RESERVE BANK OF FIJI

QUARTERLY REVIEW

December 2006

Private Mail Bag, Suva, Fiji Islands
Telephone: (679) 331 3611, Facsimile: (679) 330 1688, E-mail: rbf@reservebank.gov.fj
website: http://www.reservebank.gov.fj

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OVERVIEW

Growth in the global economy continued in the December quarter, led by the United States (US), Japan and the Euro-zone. The upward economic expansion was also supported by dynamic growth in the various Asian economies, particularly China. The International Monetary Fund (IMF) estimates that the world economy grew by 5.1 percent in 2006 and will expand by 4.9 percent in 2007. The projected moderate slowdown is mainly due to higher interest rates, while other downside threats include the volatility of oil prices, geo-political tensions and terrorism activities.

Despite recent evidence showing some moderation in economic growth, Fiji's major trading partner countries were on track for positive growth in 2006. However, in 2007, growth in the US, Japanese and Euro-zone economies are expected to slow, due to modest growth in consumption and business investment.

Trading in the international financial markets resulted in an increase in world equity prices while bond markets generally weakened. In the currency markets, the US dollar weakened against all of Fiji's major trading partner currencies except for the Japanese Yen.

Domestically, the economy was projected to expand by 3.6 percent in 2006. However, during the final quarter, the unanticipated closure of operations at the Vatukoula gold mine and the political crisis during November and December is expected to result in a lower growth rate than the previous forecast of 3.6 percent.

During the final quarter of 2006, sectoral performances were mixed. While the sugar, fishing, electricity and building & construction industries performed better on an annual basis, outcomes in the tourism, clothing & footwear, timber and copra industries were lower. Gold output also fell sharply on an annual basis during the review period.

On the demand side, consumer spending remained buoyant, as evident by higher Value Added Tax (VAT) collections, lending for consumption purposes, and imports of consumption goods, during the review period.

Investment has been improving, as suggested by partial indicators. According to the 2006 September Quarter Building and Construction Survey Report released by the Fiji Islands Bureau of Statistics (FIBOS),[1] around $242 million was spent on capital works in the first 9 months of 2006, an increase of 30.0 percent on an annual basis. In addition, the latest accrual trade data showed that cumulative to November 2006, import payments for investment goods rose by 17.3 percent on an annual basis.

According to the 2007 National Budget released under the former Government, estimates for the underlying fiscal deficit for 2006 stood at $193.1 million, or 4.0 percent of GDP, lower than the 4.6 percent of GDP announced in the 2006 Budget. Given the various fiscal measures announced recently by the Interim

[1] The Survey covers all private sector enterprises operating in the private and public sectors of the construction sector.

Administration, there is likely to be revisions to public finance projections to be announced in the new 2007 National Budget. However, expectations are that the new budget will still target a deficit of 2.0 percent of GDP.

At the end of 2006, inflation was 3.1 percent. The underlying measure of inflation, the trimmed mean, was 1.9 percent in December, up from 1.8 percent registered at the end of the September quarter.

Employment conditions in certain sectors of the economy deteriorated towards the end of the year. Following the political crisis, tourist arrivals fell, resulting in some casual and part-time employees being laid off, while some permanent employees worked on reduced hours. In addition, recruitment intentions were also weak as job advertisements during the December quarter survey fell by around 13.0 percent over the comparable period last year. However, on the whole, employment conditions were still buoyant in other sectors in the year to December. During 2006, around 7,200 taxpayers were registered with the Fiji Islands Revenue & Customs Authority (FIRCA), representing an annualised increase of around 20.0 percent.[2]

On the external front, the latest accrual trade data showed that cumulative to November 2006, merchandise export earnings fell by around 0.7 percent, compared with a decline of around 0.1 percent in the corresponding period in 2005. For the same reference period of 2006, merchandise import payments rose by around 16.9 percent, compared to a growth of around 10.5 percent in the corresponding eleven-month period in 2005.

Following the political events of 5 December, the Reserve Bank implemented additional policies to safeguard Fiji's external financial position, effective 6 December. The policy measures were aimed at stemming any speculative outflow of foreign reserves. They included the tightening of capital controls on various foreign exchange transactions, the introduction of a credit ceiling on individual banks and an increase in interest rates charged to banks that use the Reserve Bank of Fiji's lending facilities.

At the end of 2006, official foreign reserves were around $823.0 million, sufficient to cover 3.3 months of imports.

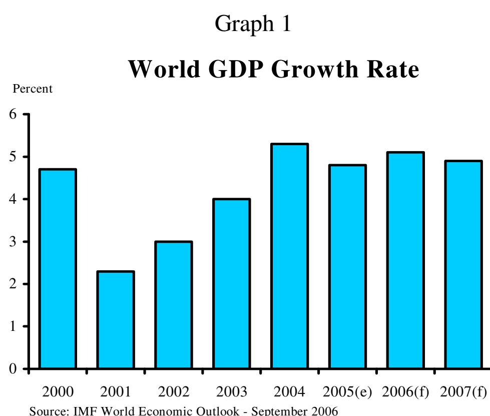
[2] The number of newly registered taxpayers with FIRCA is a partial indicator of employment conditions.

THE INTERNATIONAL ECONOMY

International Economic Conditions

International economic conditions continued to grow at a moderate pace in the final quarter of 2006, with the current global expansion being driven by the rapid growth of the US, Japan and Euro-zone economies. The US economy remains the main engine of global economic growth despite a slowdown in economic activity in the last quarter. In addition, dynamic growth of various Asian economies, particularly China, has contributed positively to global growth. The IMF estimates that the world economy grew by 5.1 percent in 2006 compared with a 4.8 percent growth in 2005 (Graph 1).

Graph 1



For 2007, the world economy is projected to record a growth of 4.9 percent. The slowdown is due to some downside risks that could also hamper this optimistic global growth outlook. Firstly, the medium term upward trend in oil prices has mainly been demand driven. As a consequence, the negative global welfare effects have largely been compensated by continued income growth worldwide. While there has been some recent reprieve in oil prices, in the near term the global oil market is expected to remain tight. Due to under-investment in global oil production capacity and shocks such as natural disasters and terrorist attacks, supply constraints in the oil market is expected to keep prices high in the near future. As a result of high oil prices, inflation rates have edged up worldwide, prompting central banks to tighten monetary policy, thus affecting the current pace of growth. Finally, geo-political tensions and terrorism threats could also slow the current growth prospect.

Monetary policy remained on a tightening bias in the review period, in response to inflationary pressures. In particular, Australia and the Euro-zone tightened their monetary policy stances during the quarter while the US and New Zealand kept their policies unchanged after increasing rates during the year.

Despite evidence showing some moderation in economic growth, Fiji's major trading partner countries were on track to record positive growth in 2006. However, in 2007, the US, Japanese and Euro zone economies are expected to slow, consistent with modest growth in consumption and business investment (Graph 2).

The **Australian** economy grew at a modest pace of 0.3 percent in the September quarter, after a revised 0.5 percent growth during the previous quarter. The slowdown in growth was led by a decline in consumption activity.

Graph 2

Sources: Consensus & Asia Pacific Consensus Forecast - December 2006

Economic indicators showed a mixed performance during the review quarter. Retail sales rose in October and consumer confidence rebounded in December, indicating positive consumption activity.

Business investment fell in the September quarter, while the trade deficit widened to a five-month high in October. Moreover, business confidence held steady at an eight-month low in November, on expectations that rising interest rates will curb economic growth.

In response to rising inflationary pressures, the Reserve Bank of Australia (RBA) raised its benchmark interest rate (the official cash rate) by 25 basis points to 6.25 percent in November, its third rate hike in 2006.

The economy is expected to expand by 2.6 percent in 2006, and by 3.0 percent in 2007. Consumer prices are expected to slow from 3.6 percent in 2006 to 2.8 percent in 2007, within the RBA's target band of 2-3 percent.

New Zealand's economic growth increased to 0.8 percent in the third quarter, from 0.5 percent in the June quarter, driven by stronger consumer spending.

Recent indicators show that economic activity remained encouraging in the current quarter. Manufacturing activity expanded in October, while retail sales also rose in the same month. Moreover, business confidence rose to a 21-month high in December.

The Reserve Bank of New Zealand maintained its key interest rate at 7.25 percent during the fourth quarter.

The economy is expected to record a growth of 1.9 percent in 2006 and 2.0 percent in 2007. The year-end inflation rate is expected to moderate from an estimated 3.6 percent to 2.6 percent in 2007.

Economic growth in the **United States** slowed from 0.6 percent in the second quarter, to 0.4 percent in the third quarter. The economy weakened on the back of industrial and housing sector sluggishness.

Recent data showed that economic performance was generally mixed during the December quarter. On the positive side, an index of leading US economic indicators[3] rose for a second month in October, providing some optimism for the months ahead. Industrial production also increased in October.

While consumer spending gathered pace in November, consumer confidence fell in December, from a 15-month peak in the previous month. Retail sales also fell in October, and jobless claims increased.

The Federal Reserve kept the benchmark interest rate unchanged at 5.25 percent during the review quarter.

The economy is expected to grow by 3.3

[3] The index of leading US economic indicators is a function of, amongst others, M2, interest rate spread, index of consumer expectations, stock prices (500 common stocks) and average weekly initial jobless claims.

percent in 2006, before moderating to 2.3 percent in 2007. Inflation is anticipated to slow from an estimated 3.3 percent in 2006 to 2.0 percent in 2007.

The **Euro-zone** economy grew by 0.5 percent during the third quarter, after a revised 1.0 percent growth in the previous quarter. Higher interest rates curbed consumer spending, while a slowdown in the US economy reduced demand for the zone's exports.

Latest indicators show positive economic performance in the fourth quarter. Consumer confidence in the Euro-region rose to a six-year high in November, while manufacturing activity also expanded in the same month.

Furthermore, the Euro-zone's two major economies, Germany and France, both reported positive results. German business and consumer confidence rose in November, while the unemployment rate fell in the same period. French unemployment also fell in November, while consumer spending rose.

The European Central Bank (ECB) raised its benchmark interest rate to 3.25 percent in October, to rein-in inflation.

The Euro-zone is expected to expand by 2.7 percent in 2006, and is estimated to slow to 2.0 percent in 2007. Year-end inflation for 2007 is forecast at 2.1 percent, compared with 2.2 percent estimated in 2006.

Japan's economic growth slowed marginally from 0.3 percent in the second quarter to 0.2 percent in the third quarter, led by weaker private consumption.

Nevertheless, recent data showed that industrial production rose in November, buoyed by overseas demand for cars and electronics. Retail sales and exports also gathered pace in the same month. Moreover, business confidence rose to a two-year high in December.

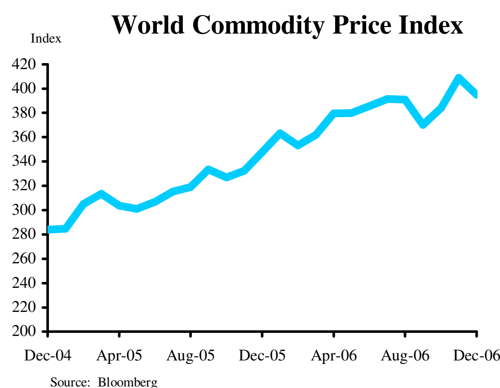
The Bank of Japan maintained its key overnight lending rate at 0.25 percent during the December quarter.

For 2006, Japan's economy is anticipated to grow by 2.4 percent, compared to 2.0 percent estimated for 2007. Inflation is forecast to increase marginally, from an estimated 0.2 percent in 2006 to 0.3 percent in 2007.

World commodity prices rose by around 6.7 percent over the fourth quarter, underpinned mainly by increases in sugar and gold prices (Graph 3).

Graph 3

World Commodity Price Index



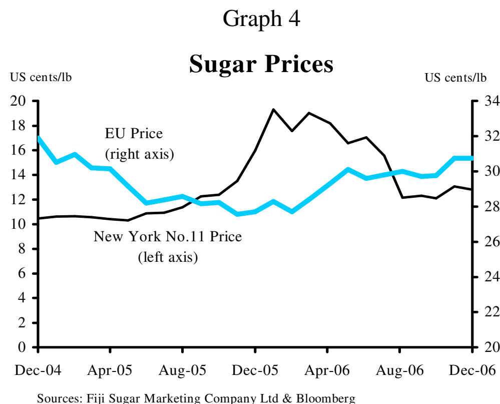
Source: Bloomberg

Over the December quarter, **world market sugar prices** rose by around 4.0 percent (Graph 4), despite being volatile on a monthly basis. World sugar prices fell in October on mounting speculation that rising production from Asia and the world's largest producer, Brazil, will create a global surplus of the sweetener. However, sugar prices rose strongly mid-quarter, on speculation that a ban on sugar exports by India, the

world's fourth-largest sugar exporter, will be extended into December,[4] raising concerns of a supply shortfall. Nonetheless, sugar prices fell in December, on speculation that India will remove the ban on exports, adding to a projected surplus in the world market. Overall, the decline in December was not large enough to offset the strong rise in November.

Graph 4

Sugar Prices



Sources: Fiji Sugar Marketing Company Ltd & Bloomberg

In the months ahead, prices are expected to remain low, on anticipation of excess supply.

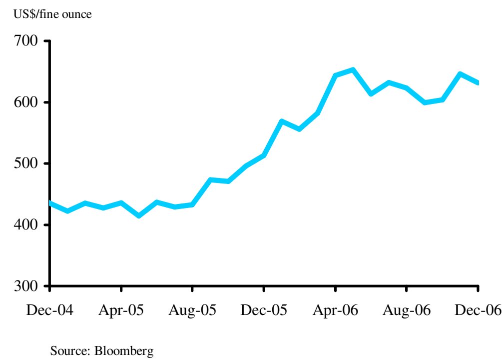
At the end of December, the European Union (EU) sugar price was around US31 cents per pound, having risen slightly over the quarter, due to a stronger Euro against the US dollar.

Gold prices rose by around 5.5 percent over the December quarter (Graph 5). Gold prices rallied in October and November, after a weaker US dollar boosted the appeal of the dollar-denominated metal from European buyers.

However, gold prices fell in the last month of the quarter, after the Euro's appreciation against the dollar stalled, eroding the precious metal's appeal as an alternative investment.

Graph 5

Gold Price

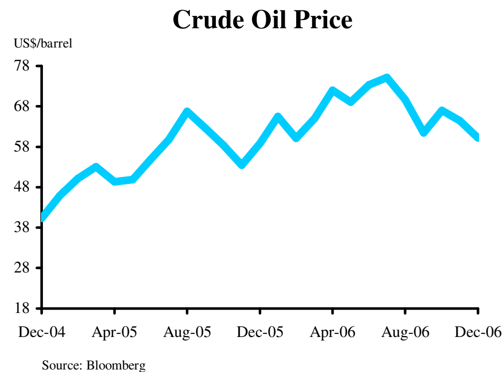


Source: Bloomberg

At the end of December, the **Brent crude oil price** was around US$60 per barrel, a decline of around 2.0 percent when compared to the price recorded at the end of September (Graph 6).

Graph 6

Crude Oil Price



Source: Bloomberg

Crude oil prices rose in October, amid rising expectations that the Organization of Petroleum Exporting Countries' (OPEC) members will adhere to planned production cutbacks.[5]

[4] India, the world's biggest sugar consumer, halted sugar exports in July to ease domestic supply pressure and contain inflation.

[5] The OPEC agreed in October to lower output by 1.2 million barrels a day from 1 November to stem a slide in oil prices.

However, crude oil prices fell in the latter months of the quarter, as warmer US weather conditions reduced heating demand from the world's largest consumer of energy.

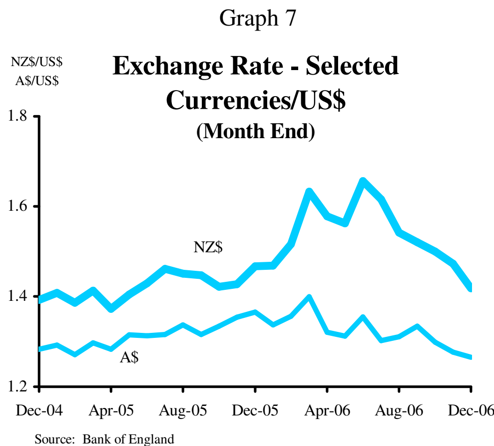
Looking ahead, concerns of strong global demand are expected to maintain upward pressure on crude oil prices.

International Financial Markets

Over the fourth quarter, the US dollar weakened against all of Fiji's major trading partner currencies except for the Japanese Yen.

During the quarter, the Australian and New Zealand dollars strengthened against the US dollar (Graph 7).

Graph 7

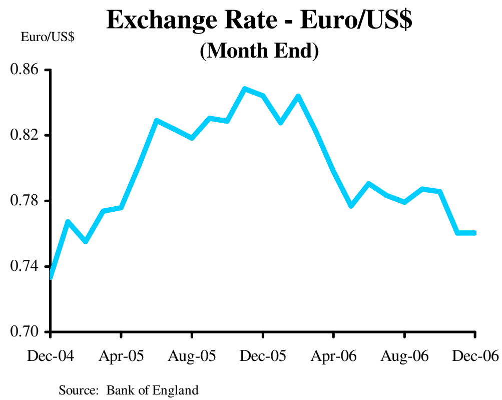


The Kiwi dollar strengthened against the Greenback throughout the quarter, buoyed by expectations that the New Zealand central bank will not reduce its key interest rate anytime soon.

Likewise, the Australian dollar strengthened against the US dollar throughout the quarter, as investors flocked to the higher yields available on Australian government bonds, following three interest rate increases by the RBA in 2006.

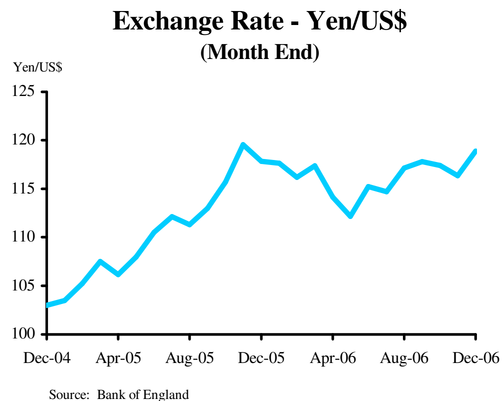
The Euro generally strengthened against the Greenback over the fourth quarter (Graph 8). The Euro appreciation occurred in the first two months of the quarter, after speculation that the US Federal Reserve would reduce interest rates, which prompted investors to demand more Euro-denominated assets. The Euro then weakened slightly in December, following the release of positive US economic indicators.

Graph 8



The Yen generally weakened against the US dollar over the quarter (Graph 9).

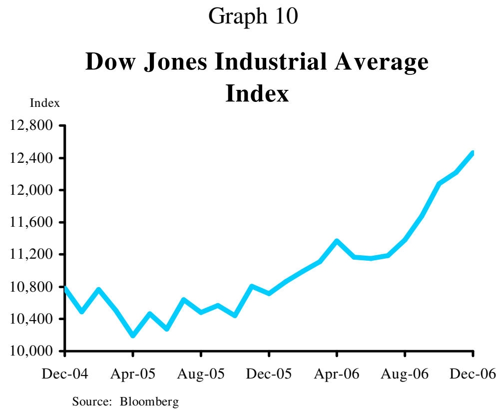
Graph 9



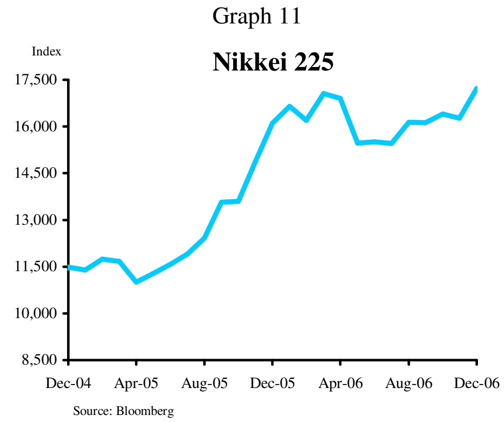
The Yen initially gained in the first two months of the quarter, after speculation that the US Federal Reserve would reduce interest rates prompted investors to switch to Yen-denominated assets from US dollar-denominated assets. However, in December, the Yen weakened again, following positive US economic indicators.

Trading in international financial markets saw world equity prices increase during the review quarter, when compared to the previous three months.

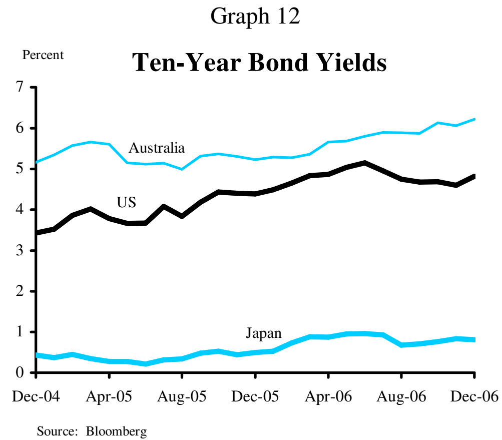
Over the December quarter, the Dow Jones Industrial Average Index rose by around 7.0 percent (Graph 10), after higher energy and commodity prices boosted profits of related companies.



The Nikkei 225 Stock Average Index rose by around 7.0 percent (Graph 11) over the last quarter, on reaction to higher overseas demand for Japanese exports, particularly automobiles, which increased optimism of company profits.



Over the last quarter of 2006, bond markets generally weakened. Ten-year bond yields for the US, Japan and Australia generally rose (Graph 12).



US bond yields rose, albeit marginally, over the three months to December, after an increase in US stocks prompted investors to switch from bonds to stocks. US stocks rose as higher energy and commodity prices led producing companies to increase their profit outlook.

Australian bond yields rose in the last

quarter of 2006, as positive economic indicators signalled a strengthening Australian economy, thus prompting investors to switch from bonds to other assets.

An increase in stock prices, especially automobile producing companies, lured investors away from bonds, causing Japanese bond yields to rise over the three months of the last quarter.

THE DOMESTIC ECONOMY

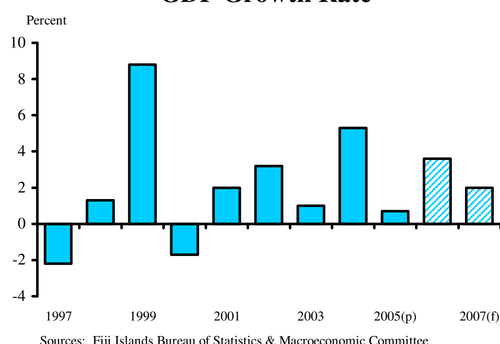
Domestic Economic Conditions

Fiji's economy was expected to expand by 3.6 percent in 2006. However, with the unanticipated closure of operations at the Vatukoula gold mine and the military takeover in early December, it is estimated that growth for 2006 will be revised downwards from the previous forecast. Growth for 2007 was earlier envisaged to slow to 2.0 percent (Graph 13), but a contraction is now expected.

Economic growth in 2006 is estimated to have been largely driven by better prospects in the community, social & personal services; building & construction; transport & communication and agriculture, forestry, fisheries & subsistence sectors. Positive developments in these sectors are expected to have more than offset the negative contribution from the mining & quarrying sector.

Graph 13

GDP Growth Rate



Sources: Fiji Islands Bureau of Statistics & Macroeconomic Committee

Consumer Spending

In the year to October, partial indicators of **consumer spending** registered buoyant performances. Cumulative to October, VAT collections from domestic activities[6] recorded a healthy growth of 11.0 percent, on an annual basis. Lending for consumption purposes and imports of consumption goods also increased.

Production

Mixed sectoral performances were registered during the review period. While the sugar, fishing, electricity and building & construction industries performed better on an annual basis, outcomes in the tourism, clothing & footwear, timber and copra industries were lower. Gold output also fell sharply on an annual basis during the review period.

Compared with the previous season, the **sugar** industry recorded a favourable turnaround in production (Graph 14) in 2006, attributed largely to a relatively longer crushing season.[7]

Cane output in the 2006 crushing season was around 3.2 million tonnes, an increase of 15.7 percent over the previous season. In line with the good cane harvest, sugar

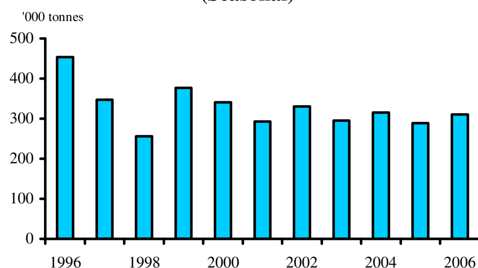
[6] There are 3 broad categories of VAT collections. These include import VAT, cash collections and Government collections.

[7] The 2006 sugar crushing season started on 31 May 2006 and ended on 11 January 2007. Compared with the 2005 crushing season, the 2006 crushing season was 6 weeks longer.

output rose by 7.3 percent to around 310,000 tonnes (from around 289,000 tonnes produced in the 2005 season). The relatively slower growth in sugar output was due to an increase in the Tonnes Cane to Tonnes Sugar ratio to 10.4 from 9.7 recorded during the corresponding period in 2005, indicating that cane quality had deteriorated in the 2006 season.

Graph 14

Sugar Production
(Seasonal)

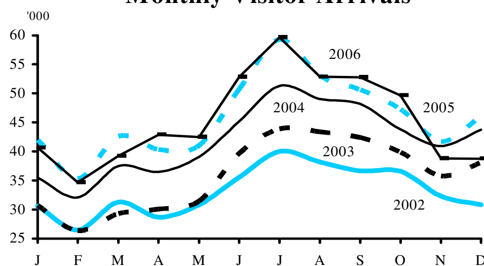


Sources: Fiji Sugar Corporation Ltd & Fiji Islands Bureau of Statistics

For the **tourism** industry, provisional data from FIBOS indicate that visitor arrivals for 2006 totalled around 545,000, representing a 0.9 percent decline on an annual basis.

Graph 15

Monthly Visitor Arrivals



Source: Fiji Islands Bureau of Statistics

The tourism industry had registered a positive performance in the first 9 months of 2006, however, in the final quarter, travel advisories issued by certain Governments following the political events of December, slowed the flow of visitors to Fiji. This resulted in the loss of jobs for some casual workers and reduced hours for permanent staff at various tourist establishments in the country.

Nevertheless, the industry players have re-activated the Tourism Action Group (TAG)[8] – in a bid to revive visitors to Fiji and take the industry forward into 2007.

The TAG's recovery plan involves extensive marketing in the two main markets of Australia and New Zealand, targeted at improving the relatively low hotel occupancy rates for the final quarter of 2006 and increasing forward bookings for the first quarter of 2007.

The TAG marketing plan centred on a 40.0 percent discount off wholesale contract rates[9] offered by hotels, resorts and other operators coupled with a child's fare initiative by Air Pacific Limited of $199 (tax inclusive). The TAG targeted Boxing Day as the start date of the initiative, which was a traditional programme day for specials and sales in Fiji's two key tourism markets.

The Boxing Day initiative comprised the first phase of the TAG's programme, while other phases are currently being developed, with the entire marketing campaign likely to total around $5 million.

Similar campaigns are expected for Japan, North America and other significant Asian markets, as the TAG aims to restore

[8] The TAG comprises hoteliers, airlines, tour operators and the Fiji Islands Visitors Bureau, and was first formed in the aftermath of the 2000 crisis

[9] Referred to as a $4 million discount, calculated as the costs incurred to hotels and for ground arrangement expenses, that businesses are expected to recover later.

visitor arrival numbers to pre-December 2006 levels by mid-2007.

The performance of the **textiles, clothing and footwear** industry declined during the review period. Cumulative to November, export earnings totalled $93.1 million, representing a decline of around 28.7 percent over the comparable period last year.

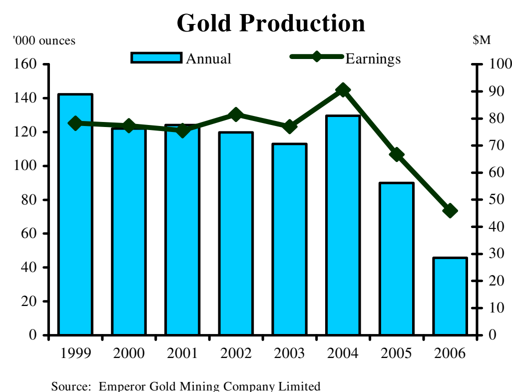
In related developments, as part of the terms and conditions set by the Australian Government prior to the reduction of the Minimum Local Area Content (MLAC)[10] from 35.0 percent to 25.0 percent, a Structural Adjustment Package (SAP) is to be implemented by the garment industry. The SAP is expected to increase productivity, provide training for industry players and possibly, develop garment industry policies through assistance from the Fiji Government.

The training element of the SAP is scheduled to start in January 2007. In addition to the training element, the collection of productivity data will be carried out until 2008, when a final report on the effectiveness of the SAP will be compiled.

The satisfactory uptake of the training element of the SAP by garment industry players is one of the prerequisites for the reduction of the MLAC by the Australian Government in January 2008.

Output in the **mining and quarrying** sector deteriorated significantly during the review period. In 2006, total gold ore extracted amounted to almost 46,000 ounces, 49.0 percent lower than the level in 2005 (Graph 16). On 5 December, Emperor Gold Mining (EGM) Company Limited announced the closure of the Vatukoula gold mine, citing it was no longer viable to continue mining.

Graph 16



In line with the lower production, total gold export earnings in 2006 also declined on an annual basis by 31.0 percent to around $46 million.

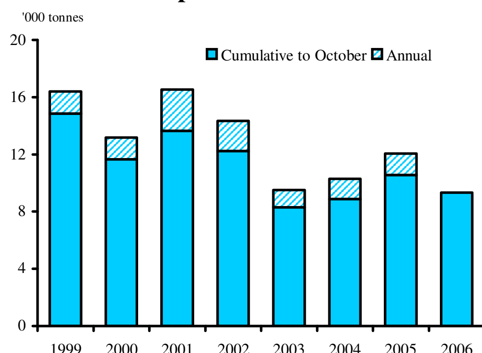
The performance of the **copra** industry continued to be sluggish in the review period. In the year to November, copra production totalled around 9,300 tonnes (Graph 17), a decline of around 12.0 percent over the corresponding period in 2005. Industry stakeholders identified rising costs of production and transportation as the main reasons for poor copra production during the review period.

In October, the minimum mill gate price of copra remained unchanged at $500 per tonne. Government's subsidy towards the mill gate price was $72.22 per tonne.

[10] MLAC criteria under the SPARTECA (TCF Provisions) Scheme requires Fiji garment manufacturers to utilise at least 35 percent of locally available resources (materials and labour) to qualify for duty free and unrestricted access into the Australian and New Zealand markets.

Graph 17

Copra Production



Source: Coconut Industry Development Authority

Electricity generation continues to hold up well. The Fiji Electricity Authority (FEA) generated a total of 737 megawatt hours of electricity in 2006. This represents an increase of around 7.7 percent on an annual basis.

The medium term outlook for the electricity industry is encouraging. The Nadarivatu Hydro Power Project by FEA is expected to be commissioned in the second half of 2009, adding close to 40 megawatts to the existing Viti Levu power system. This project is part of the FEA's aim to meet at least 90.0 percent of Fiji's energy needs via renewable energy sources by 2011.

The **fishing** industry performed better during the review period. Cumulative to November, total fish export receipts amounted to around $83.6 million, a 11.3 percent increase over the corresponding period last year.

The **timber** industry posted poor performance in the review period. Cumulative to November, timber export receipts totalled $34.4 million, 15.1 percent lower than the earnings recorded for the corresponding period in 2005. Looking ahead, the completion of the Wairiki-Bua port should provide an impetus to the growth of the timber industry over the medium term.

The **building & construction** sector continued its robust performance in the third quarter of this year. According to the September Quarter Building and Construction Survey Report released by the FIBOS, around $242.0 million was spent on capital works in the first 9 months of the year, an increase of 30.0 percent on an annual basis. By categories, cumulative to September, the value of work put-in-place by the private and public sectors rose by around 37.0 percent (to $195 million) and 9.0 percent (to $47 million), respectively, over the year.

Consistent with the performance of the building & construction sector, trends in other partial indicators also signal a correlating growth in **investment** levels during the review period.

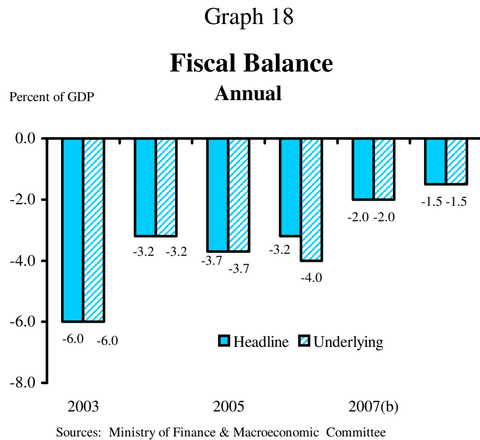
In the year to November, accrual trade data shows that import payments for investment type goods increased by 17.3 percent, compared to the previous year. Lending to private individuals for housing purposes and to the construction sector also remained favourable. Against this backdrop, investment is estimated to have risen to around 18.0 percent of GDP in 2006. However, investment in 2007 is expected to fall slightly, as some investment plans are expected to be put on hold as a result of the political situation.

Public Finance

The 2007 National Budget released under the former Government had projected the

underlying fiscal deficit for 2006 at $193.1 million, or 4.0 percent of GDP, lower than the 4.6 percent of GDP announced in the 2006 Budget. In addition, with the $36 million worth of asset sales realised in 2006, the headline deficit is estimated to be 3.2 percent of GDP, lower than the 4.0 percent of GDP announced in the 2006 Budget (Graph 18).

Graph 18



Total expenditure for 2006 is estimated to be $1.5 billion, an increase of around 11.3 percent over 2005, while total Government revenue is estimated at $1.4 billion, representing an annual growth of 13.9 percent.

For 2007, Government had budgeted a deficit of 2.0 percent of GDP. However, given the various fiscal measures announced recently by the Interim Administration, there is likely to be revisions to public finance projections, to be announced in the new 2007 National Budget on 2 March, 2007.

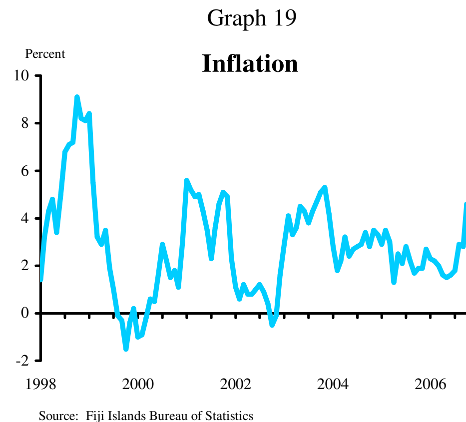
Indications from the Interim Administration suggest, however, that the new Budget will still maintain the deficit target of 2.0 percent of GDP for 2007.

Government's outstanding debt is estimated to be $2.6 billion, or 52.8 percent of GDP in 2006. In line with the relatively lower fiscal deficit, total Government debt is expected to fall to 52.1 percent of GDP ($2.7 billion) in 2007.

Inflation

In December, year-on-year inflation was 3.1 percent, compared with 2.8 percent for September (Graph 19). Over the quarter, consumer prices picked up by around 2.3 percent. This was largely due to higher prices for heating & lighting, food, alcoholic drinks & tobacco, clothing & footwear, housing and miscellaneous items. Prices under the transport category declined while charges for services and costs of durable household goods remained unchanged.

Graph 19



The increase in heating & lighting costs was largely influenced by the introduction of the fuel surcharge on electricity, while the higher food costs was largely a seasonal phenomenon. However, the lower prices recorded under the transport category were underpinned by the reduction in domestic fuel prices reflecting the easing global oil prices

during the review period.

The underlying measure of inflation, the trimmed mean, was 1.9 percent in December, up from 1.8 percent registered at the end of the September quarter.

Looking ahead, price pressures will depend largely on the policy adjustments that will be announced in the new 2007 Budget. However, a possible slowdown in economic growth in 2007 may create additional excess capacity in the economy and hence ease price pressures to a certain degree.

Labour Market

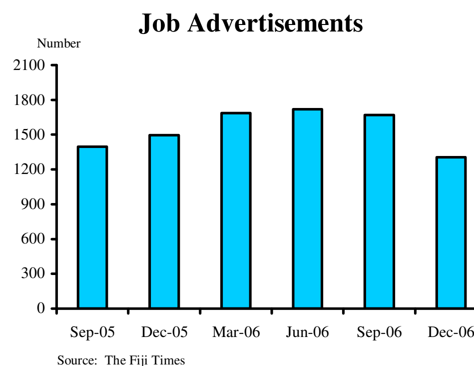
Employment conditions deteriorated for certain sectors of the economy during the December quarter. Political developments during the review period resulted in a slowdown in tourist arrivals and hence forced some major resorts and hotels to lay off casual and part-time employees. It was also reported that some permanent hotel employees had to work reduced hours. Further exacerbating the negative impact on the labour market was the closure of the EGM Company Limited and the ensuing loss of employment for around 1,800 people in December 2006.

The fall in employment however, appears to have been contained within the hotel and mining sectors, rather than a systemic problem that affected the other sectors of the economy. In 2006, around 7,200 taxpayers were registered with the FIRCA, an annualised increase of around 20.0 percent. The highest number of new taxpayers in 2006 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.

However, the recent political developments had the effect of stalling recruitment intentions in several sectors during the quarter. The December Survey of Job Advertisements registered a decline of around 13.0 percent over the comparable period last year (Graph 20). Subdued recruitment intentions were noted largely in the mining & quarrying, manufacturing; agriculture, forestry & fishing; construction; finance, insurance, real estate & business services; electricity & water and transport, storage & communication sectors. The slowdown in recruitment intentions could be attributed to employers taking a wait-and-see approach during the period of heightened tensions in November and December 2006.

Graph 20

Job Advertisements



The External Sector

Subdued exports remain a concern. Latest accrual trade data showed that cumulative to November 2006, exports earnings fell by around 0.7 percent, compared to a 0.1 percent fall in the corresponding period in 2005. Excluding re-exports of mineral fuels from exports, the poor performance

of the exports sector becomes more pronounced with a decline of around 3.0 percent.

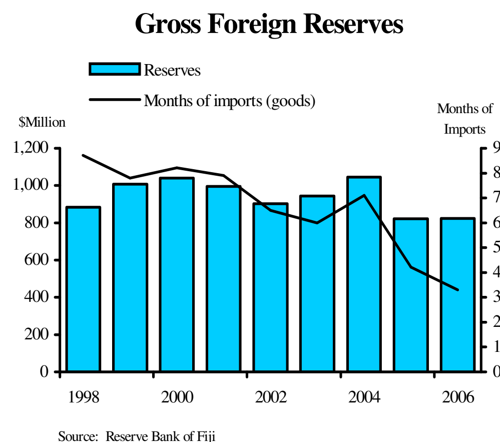
Export earnings from most of the traditional sectors have fallen over the review period. This included earnings from garments, sugar, gold, molasses, timber, footwear & headgear, textiles and coconut oil. These are the more significant sectors and hence the decreases in these areas more than offset the higher inflows from re-exports, mineral water, fish, fruits & vegetables, yaqona and other exports.

Higher imports continue to pose risks to a wider trade deficit. Cumulative to November 2006, merchandise import outlays rose by around 16.9 percent, compared with a growth of around 10.5 percent in the same period in 2005. Excluding imports of mineral fuels, the rise in outflows was still a significant 11.2 percent, compared with an increase of 1.7 percent in the corresponding period in 2005.

Higher import payments were evident across all categories: intermediate, investment and consumption type goods. Mineral fuels and crude materials contributed to the higher import payments for intermediate goods, while the higher outflows for investment goods was led by payments for machinery and chemicals imports. The increase in consumption goods outlays was due to higher import payments for food and manufactured goods.

Foreign reserves at the end of 2006 were around $823.0 million, sufficient to cover 3.3 months of imports (Graph 21).

Graph 21

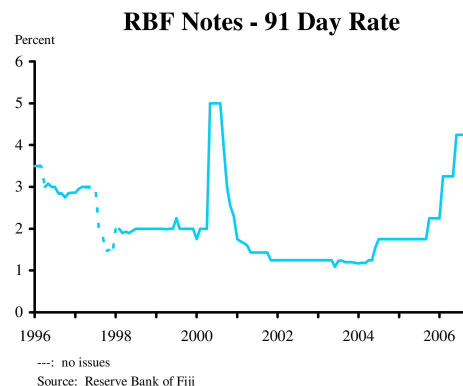


Domestic Financial Conditions

Money Markets

Inter-bank activity fell in the December quarter. Total inter-bank turnover fell to $476.1 million from $645.8 million in the September quarter. However, the weighted average inter-bank rate rose to 5.46 percent in the December quarter from 5.23 percent in the September quarter (Graph 22).

Graph 22



The monetary policy stance remained unchanged during the December quarter with the policy indicator rate maintained at 4.25 percent.

As part of open market operations, around $0.25 million worth of RBF Notes were allotted during the December quarter, $1.95 million lower than during the September quarter. The decline was largely attributed to more attractive rates offered on other securities in the money market. The yield on the RBF Notes during the review period averaged 4.25 percent.

During the same period, Government issued $153.9 million worth of treasury bills, an outturn which was $21.5 million lower than that traded in the September quarter.

Capital Markets

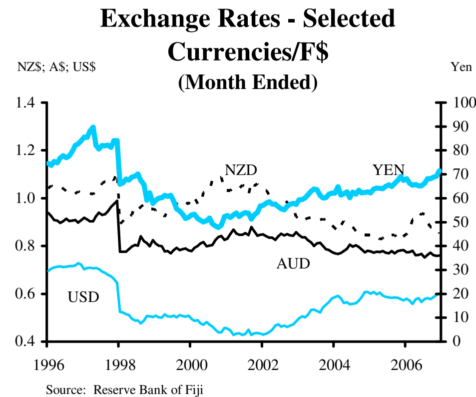
Government issued bonds worth $80.1 million during the fourth quarter compared with $81.3 million issued in the September quarter. The maturities offered ranged from 7 to 15 years, with weighted average yields registering between 10.10 percent and 12.04 percent.

Statutory corporations also issued bonds during the review period. The Fiji Development Bank raised bonds worth $30.1 million while Housing Authority came into the market for a total of $11.0 million.

Foreign Exchange Markets

Movements in exchange rates revealed that compared with the previous quarter, the Fiji dollar strengthened against the Japanese Yen (4.8%), US dollar (3.9%) and the Euro (0.4%) but weakened against the New Zealand (3.1%) and Australian (1.5%) dollars, during the December quarter (Graph 23).

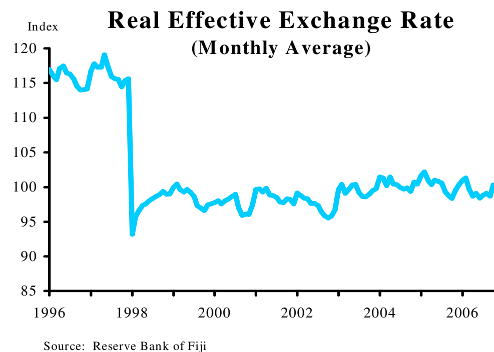
Graph 23



The Nominal Effective Exchange Rate Index (NEER), which reflects aggregate exchange rate movements between the Fiji dollar and currencies of major trading partner countries, rose marginally over the quarter, indicating an appreciation of the Fiji dollar against the basket of currencies.

During the same period, the Real Effective Exchange Rate Index (REER) of the Fiji dollar, which adjusts the NEER for inflation differentials across Fiji's major trading partner countries also rose (Graph 24).

Graph 24



Financial Intermediaries

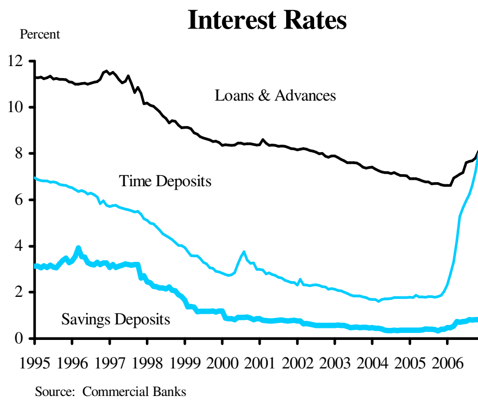
Interest rates continued its upward trend

during the fourth quarter. At the end of December, the savings and time deposit rates of commercial banks was 0.84 percent and 9.05 percent, reflecting an increase over the September quarter by 4 basis point and 242 basis points, respectively (Graph 25). Additionally, the interest rate on new deposits rose by 412 basis points, to 12.41 percent.

In line with the increase in deposit rates, the weighted average lending rate on outstanding loans also increased, reaching 7.89 percent during the same period. The interest rate on new loans extended by commercial banks, however, fell by 24 basis points, to 9.75 percent.

Movements in interest rates offered by Licensed Credit Institutions (LCIs)[11] also rose during the review quarter. The weighted average lending rate rose by 21 basis points to 11.67 percent, while the interest rate on time deposits increased from 7.00 percent in September to 8.71 percent at the end of December.

Graph 25

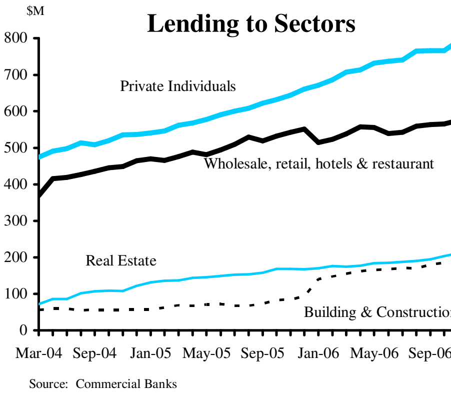


Latest data on monetary aggregates revealed that in November, broad money supply (M2) rose by 16.9 percent, compared with around 15.0 percent in the September quarter.

Narrow money, which comprises demand deposits and currency in circulation declined further in November, after falling in the preceding 4 months. This development is mainly due to the consistent build up in time deposits as a result of higher rates offered by commercial banks on term deposits. Gross time deposits of banks rose by an annual growth of 81.1 percent or $553.2 million in the year to November 2006.

Commercial banks' outstanding credit grew by 21.4 percent in the year to December as a result of higher commercial bank credit disbursements to private individuals (mainly for housing purposes), and the building and construction, real estate, manufacturing and wholesale & retail trade sectors (Graph 26).

Graph 26



Lending by LCIs also slowed in December. The annual growth rate of LCIs' outstanding credit was 14.3 percent, compared to a growth of 17.6 percent in the year to September, and totalled $320.7 million.

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

Banking Industry Quarterly Condition Report – September 2006

Overview – Commercial Banks

The **overall** condition of the banking industry remained satisfactory, as modest asset growth was recorded against a strong capital position and satisfactory earnings. Although asset quality improved in some areas, the probability of more strain remains high if early indicators are not rectified in time. Liquidity was strained in parts of the industry.

Total assets grew by 15.6 percent over the year to $3.2 billion fuelled by loan growth. On the **liabilities** side, total deposits increased by 11.1 percent to $2.7 billion.

The **capital adequacy** ratio of commercial banks was 11.4 percent, well above the minimum prudential requirement of 8.0 percent.

Asset quality remained satisfactory as impaired loans declined and general provisions increased. However, classified loans and past dues increased, particularly in the early classification stages, giving early signs of a possible deterioration in asset quality in the future as higher interest rates come to bear on borrowers.

Management is rated as satisfactory, in line with the performance in the other prudential categories.

Earnings were assessed to be satisfactory. Combined pre-tax quarterly profits improved to $33.5 million. Interest expense for the quarter increased but a larger growth in interest income cushioned the impact on operating income.

Liquidity remains marginal. Liquidity ratios dropped significantly over the quarter while the industry had to manage their cashflows extremely closely. Liquidity is expected to remain marginal in the next few quarters in view of the current tightening bias.

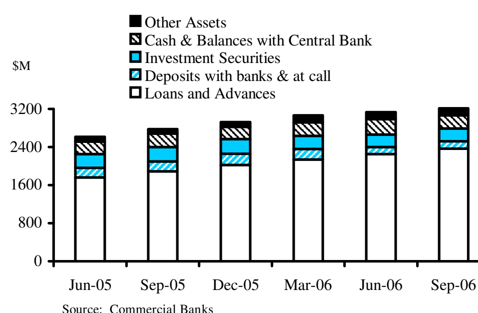
Balance Sheet

As at September 2006, the banking industry's total assets was $3.2 billion. This grew by 2.5 percent over the quarter and 15.6 percent over the year fuelled by the growing loan portfolio of the industry (Graph 27).

The quarterly growth rate (2.5%) in total assets increased slightly from the June 2006 quarter (2.2%) but remained on a downward trend from the previous quarters. Growth, on an annual basis, also slowed when compared with 19.9 percent recorded in June 2006.

Graph 27

Structural Change and Growth in Banks' Assets



Source: Commercial Banks

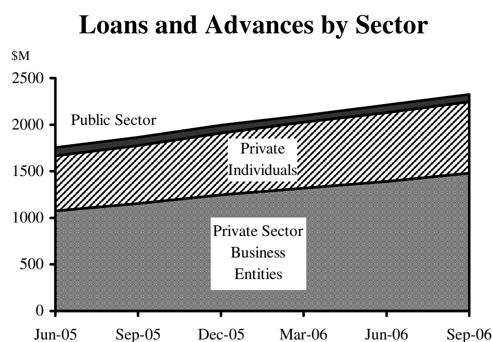
Loans and advances grew by 5.3 percent over the quarter, to $2.4 billion (Graph 28). However, quarterly loan growth slowed further from the 5.5 percent recorded in June 2006 and the 7.3 percent in December 2005. This also compares with 6.7 percent recorded in September

2005.

The increase in loans was mainly driven by lending to private sector business entities, which grew by 6.3 percent over the quarter, while loans to private individuals grew at a slower pace of 3.8 percent in the September quarter.

Graph 28

Loans and Advances by Sector



Source: Commercial Banks

The wholesale & retail trade sector recorded an increase of $24.8 million over the quarter after a low growth of $1.0 million reported in the June quarter.

Among the high priority sectors, negative growth continued from the last quarter in the agriculture, and mining & quarrying sectors. Private individuals' first home loan purchases declined by 9.7 percent, from a 3.9 percent increase in the last quarter. The Non-Bank Financial Institutions (NBFI) sector also declined over the quarter, by 3.4 percent. A slowdown in growth was recorded in the manufacturing, building & construction and transport sectors. The real estate and electricity & gas sectors recorded increases.

Along with loans, investments recorded a moderate increase of $7.2 million. Liquid assets, however, declined significantly led by a fall in the settlement account balances. Liquid assets were utilised to fund the growth for loans, as inflows of funds through deposits were inadequate.

Total deposits increased by 1.7 percent over the quarter to $2.7 billion. On a yearly basis, this increased by 11.1 percent. Arising from the higher interest rates over the quarter, there was a shift of deposits from demand to the time category. Time deposits of NBFIs rose by $37.8 million, private sector business entities by $35.4 million and private individuals by $23.4 million.

Capital Adequacy

As at September 2006, the industry recorded a strong 11.4 percent capital adequacy ratio (Graph 29). This compares to 12.0 percent recorded in the June quarter and 11.6 percent in September 2005.

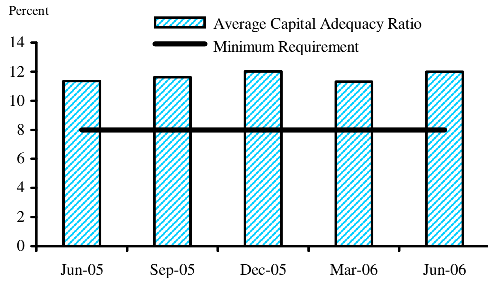
The ratio has deteriorated by 50 basis points over the quarter mainly due to a faster rate of growth in the risk weighted assets than total capital.

The growth in risk assets, by $112.8 million, mainly stemmed from loan growth in the 100 percent risk weight category, while growth in total capital (by $2.3 million) was the net result of a $26.1 million increase in un-appropriated profits (Tier 2)[12] and a $16.6 million decrease in disclosed reserves.

[12] Supplementary capital comprising items which exhibit some but not all characteristics of capital, such as unaudited profits, revaluation reserves and general provisions for doubtful debts.

Graph 29

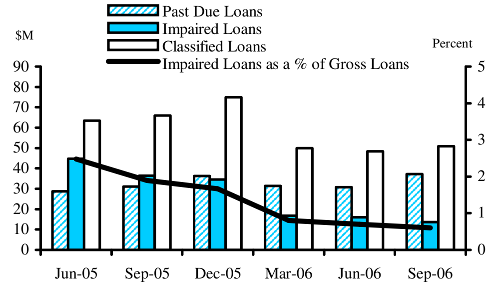
Capital Adequacy Ratio of Banks



Source: Commercial Banks

Graph 30

Asset Quality



Source: Commercial Banks

Asset Quality

Overall, the asset quality of banks was assessed to be satisfactory. Improvements were noted as impaired loans declined by $2.4 million to $13.7 million and general provisions were raised by $3.5 million to $32.7 million.

At the same time, classified loans increased by $2.5 million and past due levels increased by $6.5 million (both concentrated in the early stages of classification). These give early signals of possible deterioration in asset quality in the next few quarters.

Individual banks reported mixed movements for the quarter with some banks recording an improvement and other banks recording deterioration in classified and past due loans.

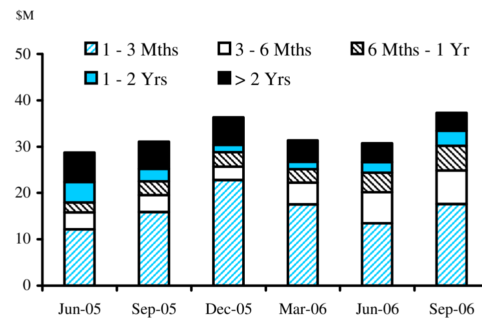
Out of the $50.8 million classified loans, $13.7 million were considered as impaired. Total impaired loans reduced by $2.4 million over the quarter and represented 0.6 percent of gross loans and advances (Graph 30).

Past due loans increased by $6.5 million over the quarter, to $37.3 million (Graph 31). This stemmed mainly from a $4.1 million increase in the 1-3 months category.

Problem loans of banks are concentrated in the private individuals sector, led by problem housing loans which comprise 37.1 percent of all problem loans. The mining and quarrying sector represents 23.9 percent, wholesale/retail sector 11.6 percent and the real estate sector 5.8 percent.

Graph 31

Past Due Status



Source: Commercial Banks

As at September 2006, banks held $40.9

million in provisions for doubtful debts. This increased by $3.4 million or 9.1 percent in the September quarter, as the industry continued to increase its general provisions, to cushion against the possible impact of the rise in interest rates on asset quality.

General provisions coverage of gross loans and advances has increased to 1.4 percent from 1.3 percent in June 2006 and 1.2 percent in September 2005.

Specific provisions fell slightly (-$0.1m) over the quarter and covered 59.8 percent of total impaired assets, compared to 51.7 percent in June.

The current level of classified and past due loans is considered moderate and the level of impaired assets is considered low. The asset quality position does not pose any major threat to earnings or capital of the banking industry. However, with the impending consequences of the monetary policy tightenings and the already rising past due and classified loans in the early stages of classification, the volume of impaired loans could rise in the next few quarters if these early signs are not addressed adequately.

Earnings

The combined banks' earnings was assessed to be satisfactory. The banking industry earned pre-tax profits of $33.5 million over the quarter. This compares to $32.3 million in June 2006 and $27.2 million in September 2005.

Interest expenses continued to increase, although at a much slower rate of 23.3 percent compared to 157.6 percent in the June quarter. A $7.4 million increase in interest income more than accounted for the increase in interest expense of $3.9 million, however, most of the increase came from business loans rather than housing and personal loans.

Banks' Income Statement

	Sep 05	Jun 06	Sep 06	% Change	
		$M		Over Qtr	Over Yr
Interest Income	36.5	50.9	58.4	14.6	59.8
Interest Expense	5.5	16.7	20.6	23.3	275.9
Net interest income	31.0	34.2	37.8	10.4	21.7
Add: **Non interest income**	27.1	23.3	22.2	-4.8	-18.0
Income from overseas exchange transactions	9.5	9.0	9.8	8.9	2.6
Commission	2.6	3.1	1.3	-58.8	-50.4
Fee Charges	11.7	11.1	10.6	-4.8	-9.7
Other income	3.2	0.1	0.5	486.7	-83.2
Total operating income	58.1	57.5	60.0	4.2	3.2
Less: Operating expenses	29.0	26.0	27.7	6.4	-4.4
Less: Bad Debts & provisions	1.9	-0.9	-1.3	50.7	-166.7
Equals:					
Profit before tax	27.2	32.3	33.5	3.7	23.4
Less: Tax	8.4	7.3	11.6	57.7	37.0
Add Extra ordinary items	0	0	0	-	-
Equals:					
Net profit after tax	18.8	25.0	22.0	-12.1	17.3

Source: Commercial Banks

Non-interest income registered a 4.8 percent decrease while operating expenses increased by 6.4 percent over the quarter, both contributing negatively to profits.

Banks also wrote back $1.3 million of bad debts and provisions expenses over the quarter as a result of an improvement in asset quality. This also contributed positively to pre-tax profits.

Despite the increase in pre-tax profits, an increase in tax allocation in the September quarter caused an overall decrease in after-tax profits.

Similarly, in spite of the higher pre-tax gains, the pre-tax return on assets for the banking industry remained unchanged at 4.2 percent compared to the June quarter. Return on equity fell to 35.6 percent from 43.1 percent in the June quarter due to lower after-tax profits and a higher level of capital and reserves.

Banks continue to record satisfactory earnings; however, interest expenses are expected to remain high for at least another year as banks continue to compete for time deposits. Together with this, interest income is expected to rise as the rise in variable lending rates filters in.

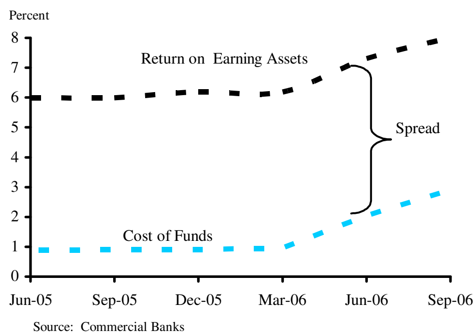
Interest Margin and Spread

Over the September quarter, both the return on earning assets and the cost of funds for the banking industry accelerated (Graph 32). The cost of funds increased from 2.4 percent in June to 2.9 percent in September.

As banks continued to increase lending rates to offset the increased cost of funds, the yield on earning assets increased further to 8.0 percent in September from 7.3 percent in June.

Graph 32

Margins and Spreads



After decreasing in the June quarter, the interest spread appears to be on the recovery path, with the recording of an improved spread of 5.1 percent in September (4.8% in June).

Efficiency

The efficiency ratio (operating costs to operating income) of banks deteriorated over the quarter to 46.2 percent, from 45.3 percent in June. However, this is still an improvement compared to 49.9 percent in September 2005. The slight deterioration over the quarter was the result of an increase in operating expenses.

Liquidity and Funding

Liquidity across the banks continues to be rated marginal although liquidity distribution is skewed across the industry. Liquidity ratios dropped significantly over the quarter as liquid assets were utilised to meet the shortfalls between loan draw-downs and funding from deposit inflows.

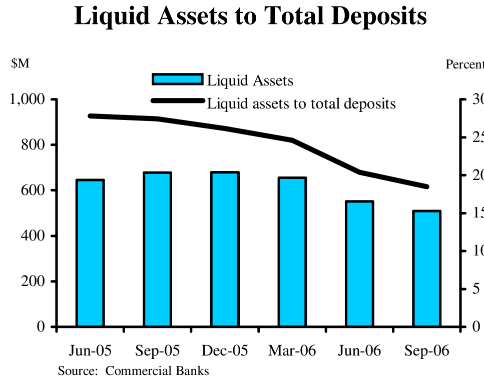
Total liquid assets dropped further by $42.2 million over the quarter to $509.1 million. This compares to the $102.8 million decrease recorded in the last quarter. On an annual comparison, liquid assets have dropped by $170.0 million (25.0%). This was mainly a result of banks setting aside funds to meet their higher statutory reserve deposit (SRD) requirement (raised from 5.0% to 7.0% in 8 May 2006) and to fund loan commitments, in a much tighter liquidity environment.

Due to the fall in the level of liquid assets, the ratio of liquid assets to total assets reduced to 15.9 percent, from 17.6 percent in June. The liquid assets to deposits ratio also declined, to 18.5 percent from 20.4 percent in June (Graph 33).

As at 30 September 2006, the 15 largest depositors in the industry represented 22.2 percent of total deposits. Analysis of individual institution's large depositors indicated that 3 banks did not hold adequate liquid assets to fully cover their 15 largest depositors.

Graph 33

Liquid Assets to Total Deposits



The maturity mismatch analysis shows positive inflows for the less than 1 month category. However, banks have a negative mismatch of $437.3 million in the subsequent 12 months. This reflects the concentration of time deposits in short term categories while inflows from loans & advances are concentrated in the longer term. However, these outflows (mismatch) can be met by liquid assets held by banks.

Overview – Credit Institutions

The **overall** performance of credit institutions remained satisfactory during the quarter. The combined assets growth was generally driven by loans and advances.

Credit institutions' **capital adequacy** ratio remained strong at 21.9 percent, well above the 10 percent minimum.

Asset quality continues to be rated marginal despite decreases in classified loans and an increase in provisions. Like banks, credit institutions also experienced an increase in past dues in the early stages of classification (1-3 months category) signalling a possible deterioration in asset quality in the future.

Earnings are considered satisfactory. Pre-tax profits for the quarter increased to $3.5 million despite a decline in net interest income. The increase in profits stemmed from a decrease in bad debts and provisions expenses.

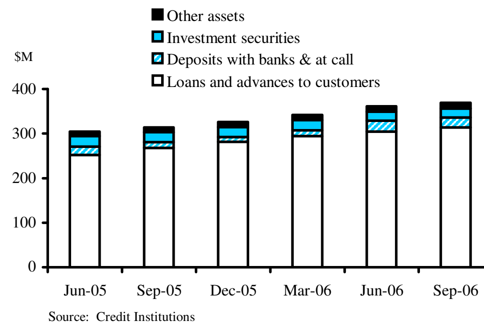
Liquidity of credit institutions remains marginal. Liquid assets dropped to $42.1 million and liquidity ratios deteriorated over the quarter as institutions competed for new deposits and negotiated to hold existing customers.

Balance Sheet

Credit institutions' assets also grew at a slower rate this quarter compared to the June quarter. Total assets were $346.7 million, up by 2.1 percent over the quarter (Graph 34). The quarterly growth rate continued its slowdown from the previous four quarters.

Graph 34

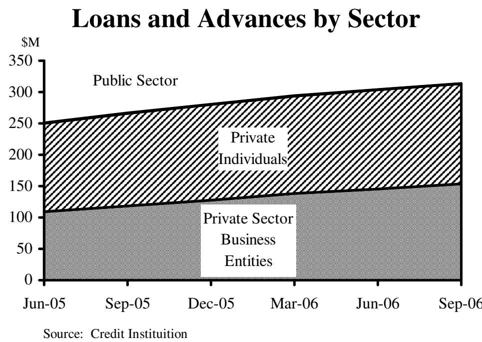
Structural Change and Growth in Credit Institutions' Assets



Asset growth was generally driven by loans and advances (Graph 35), which grew by 3.2 percent over the quarter and 17.2 percent over the year, to $313.9 million. Loan growth also slowed over the last two quarters compared to a quarterly growth rate of 4.8 percent in March, 5.1 percent in December and 6.2 percent in the September 2005 quarter.

Loan growth over the quarter was driven by lending to private sector business entities. Among the sectors contributing to this growth, the most was the real estate sector, a low priority sector. However, the quarterly growth in the real estate sector continued to slow (Jun-06: 17.7%; Mar-06: 20.1%; Dec-05: 21.1%).

Graph 35



Among the high priority sectors, increases were noted in the building & construction (+12.8%) and transport & storage (+6.4%) sectors, while the manufacturing, agricultural and mining sectors showed little change.

The private individuals sector (low priority) also registered an increase of $1.9 million (1.2%). However, quarterly loan growth in this sector has continued to slow.

New loans and advances stayed at $36.1 million in the September quarter. New loans experienced a downward trend, compared to $44.6 million in March and $42.2 million in the September 2005 quarter.

On the funding side, notable movements were recorded for term deposits and amounts owing to holding company. Term deposits were up 9.5 percent to $184.3 million at the end of September. Amounts owing to parent company decreased by 7.8 percent to $97.1 million.

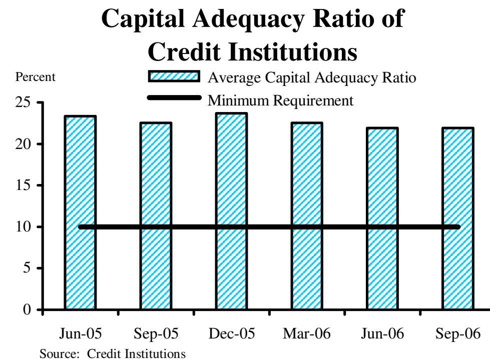
Capital Adequacy

As at September 2006, credit institutions recorded a strong 21.9 percent capital adequacy ratio, the same level as June and well above the minimum 10 percent benchmark. This compares to 22.5 percent in September 2005 (Graph 36).

The ratio fell by 60 basis points over the year mainly due to a faster rate of growth in risk weighted assets, than total capital (+ 8.5%).

On an individual basis, all credit institutions were above the 10 percent requirement. Credit institutions are expected to remain well capitalised in the coming quarters.

Graph 36



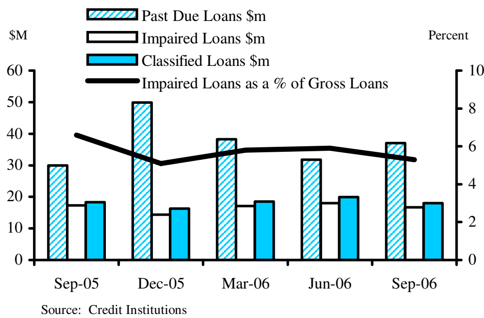
Asset Quality

Credit institutions' asset quality continued to be rated marginal, despite a decrease in classified loans and the ratio of classified loans to gross loans and an increase in provisions (Graph 37). This is due to an increase in all three credit institutions' past due loans in their early stage of classification (1-3 months past due).

Classified loans decreased by 9.4 percent to $18.0 million. This stemmed from a decrease in substandard loans (-$2.0m). Out of the $18.0 million classified loans, $16.7 million were considered impaired. Impaired loans represented 5.3 percent of gross loans and advances.

Graph 37

Asset Quality



Past due loans increased by $5.3 million over the quarter to $37.0 million. This stemmed mainly from a $6.4 million increase in the 1-3 months category across all three credit institutions.

The ratio of classified loans to gross loans decreased to 5.8 percent, an improvement of 79 basis points from June and 108 basis points from September 2005.

As at September 2006, credit institutions held $16.4 million provisions for doubtful debts. This increased by $0.4 million in the September quarter.

General provisions coverage of gross loans and advances has increased to 3.3 percent from 3.2 percent in June and 3.1 percent in September 2005.

Earnings

Credit institutions' earnings were assessed to be satisfactory. The industry recorded before tax profits of $3.5 million in the September quarter, an increase of 15.9 percent over June.

Net interest income fell 3.1 percent as interest expenses grew faster than interest income.

A $0.6 million (54.1%) decrease in bad debts and provisions also contributed significantly towards the increase in profits.

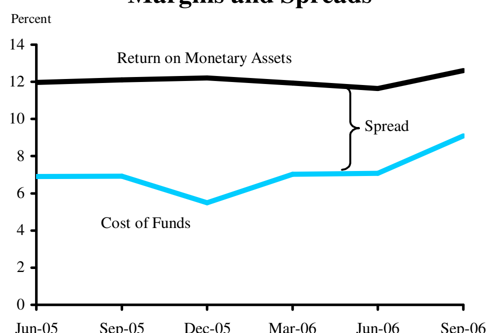
Given the increase in profits, return on assets (ROA) before tax increased by 43 basis points to 4.1 percent and ROA after tax increased 34 basis points to 3.5 percent. Return on equity (ROE) increased 276 basis points to 21.8 percent over the quarter.

Credit institutions' efficiency as measured by the ratio of operating expenses to operating income also improved to 42.8 percent.

Credit institutions' cost of funds began to show signs of the tightening in liquidity and interest rates hikes (Graph 38).

Graph 38

Margins and Spreads



Source: Credit Institutions

Despite efforts to maintain interest margins, the cost of funds rose at a much faster rate than the yield on earning assets, causing a contraction in the overall spread by 110 basis points (from 4.6 percent in June to 3.4 percent in September).

Credit Institutions' Income Statement

	Sep 05	Jun 06	Sep 06	% Change	
		$M		Over Qtr	Over Yr
Interest Income	8.5	9.3	10.4	11.9	22.3
Interest Expense	2.5	2.7	4.0	47.8	59.8
Net interest income	5.9	6.5	6.3	-3.1	6.3
Add: **Non interest income**	0.9	0.8	0.8	-6.4	-19.1
Commission	0.1	0.1	0.1	4.1	43.8
Fee Charges	0.6	0.4	0.3	-23.6	-46.0
Other income	0.2	0.2	0.3	22.6	42.5
Total operating income	6.8	7.3	7.0	-3.5	3.0
Less: Operating expenses	2.9	3.2	3.0	-5.5	2.4
Less: Bad Debts & provisions	0.6	1.0	0.5	-54.1	-24.5
Equals:					
Profit before tax	3.3	3.1	3.5	15.9	8.9
Less: Tax	0.7	0.5	0.6	19.3	-16.8
Add Extra ordinary items	0.0	0.0	0.0	0.0	0.0
Equals:					
Net profit after tax	2.6	2.6	3.0	15.2	15.5

Source: Credit Institutions

The return on monetary assets increased by 90 basis points to 12.6 percent, while cost of funds increased by a massive 200 basis points to 9.1 percent in September.

Credit institutions' spreads have come under immense pressure with fixed interest loans restricting their ability to immediately increase return on monetary assets in line with cost of funds. As these loans move into their variable rate stage, it is expected that the return on monetary assets will show further improvement.

Liquidity

The liquidity position for credit institutions continues to be rated marginal. Liquidity ratios dropped over the quarter as liquid assets were utilised to meet maturing obligations, debts owing to parent companies and to facilitate loan draw-downs (Graph 39).

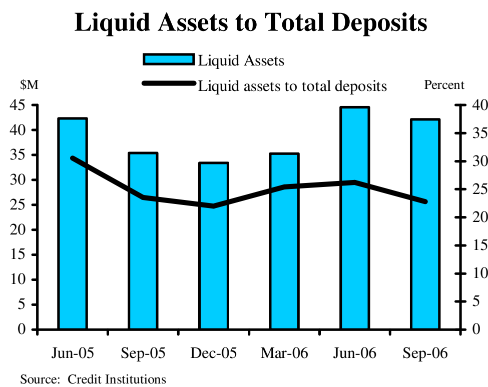
Total liquid assets dropped $2.4 million over the quarter to $42.1 million. On an annual comparison, however, liquid assets are still above September 2005 levels.

Due to the fall in the level of liquid assets, the ratio of liquid assets to total assets declined to 12.1 percent from 13.1 percent in June. The liquid assets to total funding (time deposits and bank overdrafts & loans) ratio also declined to 22.8 percent from 26.2 percent in June.

The combined 15 largest depositors' balances were $90.9 million, a 19.0 percent increase over the quarter. As a result, liquid assets coverage of the 15 largest depositors deteriorated over the quarter from 58.3 percent in June to 46.3 percent.

Graph 39

Liquid Assets to Total Deposits



Source: Credit Institutions

In contrast to June, the maturity mismatch analysis now shows a negative mismatch (outflow) for the less than 1 month category. The analysis reflects a further negative mismatch of $62.3 million within the next 12 months. This is a reflection of the concentration in short term deposits while inflows from loans and advances are over the long term.

Outlook

Liquidity is expected to remain marginal in the next few quarters as no change to the current tightening bias is expected. Close liquidity monitoring of all banks will continue.

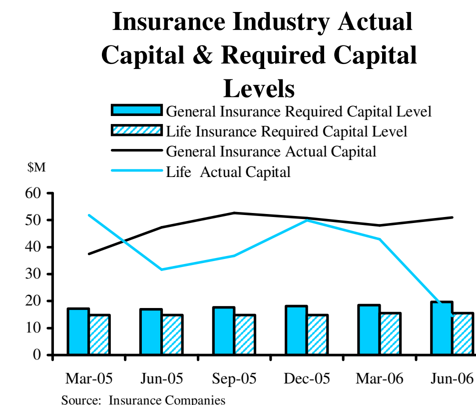
Insurance Industry Quarterly Condition Report – June 2006

For the quarter ended June 2006, the insurance industry continued to register positive growth.

The insurance industry maintained its **capital** at $65.5 million against a required capital level of $35.2 million, a 17.0 percent decrease from the same period in 2005. The main contribution to this decline emanated from the life insurers admissible assets which fell by $15.0 million (Graph 40).

Graph 40

Insurance Industry Actual Capital & Required Capital Levels



Source: Insurance Companies

Combined **assets** of the industry recorded a slight increase to reach $701.5 million. While life insurers continued to hold a larger market share by accounting for 69.3 percent of total industry assets, the growth during the quarter was driven mainly by the general sector.

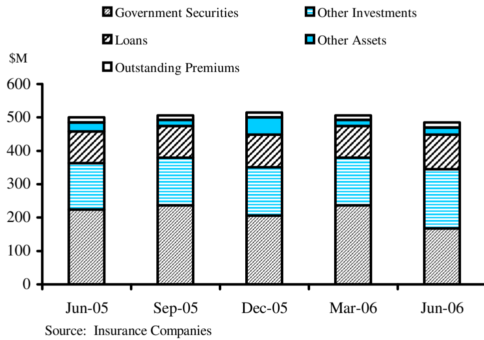
The distribution pattern of assets remained consistent. Government securities continued to dominate the asset base of life insurers at 34.6 percent of total assets, followed by loans to policy holders (21.2%) and property (13.2%). Of the total loans, 99.1 percent are secured (Graph 41).

All insurers satisfactorily complied with the **reinsurance** requirements.

The insurance industry's combined **liabilities** (excluding shareholders funds) recorded an increase of 6.2 percent to $612.3 million. This was underpinned by growth in the life insurers' balance of revenue account which continues to form the bulk of insurance industry liabilities at $439.9 million.

Graph 41

Distribution of Assets for Life Insurance Companies

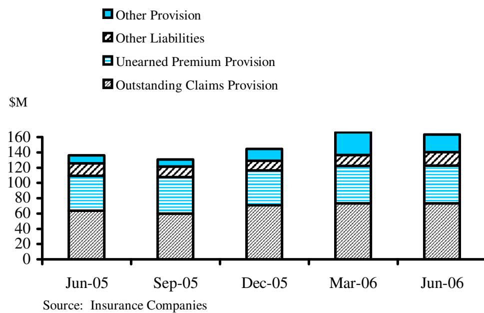


Total liabilities of the life insurance industry increased by 3.2 percent to reach $459.1 million over the review quarter. The increase in total liabilities was dominated by a $17.5 million increase in the insurers' balance of revenue account to $439.9 million.

Total liabilities of the general insurance industry grew by 16.0 percent to reach $153.2 million in 2006 (Graph 42).

Graph 42

Distribution of Liabilities for General Insurance Companies



The major liability, outstanding claims provisions (including claims incurred but not reported), amounted to $73.2 million and accounted for 47.8 percent of total liabilities.

The bulk of the balance of liabilities of general insurers comprised unearned premium provisions (UPP) recorded at $49.6 million or 32.4 percent of total liabilities.

After providing for tax of $0.2 million, the industry reported an **overall net profit** of $1.2 million for the quarter ended June 2006, a decline of $17.2 million from June 2005. The low overall net profit was due to a $4.2 million net loss (June 2005: $13.8 million profit) recorded by life insurers due mainly to the revaluation to market values of government securities. However, the general insurance sector contributed an increase of $0.8 million net profit to reach $5.4 million in the 2006 June quarter (Jun-05: $4.6m).

The industry's **liquidity** position is considered satisfactory with the bulk of the assets in the form of government securities and an increasing holding in bank deposits.

Insurance Brokers

Total **earnings** of insurance brokers continued to increase over the June 2006 quarter. The increase was mainly due to higher brokerage income earned as commission.

The **amounts due to licensed insurers** by insurance brokers increased to $3.4 million over the year resulting in an overall increase in the insurance broking account balance to $4.5 million.

For the quarter ended June 2006, 96 **offshore placement** applications processed amounted to $5.0 million. The number of offshore placements increased from 84 to 96 over the year, whilst the

amount remitted offshore remained almost the same.

Outlook

The insurance industry has capitalised on the recent Reserve Bank announcements of increased interest rates, by investing heavily in bank deposits, whilst moving slightly away from government security investments. The industry is expected to continue on its current growth trend.

For the Record

RESERVE BANK OF FIJI ANNOUNCES POLICY CHANGES

Statement by the Governor of the Reserve Bank of Fiji, 6 December 2006

The Reserve Bank of Fiji today put in place various policy measures to protect Fiji's foreign exchange reserves in light of the current political situation. These are:

1. The tightening of capital controls **on various foreign exchange transactions**. Transaction limits have been reduced in several categories, documentary requirements have been increased, and some delegations to commercial banks to approve certain foreign exchange transactions have been rescinded.

2. The introduction of a **credit ceiling** on individual banks. From today, commercial banks' loans and advances to the private sector must be held at or below levels prevailing on 30 November 2006. The credit limit is an aggregate limit, not a limit on lending to individual commercial banks' customers. Commercial banks are free to lend to individual customers, as long as they manage their total lending within the overall limit. The ceiling on bank lending applies to their average lending over one month.

3. An increase in **interest rates charged to banks** that use Reserve Bank of Fiji lending facilities:

(a) **Repurchase Facility Rate:** The latest weighted average overnight interbank rate plus 10 percentage points.

(b) **Secured Advances:** The latest weighted average overnight interbank rate plus 10.5 percentage points.

(c) **Unsecured Advances:** The latest weighted average overnight interbank rate plus 15 percentage points.

(d) **Rediscount Facility:** The Reserve Bank will rediscount RBF Notes and Treasury Bills with a 10 percentage points margin above the current market yield on the remaining term to maturity of the security.

The Reserve Bank however is also mindful of the practical implications of the credit ceiling. To ensure that genuine transactions are not affected, deserving cases can be referred by commercial banks to the Reserve Bank of Fiji for consideration and approval.

These strong measures are necessary to ensure that reserves are safeguarded under the current circumstances. The measures will be reviewed regularly and it is hoped that some relaxation will be possible once the political situation normalises and financial pressures abate.

For the Record

RESERVE BANK OF FIJI ISSUES NEW BANKING LICENCE

Statement by the Governor of the Reserve Bank of Fiji, 15 December 2006

The Reserve Bank of Fiji has issued a banking licence to Bank of South Pacific Limited to conduct banking business in Fiji from Monday 18 December 2006. The Bank of South Pacific is the largest bank in Papua New Guinea with assets worth F$1.7 billion. The Bank is listed on the Port Moresby Stock Exchange. It has a network of 39 branches across Papua New Guinea and one overseas branch in Niue.

Mr. Savenaca Narube, Governor of the Reserve Bank of Fiji welcomed the presence of a strong regional bank in Fiji's financial system. He added that "Fiji's financial system is sound" and he looked forward to Bank of South Pacific's contribution to the financial services and products in Fiji. Mr. Narube said, "It was encouraging to see Bank of South Pacific's confidence in the Fiji economy".

Bank of South Pacific Limited has acquired Habib Bank Limited's Fiji operations. Habib Bank Limited will be closing its operations in Fiji from close of business on Friday 15 December 2006. Mr. Narube thanked Habib Bank Limited for its contribution to the Fiji economy.

For the Record

RESERVE BANK CLARIFIES INTERNATIONAL BOND ISSUE

Statement by the Governor of the Reserve Bank of Fiji, 15 December 2006

In reply to what was reported on the news broadcast on Wednesday this week and to clear many misconceptions, the Reserve Bank of Fiji wishes to clarify that the Fiji Government raised only US$150 million in the international bond market.

When the bond issue was announced in the international market, offers from investors to buy these bonds amounted to over a billion US dollars. However, only US$150 million was accepted and taken up. This debt of US$150 million will be settled in 2011.

An interest rate of 7 percent will be paid annually. This interest rate is fixed over the life of the bond, which is 5 years, and will not change, regardless of how the bond trades in the secondary bond market.

Since its launch, the price of the bond has fallen from US$99.80 (face value of US$100) to a low of around US$86. Such price changes will be carried by traders of the bonds in the secondary market, and not by Fiji. There has, however, been some small recovery in the price the bond is traded at, with the price yesterday at around US$91.50. Again, these are prices that the holders of Fiji's bond will bear, should they trade the Fiji bond in the secondary market.

To clarify misconceptions on ratings on Fiji by credit agencies, the Reserve Bank wishes to state that Fiji was first put on a negative credit watch by Standard & Poors (S&P) on November 2, 2006 and then on November 8 S&P lowered its foreign currency and local currency long-term credit ratings on Fiji to B+ and BB- from BB- and BB, respectively. The ratings remain on Credit Watch with negative implications.

On December 7 Moodys Investors Service changed its rating outlook on Fiji to negative from stable but has not downgraded the rating of Ba2 on both foreign and domestic currency government bonds. A negative outlook was also placed on the Ba3 foreign currency country ceiling for bank deposits. Fiji's Ba1 foreign currency country ceiling for bonds retains its stable outlook.

STATISTICAL ANNEX

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SOURCES:

Reserve Bank of Fiji
Commercial Banks
Fiji Development Bank
Fiji National Provident Fund
Fiji Islands Bureau of Statistics
Ministry of Finance

ABBREVIATIONS

$: Fiji Dollars unless stated otherwise
m: Million
bn: Billion
(b) Budget
(e): Estimate
(f): Forecast
(p): Provisional
(r): Revised

n.a.: Data not available
n.i.: No issues
n.t: No trading
-: Zero
RBF: Reserve Bank of Fiji
IMF: International Monetary Fund
CIF: Cost of goods, including insurance and freight to Fiji
FOB: Free on board (the value of goods at Fiji ports before export).