ounce ^{2/}	599.54	633	632.67	454.23
London Daily Sugar Price/tonne ^{3/}	12.45	13.58	16.69 ^{3/}	278.12
Crude Oil/barrel ^{4/}	62.77	73.61	73.90	62.98
<p>n.a. - Not available/No activity n.i. - No issues n.t. - No trading * Official reserves includes foreign reserves holdings of the RBF and Non-Bank Financial Institution, as per the new definition of official reserves</p> <p>Sources: ^{1/} Fiji Islands Bureau of Statistics ^{2/} Bloomberg and Reserve Bank of Fiji ^{3/} Fiji Sugar Marketing Company Limited ^{4/} Bloomberg ^{5/} World Market Sugar Price (New York No. 11) from Jul-06</p>				