



RESERVE BANK OF FIJI

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OVERVIEW

Global economic developments have been for some time continuing to support growth in Fiji. All of Fiji's major trading partner countries and selected Asian (China, Hong Kong and Singapore) economies are on track to record positive performances this year, buoyed by rising industrial production, personal consumption and improving business investment. Nonetheless, the high crude oil prices continue to pose a downside risk to global growth.

Domestic demand remains firm. Partial indicators of consumption such as domestic Value Added Tax (VAT) collections and imports of consumption goods grew on an annual basis during the review period, supported by firm employment conditions and rising incomes. In addition, lending for consumption purposes rose in July, while the results of the June Retail Sales Survey indicate that retail sales are expected to grow by around 4 percent this year. Investment is also increasing, as suggested by the rising imports of investment goods on an annual basis.

Evidence of strong domestic economic activities can also be seen in the increasing demand for energy. For the first 8 months of the year, electricity generated by the Fiji Electricity Authority (FEA) rose on an annual basis. On the downside, however, output in the cane & sugar industries fell in the first 3 months of the crushing season. Gold output also fell by around 60 percent on an annual basis.

On the fiscal side, Cabinet has approved \$58.3 million be re-deployed from the existing budget to meet extra-budgetary requirements for the 2006 fiscal year. In addition, as per the Strategic Policy Statement¹, it is anticipated that the 2007 budget strategy will propose a fiscal framework that ensures that Government

continues on the path of fiscal consolidation in the medium term 2007 – 2009. According to the Statement, Government has set a deficit target of 2.0 percent of GDP for 2007, which it intends to progressively reduce to 1.5 percent of GDP in 2008 and to 1.0 percent of GDP in 2009. The underlying focus of the Government's fiscal policy over the medium term is to reduce deficits and thereby constrain the growth in levels of Government debt, whilst supporting investment, exports (growth) and essential services. Government projects its debt to increase slightly from 52.2 percent of GDP this year to 52.8 percent of GDP in 2007, before falling to 50.3 percent in 2008.

Recent data on monetary conditions have not been released as yet, however it is still anticipated that there will be continuing evidence of a slowdown in monetary and credit growth. In July, total money supply grew at a slower pace of 15.9 percent and private sector credit growth slowed slightly to 28.6 percent. Similarly, commercial bank lending eased further, reflecting a slowdown in lending to private individuals; wholesale & retail and hotels & restaurants; real estate and manufacturing sectors. New lending by commercial banks also fell. Lending for consumption purposes slowed, but lending for investment picked up in July. The growth in lending by Licensed Credit Institutions (LCIs) also slowed.

The slowdown in credit is a reflection of higher interest rates, which maintained an upward trend in July. Commercial banks' time and savings deposits and lending rates (for both outstanding holdings and new transactions) all increased. While the new time deposit rates offered by LCIs fell by 10 basis points in July, the interest rates charged on new loans increased substantially.

The combined effects of strong global conditions and

¹ This presents a framework to guide decisions on Budget priorities so as to ensure the Budget aligns with Government's medium-term policies and fiscal targets.

firm domestic demand are exerting some pressure on domestic price movements. Inflationary pressures are further boosted by higher international crude oil prices. In August, inflation rose to 2.9 percent, compared with 1.8 percent in July. Over the month, consumer prices rose due to higher prices of food, durable household goods, clothing & footwear and housing. With the removal of extreme price movements, the trimmed mean remained unchanged at 1.6 percent. In the coming months, the increases in prices of flour/sharps, domestic fuel and the expected increase in electricity prices are likely to exert more domestic price movements. The year-end inflation forecast however, remains unchanged at 3.5 percent.

Despite favourable conditions prevailing in the international economy, Fiji's trade performance continues to be disappointing. The latest Overseas Exchange Transactions (OET) data show that cumulative to July this year, merchandise exports fell by 11.2 percent. The annual decline was led by lower receipts from sugar, ginger, fish, mineral water, textiles, clothing & footwear and other re-exports, which more than offset the higher inflows from gold, copra, timber, re-exports of mineral fuels and other exports. Conversely, merchandise imports rose by 11.6 percent during the same period, with the increase evident across all categories.

As at the end of August, official reserves stood at \$593.3 million, sufficient to cover 2.5 months of goods imports.

SECTORAL DEVELOPMENTS

During the review period, partial indicators suggest that consumption activity remains favourable, supported by continuing growth in Net VAT collections and income. The results of the latest Retail Sales Survey also suggest that retail sales in 2006 will record a modest growth. Partial indicators suggest investment is rising, further implying activity in the building & construction sector continues to remain firm.

On a sectoral basis, electricity generation continued to grow while the performance of the cane & sugar industries remained subdued in the third crushing month of the season. In addition, there are indications that this year's gold production will likely be lower than initially expected, representing a strong decline from last year's production level.

Consumption

Consumption continues to remain upbeat this year, evident by the growth in partial indicators of

consumer spending. In the year to July, net VAT collections amounted to \$269 million, an increase of around 18 percent during the review period.

This growth was underpinned by higher VAT collections from domestic sources (14 percent), customs services (10 percent) and collections from government departments (5 percent)² when compared with the corresponding period in 2005.

Income

Cumulative to July, net income tax revenue amounted to \$205 million, indicating a 17 percent increase on an annual basis. In addition, Pay As You Earn collections, a partial indicator of individual incomes, amounted to around \$120 million during the first 7 months of the year, representing around 17 percent increase on an annual basis.

Retail Sales Survey

The June 2006 survey results have indicated that overall retail sales this year will increase by around 4 percent, lower than the earlier projection of 5.4 percent indicated in the December 2005 survey.

For this year, retailers have indicated healthy sales prospects in food, drinks and tobacco, other duty free retailing, motor cars & other transport equipment, entertainment, footwear, household goods and appliances and restaurant categories.

The 4 percent growth forecast for this year is also broadly consistent with the expansion in the partial indicators of retail sales. All categories of imports recorded an annual growth, cumulative to June and domestic VAT cash collections showed an increase of 12.7 percent on an annual basis in the year to June.

The lower projection in retail sales is most likely due to retailers' sentiments on the monetary policy tightenings by the Reserve Bank in the first half of 2006.

Electricity

Electricity production by the FEA continue to suggest rising economic activity. Cumulative to August, total electricity generated was around 502 mega watt hours (Mwh), an increase of 10.2 percent on an annual basis.

Cane and Sugar

The cane and sugar industry recorded a weaker performance in the first 3 months of the crushing

² VAT from the Customs Services, Government Departments and Domestic collections are 3 separate categories of net VAT collections.

season this year, when compared with the same period in 2005.

Mill reports from the Fiji Sugar Corporation indicate that around 1,353,000 tonnes of cane was crushed up to August this year, representing an annual decline of 8.4 percent. The Tonnes Cane to Tonnes Sugar ratio was around 10:1, similar to the level recorded during the previous review period.

In line with the lower cane output, sugar production amounted to a little over 132,000 tonnes, representing a decline of 9.9 percent on annual basis. Poor sugar production is largely attributed to frequent mill breakdowns, unfavourable climatic conditions, land tenure related issues and lower cane supply.

Gold

Output in the gold industry continues to remain weak. Cumulative to July, total gold production amounted to around 22,000 ounces, representing a sharp decline of 60 percent on an annual basis. This is the lowest level of production recorded in the year to July since 1993. Similarly, gold earnings totalled \$22 million in the review period, a deterioration of 44 percent over the same level in 2005.

Inflation

In August, inflation rose to 2.9 percent, compared with 1.8 percent in July. Over the month, consumer prices rose by 0.4 percent led by higher prices of food, durable household goods, clothing & footwear and housing. Prices of alcoholic drinks & tobacco fell, while costs of heating & lighting, transport, services and miscellaneous items remained unchanged. The higher prices of food items was underpinned by increases in prices of market items and edible oil, whilst costs of certain items under the durable household goods and clothing and footwear categories continued to reflect higher import duties. Additionally, the marginal pick up in the price of housing was due to the rise in costs of repair items. The decline in prices of alcoholic drinks & tobacco on the other hand, was largely due to a fall in prices of cigarettes.

The underlying measure of inflation, the trimmed mean, remained unchanged at 1.6 percent.

As anticipated, prices have picked up for the third consecutive month since June this year. This has been largely underpinned by inflationary pressures emanating from higher international crude oil prices and, consequently, an increase in our average trading partner inflation.

Looking ahead, the recent introduction of the electricity fuel surcharge and the increases in prices of flour/sharps and domestic fuel are likely to exert some domestic price movements. The approved electricity fuel surcharge which takes effect in October is expected to add another 0.45 percentage points to inflation.

Factoring these developments into the inflation forecast, the year-end inflation projection nevertheless remains unchanged at 3.5 percent.

Labour Market

Employment conditions remain positive. Cumulative to August, around 6,100 taxpayers were registered, representing an annualised 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.

On the wages front, the minimum wage guideline for workers under the Manufacturing sector and the Hotel & Catering trade rose by an average of around 10 percent. The new rates of remuneration became effective on 21 August for Manufacturing workers, while for employees under the Hotel & Catering category, it was effective from 25 August. Moreover, civil servants were paid out around 2 percent Cost of Living Adjustment for 2004, on 28 August this year.

Money and Credit Aggregates³

As reported in the previous economic review, the annual growth rate of credit by commercial banks slowed to 25.4 percent in July, from 25.9 percent in the previous month.

Credit for consumption increased at an annualised rate of 9.4 percent (\$57.2m), while lending for investment purposes grew by 62.7 percent (\$138.2m) in July. In addition, new loans disbursed by commercial banks fell by 20.7 percent over the year to \$56.7 million.

Similarly, lending by LCIs rose by 20.8 percent (\$53.1m) to \$308.5 million in July. The increase was largely due to higher lending to the real estate sector and private individuals.

On the supply side, total commercial bank deposits rose by 17.4 percent to around \$2.6 billion in the year

³ Available monetary and credit data remains the same as per the August review.

to July 2006, following a growth of 20.8 percent in the preceding month. This was largely attributed to increases in time deposits with commercial banks.

Interest Rates

As reported in the previous economic review, movements in interest rates have indicated further increases in July. Commercial banks' time and savings deposit rates were both up by 31 basis points and 1 basis point, to 5.96 percent and 0.74 percent, respectively. The commercial bank lending rate rose over the month by 43 basis points to 7.60 percent. In addition, interest rates on new loans also increased, to 9.26 percent from 8.48 percent in June, and the interest rate on new deposits also rose by 16 basis points to 7.53 percent in July.

Similar trends emerged from LCIs. The interest rates on new loans rose to 14.56 percent, an increase of 201 basis points over the month, while new time deposit rates fell to 8.14 percent from 8.24 percent recorded in June

External sector

Latest OET data shows that cumulative to July this year, merchandise exports fell by around 11.2 percent, compared with a decline of around 18.9 percent in the corresponding period in 2005. The decline in receipts was due to lower earnings from sugar, ginger, fish, mineral water, textiles, clothing & footwear and other re-exports which more than offset the higher inflows from gold, copra, timber, re-exports of mineral fuels and other exports.

During the same period, merchandise imports rose by

around 11.6 percent, compared to a growth of around 10.6 percent in the corresponding period in 2005, with the increase evident across all categories. The higher outflows for investment goods (5 percent) was largely made up of higher payments for machinery & electrical and chemicals imports while the growth in consumption goods payments (4.3 percent) was largely attributed to the increase in payments for duty free goods, transport equipment, food, beverage & tobacco. For intermediate goods, the increase (2.2 percent) was underpinned by mineral fuels, raw materials and textiles, clothing & footwear.

Exchange Rate Developments

On the domestic front, bilateral movements in exchange rates reveal that during the month of August, the Fiji dollar generally strengthened against the Yen (2.9%), Australian dollar (1.3%), US dollar (0.7%) and Euro (0.2%), and weakened against the New Zealand dollar (3.9 %).

The Nominal Effective Exchange Rate⁴ (NEER) Index of the Fiji dollar fell by 0.1 percent in the year to August 2006, indicating a depreciation of the Fiji dollar against the basket of currencies.

The Real Effective Exchange Rate⁵ (REER) Index of the Fiji dollar, a gauge of our international competitiveness, also fell by 0.1 percent during the review period. The decline in the REER Index reflects an improvement in our international competitiveness and was largely due to the better domestic inflation outcome. Domestic inflation was around 2.9 percent in August 2006, while average trading partner inflation was around 3.1 percent during the same period.

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⁴ 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.

⁵ 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	Aug-06	Jul-06	Jun-06	Aug-05
1. Money and Credit (year-on-year % change)				
Narrow Money	n.a.	-1.73	5.48	20.57
Currency in Circulation (monthly average)	n.a.	11.23	23.13	8.88
Quasi-Money (Time & Saving Deposits)	n.a.	32.59	31.77	10.83
Domestic Credit	n.a.	27.43	29.38	21.98
2. Consumer Prices ^{1/} (year-on-year % change)				
All Items	2.9	1.8	1.6	2.2
Food	1.9	-1.5	-0.5	1.8
3. Reserves (end of period)				
Gross Foreign Reserves (\$m)*	593.3	621.5	648.7	967.0
Months of Imports (goods)	2.5	2.6	2.7	4.7
4. Liquidity (end of period)				
Liquid Assets Margin to Deposit Ratio (%)	n.a.	5.3	5.1	10.7
Banks' Demand Deposits (\$m)	n.a.	82.6	88.4	108.4
5. Interest Rates (% p.a.) (monthly average)				
Lending Rate (Excluding Staff)	n.a.	7.60	7.17	6.68
Savings Deposit Rate	n.a.	0.74	0.73	0.40
Time Deposit Rate	n.a.	5.96	5.65	1.81
91-day RBF Note Rate (month end)	n.a.	4.25	n.i.	1.75
Minimum Lending Rate (MLR) (month end)	5.25	5.25	5.25	2.25
Overnight Inter-bank Rate	5.15	5.21	4.26	1.27
5-Year Government Bond Yield	n.i.	n.i.	n.i.	2.73
10-Year Government Bond Yield	n.i.	9.52	9.38	5.34
6. Exchange Rates ^{2/} (mid rates, F\$1 equals) (end of period)				
US dollar	0.5816	0.5775	0.5657	0.5831
Pound sterling	0.3054	0.3098	0.3097	0.3264
Australian dollar	0.7622	0.7524	0.7666	0.7794
New Zealand dollar	0.8967	0.9334	0.9369	0.8461
Swiss francs	0.7144	0.7112	0.7005	0.7398
Euro	0.4532	0.4524	0.4473	0.4771
Japanese yen	68.12	66.22	65.19	64.89
7. Commodity Prices (US\$) (monthly average)				
UK Gold Price/fine ounce ^{2/}	633	632.67	597.11	437.74
London Daily Sugar Price/tonne ^{3/}	13.58 ^{5/}	16.69	380.41	264.22
Crude Oil/barrel ^{4/}	73.61	73.90	68.90	64.09
<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>				