RESERVE BANK OF FIJI

QUARTERLY REVIEW

September 2005

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

QUARTERLY REVIEW OF THE ECONOMY & FINANCIAL CONDITIONS

OVERVIEW

World economic and financial conditions improved in the third quarter, despite the high crude oil prices and the recent hurricanes in the US. The expansion has continued to be led by the US and China, where the growth momentum has remained robust. The International Monetary Fund's global growth projection of 4.3 percent for 2005 and again in 2006, remain unchanged.

However, there are risks to this current assessment. The continuing rise in crude oil prices and the tightening of financial market conditions to subdue inflationary pressures, pose downside risks to global growth prospects.

Fiji's major trading partners are expected to record positive growth. The Australian and New Zealand economies remain on track for good growth this year. The US economic recovery continues to gather momentum, despite the impact of Hurricanes Katrina and Rita. Japan's economy also continues to strengthen, driven by strong domestic demand. Growth prospects for the Euro-zone are cautiously optimistic.

Monetary policy stances differed during the September quarter. The US and Canada raised their policy rates, in response to inflationary pressures. On the other hand, the Euro-zone, Japan, Australia and New Zealand maintained an unchanged stance.

Global financial market outcomes were mixed. The US dollar generally rose against all our major trading partner currencies. On the other hand, equity markets continued to strengthen, while bond prices generally fell.

The local economy is expected to grow by 1.7 percent this year against an average of 3.5 percent for the past four years. The medium term outlook also remains moderate with growth rates for 2006 and 2007 forecast at 2.0 and 2.4 percent, respectively.

Domestic demand continues to remain buoyant. While consumption expenditure continues to lead overall demand, net exports remains a drag on economic growth. The continuation of such a trend is not sustainable. Some policy corrections is inevitable.

On the sectoral front, the cane & sugar, copra, electricity, fisheries, timber and building & construction sectors posted positive growth during the quarter. On the other hand, the textile, clothing & footwear and mining & quarrying sectors performed weakly. Output of the textiles, clothing and footwear industry declined significantly due to the departure of the largest garment factory in Fiji and stiff competition posed by Asian producers.

The tourism industry continues to perform strongly. Moreover, the industry's forward indicators suggest visitor arrivals will increase further.

On labour market there is a slow down in employment growth. As of September, inflation stood at 1.7 percent, compared to 2.1 percent in the previous quarter. The underlying measure of inflation, the trimmed mean, was 1.3 percent in the review period, up from 1.1 percent in the previous quarter. The year-end inflation forecast is expected to be around 3 percent.

However, inflation is expected to rise in the medium term as pressures from high oil prices continue to impact on domestic production and consumption.

At the end of September, foreign reserves were $940 million, sufficient to cover 3.9 months of imports of goods and non-factor services or 5.3 months of goods only. The underlying budget deficit at the end of the period was around $64.2 million, equivalent to 1.3 percent of GDP. Government's year-end deficit projection remains intact at 4.3 percent of GDP.

THE INTERNATIONAL ECONOMY

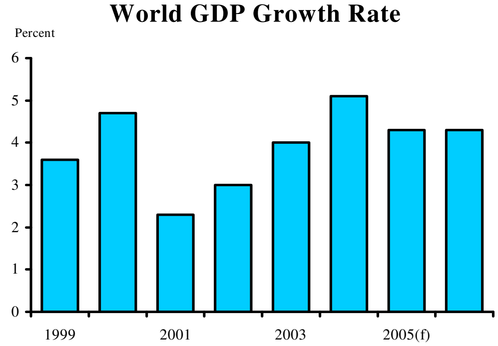
International Economic Conditions

World economic and financial conditions improved in the third quarter, despite the high crude oil prices and the recent hurricanes in the US.[1] The expansion has continued to be led by the US and China, where the growth momentum has remained robust. This has been further complemented by the positive contribution from Japan and India.

The International Monetary Fund (IMF) expects global economic growth to stand at 4.3 percent this year and in 2006, unchanged from the previous forecast (Graph 1).

Graph 1

World GDP Growth Rate



Source: IMF World Economic Outlook - April 2005

However, there are a few risks that can undermine the current assessment. Firstly, the non-subsiding high crude oil prices could disrupt current growth prospects. Secondly, significant tightening of financial market conditions to ward off inflationary pressures could reduce the accommodative stimulus to growth. Thirdly, the widening US current account deficit could slow the current US growth momentum. Finally, the relentless geo-political instability in the Middle East and terrorism concerns remains a risk.

Monetary policies stances were somewhat different during the September quarter. The US and Canada raised their policy rates, in response to inflationary pressures stemming from rising energy prices. On the other hand, the Euro-zone, Japan, Australia and New Zealand maintained an unchanged stance while the Bank of England and Sweden reduced their key interest rates.

During the September quarter, the performance of the global financial markets were mixed. The US dollar generally strengthened against all our major trading partner currencies. Equity markets continued to strengthen, while bond prices generally fell.

Positive economic growth is envisaged for Fiji's major trading partners (Graph 2). The Australian and New Zealand economies remain on track for solid economic performance this year. The US economic recovery continues to gather pace, supported by strong income growth and an improving labour market. Despite the rising cost in life and property from Hurricanes Katrina and Rita, the direct impact on economic growth is expected to be moderate. For Japan, the positive growth momentum in the first half of the year is expected to continue, driven by strong domestic demand. Furthermore,

[1] Hurricane Katrina and Rita, which struck in late August and September, respectively, did extensive damage to life and property in the State of Louisiana, and the Gulf of Mexico region; a vital economic area to the US.

growth prospects for the Euro-zone is cautiously optimistic.

Graph 2

The **Australian** economy expanded by 1.3 percent during the June quarter, following a revised 0.5 percent growth during the March quarter. The expansion was led by a surge in business investment and construction activity.

Recent indicators are also largely positive. Consistent with increasing exports, the current account deficit narrowed during the second quarter. Moreover, an index of leading economic indicators for Australia increased in July, while the unemployment rate remained at a 29-year low of 5 percent in August.

However, on a negative note, consumer confidence fell to a 2-year low in September, as high oil prices dampened spending.

In line with subdued inflationary pressures, the Reserve Bank of Australia (RBA) left its key interest rate unchanged at 5.5 percent.

Looking ahead, the Australian economy is anticipated to expand at a slower rate of 2.2 percent, after 3.2 percent growth last year. Consumer prices are expected to be around 2.6 percent this year, that is, within the RBA's target band of 2-3 percent.

New Zealand's economy, buoyed by robust consumer spending, grew at a faster pace of 1.1 percent in the second quarter, after a revised 0.7 percent growth in the previous quarter.

Latest economic indicators have been generally positive. The jobless rate declined to a 19-year low during the second quarter. Retail sales rose in July, while manufacturing expanded in August as companies stepped up output, ahead of the Christmas period.

The Reserve Bank of New Zealand (RBNZ) kept its key interest rate unchanged at 6.75 percent during the quarter on expectations that underlying inflationary pressures will remain contained.

The economy is forecast to expand at a slower rate of 2.5 percent this year, after strong growth of 4.8 percent last year. Consumer prices are expected to be around 2.7 percent this year, within the RBNZ's target range of 1-3 percent.

The **US economy** recorded a growth of 0.8 percent during the June quarter, driven by robust domestic demand, exports and higher government spending.

Recent indicators signal mixed economic performance in the current quarter. On a positive note, retail sales rose and the services industry expanded in July. The jobless rate also held at a 4-year low during the same month, while the trade deficit narrowed.

However, on a negative note, an index of leading indicators for the US economy declined in August, and consumer confidence fell largely due to record gasoline prices.

The Federal Reserve raised its key interest rate by 25 basis points each in August and September, prompted by inflationary pressures stemming from higher energy prices.

For 2005, the economy is expected to grow by 3.5 percent, compared to 4.2 percent last year. Inflation is anticipated to be around 3.1 percent.

The **Euro-zone** economy expanded by 0.3 percent during the second quarter, after a revised 0.4 percent growth in the first quarter, primarily underpinned by strong exports.

Latest indicators have been generally encouraging. European business confidence rose and the service industries expanded in July. Moreover, manufacturing in the Euro region expanded in August, while retail sales also rose during the same month.

Furthermore, Germany and France, the Euro-zone's two major economies, also reported positive results during the quarter. In July, German industrial production rose, while the unemployment rate declined. In addition, German consumer confidence also rose in August. Moreover, French consumer spending rose to a 16-month high in August.

The European Central Bank left its benchmark interest rate unchanged at 2 percent throughout the third quarter, as increasing signs of an economic recovery alleviated the need for lowering borrowing costs.

The Euro-zone economy is forecast to expand by 1.2 percent this year, after 2.0 percent growth last year. Year-end inflation is forecast at 2.1 percent.

The **Japanese** economy grew at a slower rate of 0.8 percent in the June quarter, after a revised 1.4 percent growth in the March quarter, attributed to a slowdown in exports.

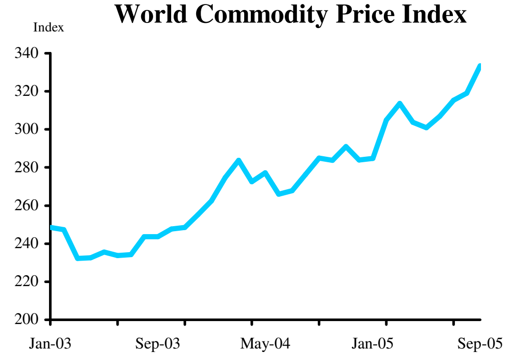
Latest indicators show the economic performance continues to strengthen. Retail sales rose in June, while industrial production also increased, led by strong external demand. Moreover, confidence amongst households also rose in August, underpinned by an improving job market.

This year, the Japanese economy is anticipated to expand by 2.0 percent, compared to 2.7 percent in 2004. Inflation is forecast at -0.4 percent this year.

World commodity prices rose by around 9 percent during the third quarter, attributed to higher prices for fats & oils, metals, foodstuff and livestock (Graph 3).

Graph 3

World Commodity Price Index

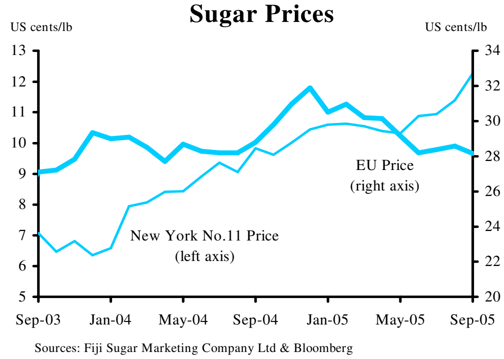


Source: Bloomberg

Over the September quarter, **world market sugar prices** rose by around 13 percent, reaching close to a 6-year high of 12.3 cents per pound in September (Graph 4). The increase was on concern that global production may not meet rising demand.[2]

Graph 4

Sugar Prices



However, sugar prices are anticipated to decline over the coming months, on expectation of higher estimated supplies from Brazil and Australia.

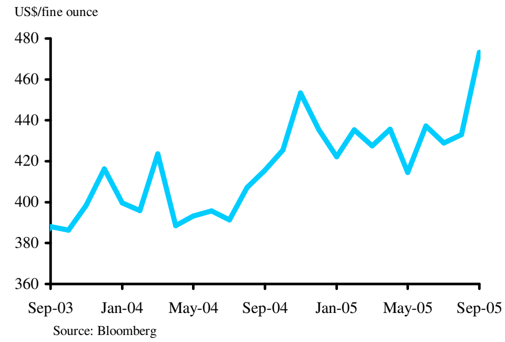
At the end of September, the European Union (EU) sugar price was around US28 cents per pound. Over the quarter, the EU sugar price fell marginally, reflecting a stronger US dollar against the Euro.

Gold prices rose by around 8 percent over the September quarter, reaching a 17-year high of US$473 per fine ounce in late September (Graph 5). In July, gold prices fell, after speculation that the stronger US dollar may reduce demand for the metal. However, gold prices surged later in the quarter, after high crude oil prices increased demand for the metal as a hedge against inflation. In addition, increasing demand from jewellers, ahead of the wedding season in India also boosted prices.

[2] World sugar production has lagged consumption in the past two years. Poor production from India, Thailand and Cuba has added to the slowdown in global sugar supply.

Graph 5

Gold Price

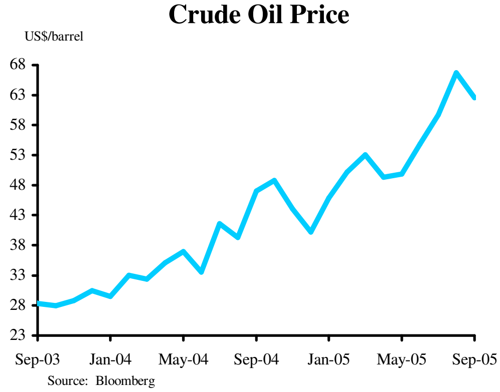


In the coming months, gold prices are expected to remain high (above US$440 per fine ounce), as expectations of inflationary pressures, stemming from higher oil prices is anticipated to boost demand for the metal.

At the end of September, the **Brent crude oil price** was around US$63 per barrel, around 14 percent higher than the price recorded at the end of June (Graph 6).

Graph 6

Crude Oil Price



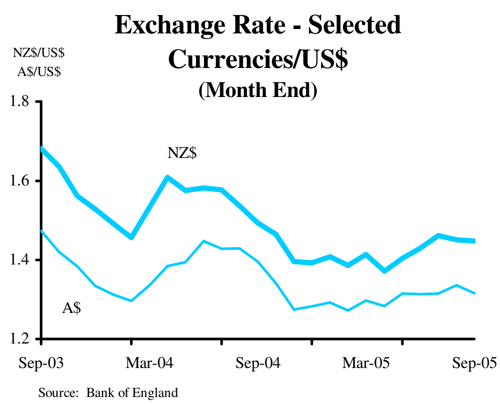
Crude oil prices rose during the first two months of the quarter, reaching a historical high of US$68 in August, on concerns that increased fuel demand may outpace supply. The adverse impact of Hurricanes Katrina and Rita on oil production in the Gulf of Mexico also contributed to the price increase. However, prices fell in September, on speculation that the higher prices may slow global demand.

In the coming months, crude oil prices are expected to remain high (above US$55 per barrel), on concerns that higher demand from the US and China will outpace the crude oil supplies to the world market.

International Financial Markets

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

Graph 7

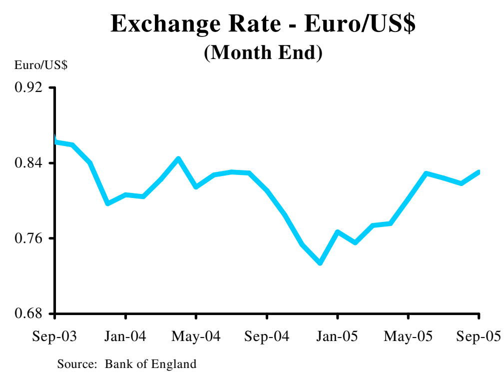


The Aussie dollar fell against the Greenback in the first two months of the quarter, on speculation that the RBA will keep its key interest rate unchanged this year. This prompted investors to switch from Aussie denominated assets to US dollar denominated assets. However, it strengthened in September, on reports that economic growth accelerated in the second quarter, boosting demand for Aussie dollar assets and, by extension, the currency.

The Kiwi dollar fell in July, after the RBNZ kept its benchmark interest rate unchanged, thus reducing the appeal of Kiwi dollar denominated assets. However, it strengthened in the remaining period of the quarter on optimism that the country's high yield advantage over the US will be sustained.

The Euro appreciated during the first two months of the quarter, on speculation that Europe's economy is picking up (Graph 8). However, the Euro weakened in September, after indications of further interest rate hikes by the US prompted investors to switch from Euro-denominated assets to US dollar-assets.

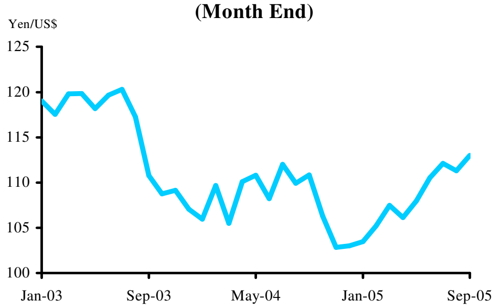
Graph 8



In July, the Yen generally weakened against the US dollar after prospects of a growing US economy increased demand for US dollar-indexed assets (Graph 9). However, the Yen strengthened in August, on speculation the US Federal Reserve may pause its campaign of interest rate hikes, prompting investors to switch to Yen denominated assets. Nonetheless, the Yen weakened again in September, as expectations of continued interest rate hikes by the US, reduced the appeal of Yen-denominated assets.

Graph 9

Exchange Rate - Yen/US$
(Month End)

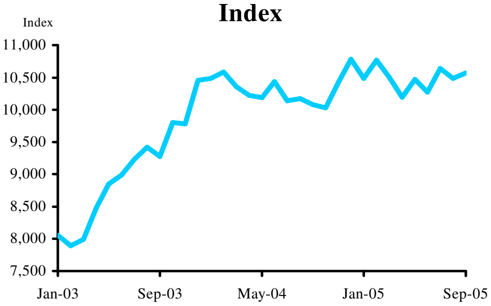


Source: Bank of England

Equity prices generally rose during the three months to September. Over the September quarter, the Dow Jones Industrial Average Index rose by around 3 percent (Graph 10). The Dow rose in July, after reports of growth in US retail sales increased optimism of the US economy, thus increasing demand for US equities. However, it fell in August, amid concern that higher fuel costs may dampen US growth prospects. Nevertheless, the Dow rose again in September, after the adverse impact of the hurricanes increased gasoline prices, raising profit outcomes of energy-related companies.

Graph 10

Dow Jones Industrial Average Index

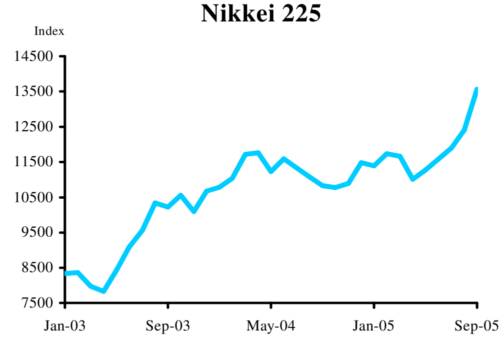


Source: Bloomberg

The Nikkei 225 Stock Average Index rose by around 17 percent (Graph 11) over the quarter, rallying close to a 4-year high in September, after prospects of an expanding economy boosted the appeal of Japanese equities.

Graph 11

Nikkei 225

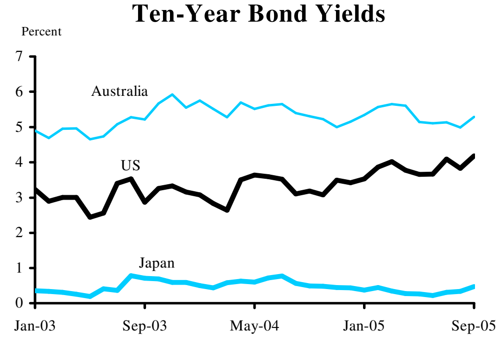


Source: Bloomberg

During the September quarter, 10-year bond yields for the US, Japan and Australia generally rose (Graph 12).

Graph 12

Ten-Year Bond Yields



Source: Bloomberg

US bond yields rose in July, after an increase in stocks reduced demand for bonds. However, yields fell in August, after concerns that rising energy prices may slow the US economy and increased demand for the safer government debt. Nevertheless, yields rose again later in the quarter, on concerns that inflation may pick up, reducing the appeal of bonds.[3]

Japanese bond yields generally rose over the September quarter, as continued economic optimism and the rally in stocks prompted investors to move away from bonds.

During the first month of the September quarter, Australian bond yields rose, after a positive outlook for the economy reduced demand for bonds. However, yields fell in August, following concerns that rising crude oil prices may slow the economic expansion, thus raising the demand for government debt. Nevertheless, yields rose again in September, on expectations that exports will accelerate, leading investors to demand stocks rather than bonds.

[3] Inflation reduces the real return on fixed income securities.

THE DOMESTIC ECONOMY

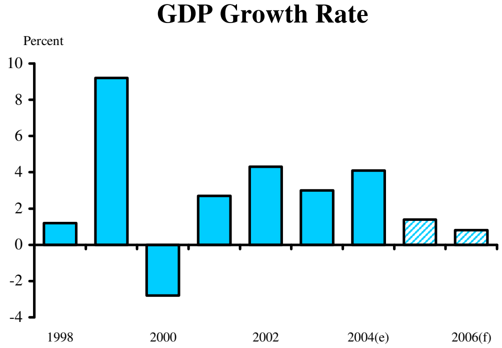
Domestic Economic Conditions

Economic growth for this year is now projected at 1.7 percent, up from 1.2 percent announced in April. For 2006, economic growth is expected at 2.0 percent (Graph 13).

The improved outlook for 2005 is underpinned by better prospects for the wholesale & retail trade, hotels & restaurants; building & construction and transport & communications sectors. Encouraging developments in these sectors are expected to more than offset the negative contributions stemming from the mining & quarrying and the community, social & personal services sectors. A sharp contraction in the textiles, clothing & footwear industry is still envisaged, with the expiry of the US quota arrangement this year.

Graph 13

GDP Growth Rate



Sources: Fiji Islands Bureau of Statistics & Macroeconomic Committee

Consumer Spending

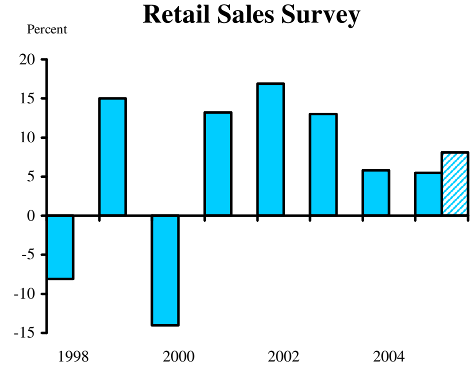
Consumption remained upbeat during the January to August period, evident by the robust growth in partial indicators of **consumer spending**.

Cumulative to August, Value Added Tax (VAT) collections from domestic activities[4] recorded a buoyant 13 percent growth over the comparable period last year. Strong performances were also registered in lending for consumption purposes and imports of consumption goods.

Looking ahead, prospects for consumption activity remain strong (Graph 14).

Graph 14

Retail Sales Survey



Source: Reserve Bank of Fiji

The results of the Reserve Bank's June 2005 Retail Sales Survey indicate that respondents anticipate gross retail sales to increase by around 8.0 percent this year, slightly higher than in the December 2004 survey.

The better-than-expected outlook for retail

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

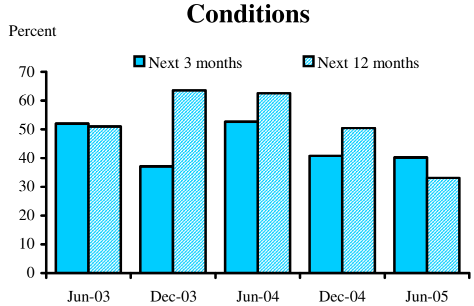
sales this year is underpinned by improved sales prospects in the duty free retailing; food, drinks & tobacco; building materials & hardware; household goods & appliances; motor cars & other transport equipment and clothing & textile categories. Strong performance in the tourism industry and the ongoing boom in the construction industry are contributing to the good performance noted in consumption activity.

Business Expectations Survey

The Reserve Bank of Fiji conducted its latest Business Expectations Survey (BES) in June this year. The survey results indicate that the prospects for general business conditions in the short-term remained relatively encouraging, with a net[5] 40 percent of respondents still expecting business to pick up in the quarter ahead (Graph 15).

Graph 15

Outlook for General Business Conditions



Source: Reserve Bank of Fiji

The tourism, finance and non-garment manufacturing industries and the building & construction sector largely underpinned this favourable outlook.

As for the 12-month outlook, sentiments were reduced by 17 percentage points. However, a net 33 percent of respondents are still optimistic about the medium-term outcome. Relatively stronger expectations were noted from the building & construction sector and the insurance, non-garment manufacturing and tourism industries.

Production

On a sectoral basis, a mixed performance was noted during the quarter. The cane & sugar, copra, electricity, fisheries, timber and building & construction sectors registered favourable growth. However, on the downside, performance was weak in the textile, clothing & footwear and mining & quarrying sectors during the review period.

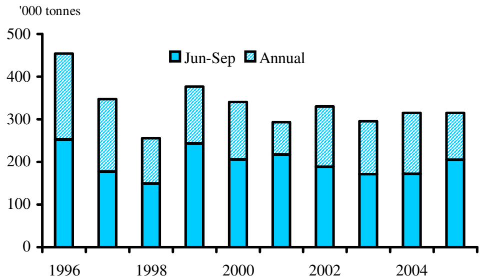
The **cane & sugar** industries continued to perform well into the third quarter of the year. Mill reports from the Fiji Sugar Corporation Limited (FSC) indicate that around 2 million tonnes of sugarcane was crushed during the first 4 months of the harvesting season. This represents a substantial growth of 21 percent on an annual basis during the review period. Consistent with the good harvest thus far, sugar production totalled 206,000 tonnes, around 19 percent higher than the level recorded over the previous comparable period (Graph 16).

The relatively good performance by the industries was due largely to an early start to the season this year. In addition, a steady cane supply to the mills and a relatively lower number of mill breakdowns contributed to this improved performance.

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

Graph 16

Sugar Production
(Seasonal)

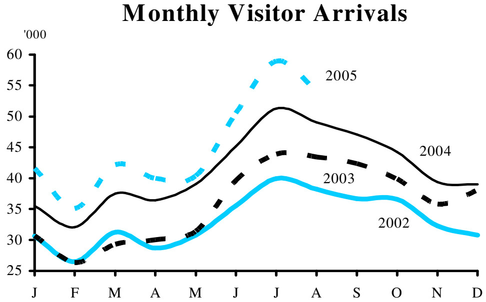


Sources: Fiji Sugar Corporation Ltd, Fiji Islands Bureau of Statistics & Macroeconomic Committee.

The **tourism** industry recorded a strong performance during the first 8 months of the year. Anecdotal evidence and industry liaison suggests that total visitor arrivals to Fiji in the year to August totalled around 362,000, approximately 11.0 percent higher than the level registered over the same period last year (Graph 17).

Graph 17

Monthly Visitor Arrivals



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

Other indicators of activity in the tourism industry also remained encouraging. For the first six months, hotel turnover grew by around 22 percent over the corresponding period last year, while the number of beds sold rose by 16 percent during the same period.

With the expiry of the peak tourism season at the end of September, it is likely that monthly arrivals may slow down in the coming months. Nonetheless, the Fiji Islands Visitors Bureau (FVB) is confident that the annual projection of 532,000 visitors will be achieved by end-December.

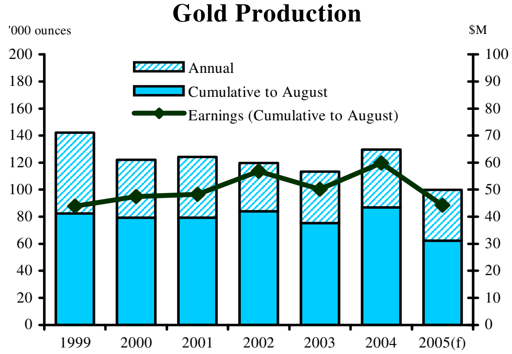
Consistent with the expected growth in arrivals, tourism earnings is currently projected at around $800 million.

As expected, output in the **textiles, clothing and footwear** industry remained depressed during the review period. In the year to July, textiles, clothing and footwear export earnings totalled $89 million, representing a sharp decline of around 38 percent. A 50 percent contraction was noted in the first quarter Industrial Production Index for the garments and footwear index. The major reason for the deterioration in output has been the closure of the largest garment factory from the industry, beginning April this year. At the same time, industry players exporting largely to the Australian and New Zealand markets, under the SPARTECA (TCF Provisions) Scheme have highlighted increasing competition posed by Asian producers in these markets.

Production in the **mining and quarrying** sector remained weak during the quarter. Cumulative to August this year, total gold output amounted to almost 62,000 ounces, 28 percent lower than the corresponding period in 2004 (Graph 18). According to industry sources, staff absenteeism and lower quality ore extraction continue to hinder output at the mine.

Graph 18

Gold Production



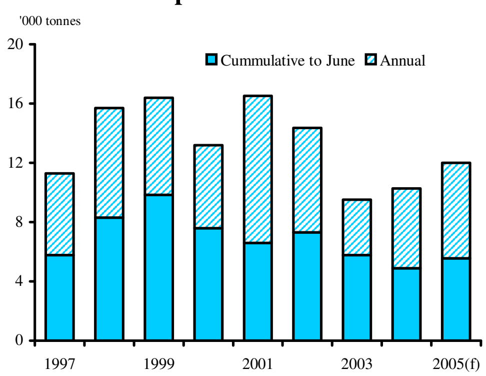
Source: Emperor Gold Mining Company Limited

In line with weak production, gold export earnings were also lower by 26 percent on an annual basis.

The **copra** industry continues to perform favourably. Copra production in the first six months amounted to around 5,600 tonnes (Graph 19), representing a 14 percent growth over the corresponding period in 2004.

Graph 19

Copra Production



Source: Coconut Industry Development Authority

In June, the minimum mill gate price of copra remained unchanged at $500 per tonne. Government's subsidy towards the mill gate price was $56.26 per tonne.

Electricity generation continues to hold up well. During January to August, total electricity generated was around 455 million kilowatt hours (kwh), an increase of 4 percent over the same period last year. Growth in electricity generation has been maintained around this level for sometime now, suggesting a steady growth in economic activity.

In anticipation of higher future energy demand, FEA has budgeted an investment of around $350 million, to be spent over 2005-2010. This includes commissioning of the Nadarivatu Hydro Station, transmission and distribution upgrades, Wailoa Half-life refurbishment, a Butoni Wind project, purchases of new diesel generator sets for the Kinoya Power Station, and development of IT and communications networks.

The **fishing** industry is estimated to have performed well. Trade data for the January to July period indicates that total fish export receipts amounted to around $49 million, representing a 20 percent increase over the corresponding period last year.

Export earnings data suggest that the performance of the **timber** industry was positive in the first seven months of this year. Cumulative to July, timber export receipts were around $28 million, 22 percent higher than the corresponding period in 2004.

The **building and construction** sector continues to maintain its buoyant performance this year. According to the Building and Construction Survey Report released by the Fiji Islands Bureau of Statistics, a total of $116 million worth of construction work has been realised in the year to June. This represents an increase of around 74 percent on an annual basis.

By categories, cumulative to June this year, the value of work put-in-place by the private sector rose by around 106 percent ($90m), while the public sector recorded an increase of 14 percent ($26m).

Large-scale tourism projects are still driving the activity in the construction sector. These include construction work at the Sofitel Fiji Resort and Spa, Momi Bay Marriott Resort, First Landing Resort, coupled with refurbishment works at the Sheraton Fiji and Sheraton Royal Resorts, the Warwick International Resort, Shangri-La Fijian Resort and the Naviti Island Resorts. Other notable projects still ongoing include construction work at the Great Council of Chiefs complex, Mid-City Plaza, Suva Central project (Stage 2), Rewa Bridge, Fiji Islands Revenue & Customs Authority's new Headquarters and upgrading works at the Nadi International Airport.

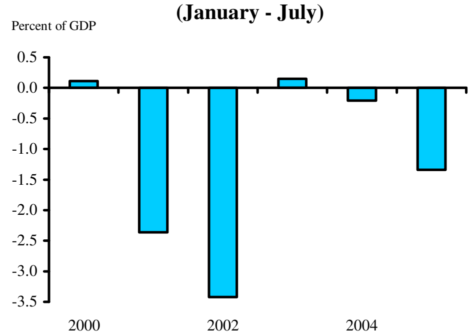
Consistent with the strong performance of the construction sector, the **investment** level in the country is gradually increasing. It is envisaged that investment will likely be around 17 percent of GDP this year. This is also substantiated by higher lending to private individuals for housing purposes and the construction sector during this quarter.

Public Finance

Provisional data on Government finance indicates that, cumulative to July, the underlying balance remained below target. The **underlying deficit** during the period was around $64.2 million, equivalent to 1.3 percent of GDP (Graph 20).

Graph 20

Underlying Fiscal Balance
(January - July)



Sources: Ministry of Finance & Macroeconomic Committee

The deficit position was mainly underpinned by a 7.0 percent increase in net expenditure and a 1.6 percent deterioration in net revenue. On a brighter note, the deficit outturn was well below the target of $191.2 million, or 4.6 percent of GDP, for the same period.

In addition, the capital/operating mix was 11:89 during the review period, with Government incurring lower-than-budgeted level of capital expenditure, aimed mainly at capital transfers and purchases. Government's year-end deficit projection remains intact at 4.3 percent of GDP.

Total outstanding **Government debt** continued to expand during the first 8 months of the year. At the end of August, total Government debt totalled around $2,359 million, or around 49 percent of GDP.

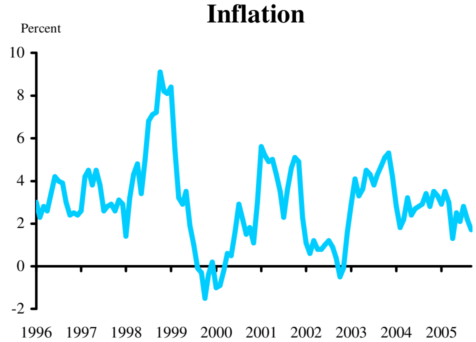
Of the total debt, 93 percent constituted domestic debt while the balance of 7 percent represented external debt. The year-end forecast for total Government debt stands at $2,447 million, equivalent to 51 percent of GDP.

Inflation

In the year to September, inflation stood at 1.7 percent, compared with 2.1 percent recorded in June (Graph 21).

Graph 21

Inflation



Source: Fiji Islands Bureau of Statistics

Over the quarter, consumer prices rose by around 0.4 percent, mainly due to higher prices of heating & lighting, transport, housing, alcoholic drinks & tobacco and miscellaneous items. These rises were partially offset by falls in the prices of food, clothing & footwear and durable household goods. Prices for services remained unchanged during the quarter.

The underlying measure of inflation, the trimmed mean, was 1.3 percent in September, up from 1.1 percent in the previous quarter.

The year-end inflation forecast has now been revised downwards to around 3 percent from 4.5 percent. While domestic fuel prices have risen for the fourth time this year, other flow-on effects have been minimal. Lower prices of primary produce was the main reason for the downward revision. However, inflation is expected to rise in the medium term, as the effects of higher oil prices become more profound and prices of domestically produced goods pick up.

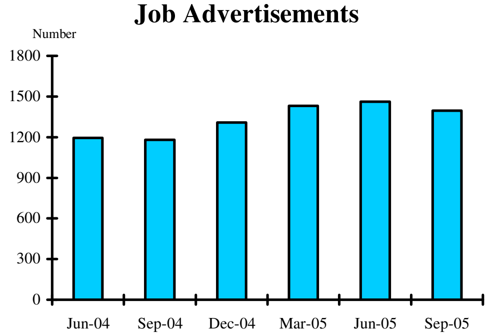
Labour Market

Partial indicators continue to show a slowdown in employment growth. During the January-September period, around 5,500 individuals were registered as taxpayers with the Fiji Islands Revenue and Customs Authority (FIRCA), representing a fall of around 18 percent over the year. For the first three quarters of this year, the community, social and personal services sector recorded the most number of taxpayers followed by the finance, insurance, real estate & business services; wholesale, retail trade, restaurants & hotels; manufacturing, and construction sector.

However, in the approaching months, the employment situation is anticipated to improve. The Reserve Bank's September Survey of Job Advertisements reported an annual increase of 18 percent (Graph 22).

Graph 22

Job Advertisements



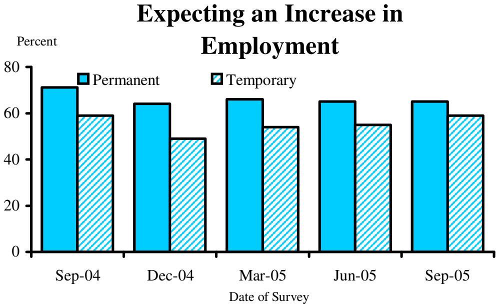
Source: The Fiji Times

The demand for workers was primarily driven by the community, social & personal services sector followed by the wholesale & retail trade, restaurants & hotels; finance, insurance, real estate & business services; transport storage & communication and construction based companies.

Furthermore, the results of the Reserve Bank's Fiji Employers Federation (FEF) Expectations Survey, conducted in September, suggest a positive outlook for employment over the next 12 months. A net of around 65 and 59 percent of the respondents expect an increase in permanent and temporary employment, respectively (Graph 23). In comparison to the previous survey, a slight improvement was recorded.

Graph 23

Net Proportion of Respondents Expecting an Increase in Employment

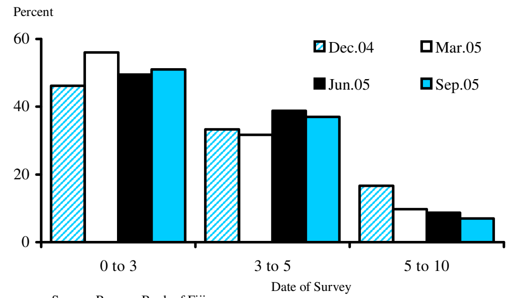


Source: Reserve Bank of Fiji

Wages growth is expected to be modest in the medium term (Graph 24). The FEF Expectations Survey revealed that around 88 percent of the respondents anticipate wages to rise between 0-5 percent, while 7 percent expect a rise between 5-10 percent.

Graph 24

Proportion of Respondents Expecting Wages to Increase



Source: Reserve Bank of Fiji

The External Sector

On the external front, latest Overseas Exchange Trade (OET) data showed that cumulative to July, merchandise exports fell by around 19 percent, compared with an increase of around 9 percent in the corresponding period last year. The decline in receipts was largely attributed to negative contributions from textiles, clothing & footwear, sugar, fish, merchanted goods, other exports, gold and timber, which more than offset positive contributions from ginger, re-exports of mineral fuels and mineral water.

During the same period, merchandise imports rose by around 11 percent, compared to growth of around 23 percent in the corresponding period in 2004.

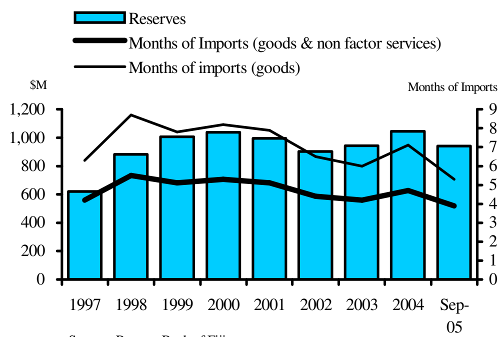
The increase in import payments was due to positive contributions from intermediate goods (5.4 percent), investment goods (4.7 percent) and consumption goods (0.5 percent). The increase in imports of intermediate goods was mainly underpinned by positive contributions from mineral fuels, while the rise in investment goods was led by higher payments for machinery & electrical equipment and chemicals.

The higher payment for consumption goods was attributed to the increase in contribution from duty free goods, government imports and merchanted goods.

Foreign reserves at the end of September were $940 million, sufficient to cover 3.9 months of imports of goods and non-factor services or 5.3 months of imports of goods only (Graph 25).

Graph 25

Gross Foreign Reserves



Source: Reserve Bank of Fiji

Domestic Financial Conditions

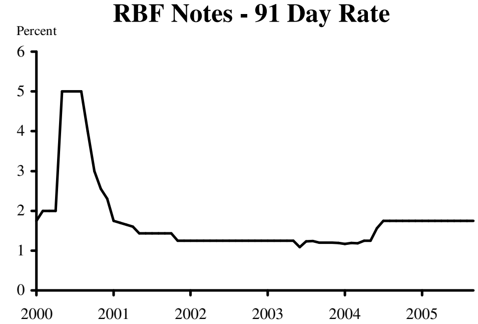
Money Markets

The demand for inter-bank funds rose during the September quarter. Total inter-bank turnover was $60.4 million during the review quarter, compared with $26.2 million in the previous quarter. The weighted average inter-bank rate during the third quarter was 1.30 percent.

The Reserve Bank's monetary policy stance remained unchanged during the July-September period, with the policy indicator rate maintained at 1.75 percent (Graph 26).

Graph 26

RBF Notes - 91 Day Rate



Source: Reserve Bank of Fiji

As part of open market operations, around $167.2 million worth of RBF Notes were allotted during the review period, compared with $265.3 million issued in the June quarter. The yield on the RBF Notes during the September quarter averaged 1.74 percent.

Government also issued Treasury Bills worth $70 million in the same period. There were 5 issues of promissory notes during the quarter, worth $27 million.

Capital Markets

During the September quarter, government issued bonds worth $107.1 million compared with $57.2 million issued in the previous quarter. The maturities offered were from 3 to 15 years, with weighted average yields ranging from 2.13 percent to 6.26 percent.

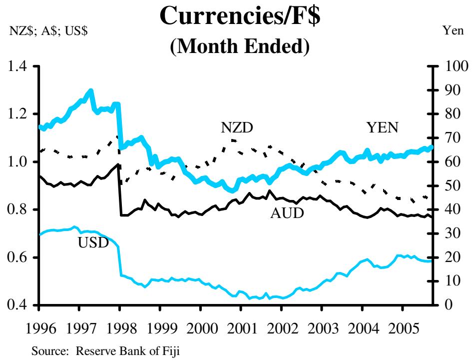
In the secondary market for bonds, there were 25 trades during the review quarter, totalling $6.5 million. This compares with 39 trades amounting to $36.4 million recorded in the previous quarter.

Foreign Exchange Markets

During the September quarter, the Fiji dollar weakened against the Euro (0.3 percent), US (0.4 percent) and Australian (0.2 percent) dollars but strengthened against the Japanese Yen (1.8 percent) and the New Zealand (0.8 percent) dollar compared with the end of the previous quarter (Graph 27).

Graph 27

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

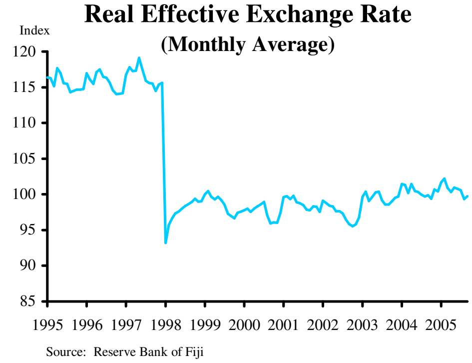


The Nominal Effective Exchange Rate Index (NEER), which reflects aggregate exchange rate movements between the Fiji dollar and currencies of major trading partners, fell marginally over the quarter, indicating a depreciation of the Fiji dollar against the basket of currencies.

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 partners also fell, implying an improvement in our competitiveness externally (Graph 28).

Graph 28

Real Effective Exchange Rate
(Monthly Average)

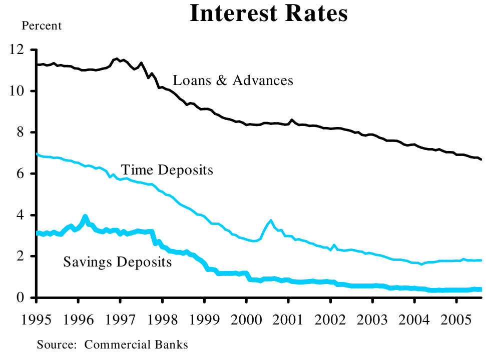


Financial Intermediaries

Latest movements in commercial bank interest rates generally reveal a mixed trend. The weighted average lending rate on commercial bank outstanding loans declined to 6.68 percent in August, compared with 6.77 percent at the end of the June quarter (Graph 29).

Graph 29

Interest Rates



During the same period, the savings rate fell by 2 basis points to 0.40 percent, while the time deposit rate rose by 3 basis points to 1.81 percent.

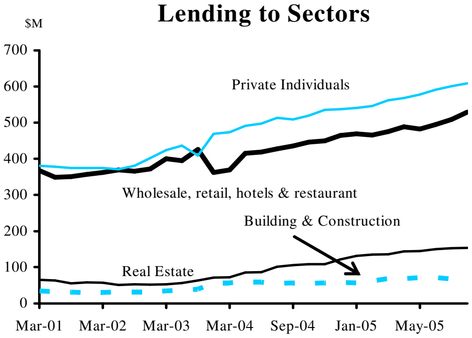
Compared with the end of the June quarter, the weighted average lending rate and the interest rate on outstanding time deposits offered by Licensed Credit Institutions (LCIs)[6] both fell by 7 basis points to 11.41 percent and 4.12 percent, respectively, at the end of August.

Monetary and credit aggregates continued to grow strongly in the year to August. During the period, broad money grew at an annual rate of 15.4 percent. The outturn was largely attributed to increases in narrow and quasi money, which in turn was influenced by rises in demand, savings and time deposits.

In the year to August, the value of loans outstanding in the banking system rose by 24 percent. This was spurred largely by higher lending to the private individuals, wholesale, retail, hotels & restaurants, building & construction as well as to the real estate sectors (Graph 30).

Graph 30

Lending to Sectors



Source: Commercial Banks

In contrast, commercial bank lending to the manufacturing, mining & quarrying and central & local government sectors declined during the same period.

Total outstanding loans and advances by LCIs, rose by 15.2 percent in the year to August, underpinned mainly by higher lending to private individuals and the real estate sector.

Banking Industry Quarterly Condition Report – June 2005

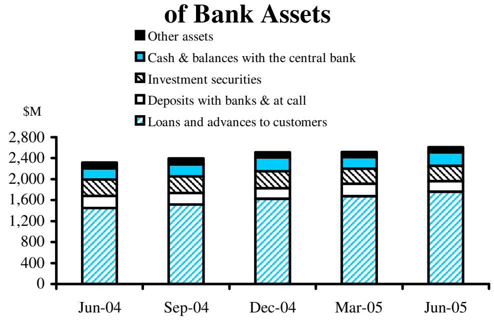
A. Commercial Banks

Balance Sheet

The banks' balance sheet grew by 3.7 percent over the quarter and 12.8 percent over the year to $2.6 billion (Graph 31).

Graph 31

Structural Change and Growth of Bank Assets



Source: Commercial Banks

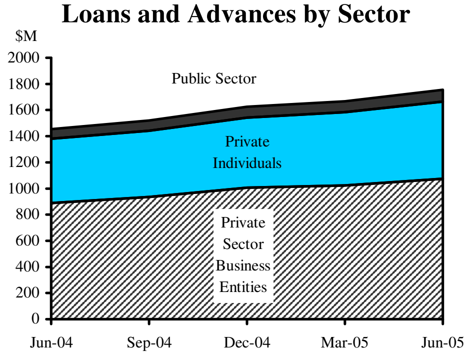
The expansion of the balance sheet was a result of growth in the banks' loan portfolios. Credit to the Private Individuals sector increased by $28.7 million, Wholesale/Retail sector increased by $18.9 million, and the Real Estate sector grew by $13.4 million, pushing up overall loan balances over the quarter to $1.8 billion (Graph 32).

Lending by banks was mainly for the purpose of development in the hotels and restaurants industry; while lending to private individuals was mainly for housing purposes.

[6] LCI's include Merchant Finance Investment Company Limited, Credit Corporation (Fiji) Limited and Home Finance Company Limited.

Graph 32

Loans and Advances by Sector



Source: Commercial Banks

Yearly comparison shows similar trends, with the real estate sector recording the highest percentage growth of 75.2 percent. The trend is in line with the demand for real estate development and the housing boom, resulting in a corresponding growth in the private individuals sector over the year by 20.2 percent.

The level of deposits increased considerably by $81.0 million (3.6 percent) over the quarter and 13.9 percent over the year. More than 50 percent of the increase stemmed from demand deposits. Demand deposits grew mainly due to $46.2 million placed by private sector business entities. Demand deposits of the private sector show an increasing trend.

Earnings

All banks recorded a *satisfactory* earnings position, registering $19.7 million as profits over the June quarter. This was 22.4 percent better than the profits over the March quarter and 28.5 percent more than the profits of June 2004.

A favourable net interest income and growth in non-interest income coupled with a reduced level of operating expenses led to the enhanced earnings position.

Growth in interest income mainly stemmed from interest earned on business loans (4.5 percent) and housing loans (8.7 percent). This is in line with the growth in loans and advances over the quarter.

With the favourable earnings position over the quarter, banks also recorded a 4.1 percent return on assets, 3 basis points better than that of the previous quarter.

Aggregate Banks' Income Statement

	Jun-04	Mar-05	Jun-05	% Change	
			$M	Over Qtr	Over Jun-04
Interest Income	29.88	33.55	34.96	4.20	17.00
Interest Expense	4.34	4.87	5.09	4.52	17.28
Net interest income	25.54	28.68	29.87	4.15	16.95
Add: **Non interest income**	19.63	21.12	22.23	5.26	13.25
Income from overseas exchange transactions	7.27	8.28	6.80	-17.87	-6.46
Commission	2.61	3.19	1.84	-42.32	-29.50
Fee Charges	9.05	9.09	12.24	34.65	35.25
Other income	0.70	0.56	1.35	141.07	92.86
Equals					
Total operating income	45.17	49.80	52.10	4.62	15.34
Less: Operating expenses	22.32	23.78	23.31	-1.98	4.44
Less: Bad Debts & provisions	2.00	2.15	2.24	4.19	12.00
Equals:					
Profit before tax	20.85	23.87	26.55	11.23	27.34
Less: Tax	5.52	7.77	6.85	-11.84	24.09
Add Extra ordinary items					
Equals:					
Net profit after tax	15.34	16.10	19.70	22.36	28.42

Source: Commercial Banks

Interest Margin and Spread

After a slight contraction in the March quarter, banks' interest spread widened again in June 2005 (Graph 33).

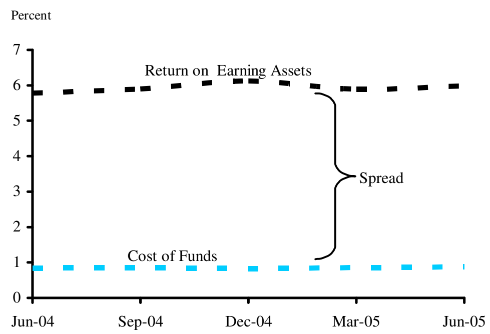
Despite heavy market competition and a

simultaneous reduction in weighted average lending rates (average lending rate reduced to 6.8 percent from 6.9 percent in March), the return on earning-assets did not fall. This may be linked to the increase in lending volumes, which contributed to the high growth in interest income.

The cost of funds increased over the quarter and could have caused the margin to contract. However, the yield on earning assets increased at a faster rate (10 basis points) than the average cost of funds, which increased by 2 basis points.

Graph 33

Margins and Spreads



Source: Commercial Banks

Efficiency

Banks raised their efficiency in the current quarter with the ratio of operating expenses-to-operating income of 44.7 percent being the lowest recorded since September 2003 (43.7 percent). Banks' efforts in reducing their costs led to the decline in operating expenses by 2.0 percent, which had a positive impact on the efficiency ratio.

In comparison the ratio was 49.4 percent in June 2004.

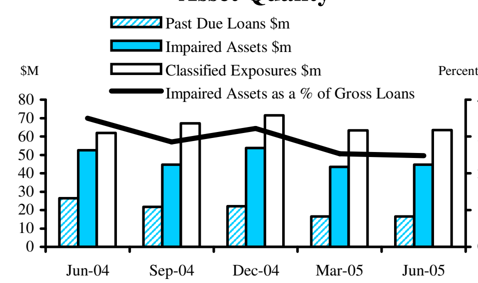
Asset Quality

Asset Quality remained *satisfactory* over the quarter with only a slight growth in the level of impaired assets (Graph 34).

As at June 2005, impaired assets of the industry stood at $44.7 million, which represented 2.5 percent of gross loans and advances. The level of impaired accounts increased by $1.2 million over the quarter mainly due to one bank downgrading accounts from its special mention category. Yearly comparison showed a decline in the level of impaired assets by $7.8 million mainly due to recoveries made by banks and write off loss accounts against specific provisions.

Graph 34

Asset Quality



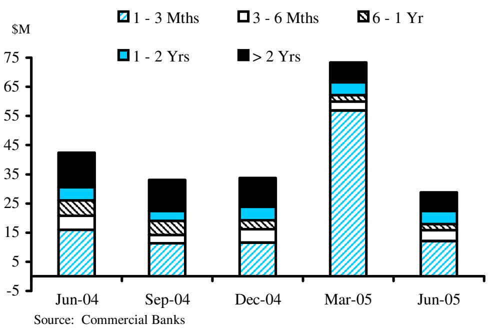
Source: Commercial Banks

Past Due loans in the 1-3 months category reduced considerably ($44.7 million) this quarter. This was due to one bank normalising one of its major accounts in the tourism sector which was previously recorded as past due (Graph 35).

In terms of problem loans by sector, most impaired loans (44.8 percent) were concentrated in the wholesale/retail sector. Under the private individuals category most problem loans (65.6 percent) were for housing.

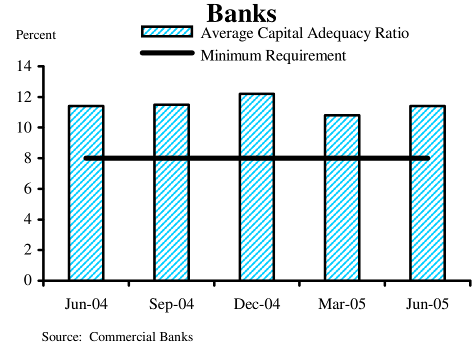
Graph 35

Past Due Status



Graph 36

Capital Adequacy Ratio of Banks



Total provisions stood at $45.0 million as at June 2005 and represented 100.5 percent of impaired assets. Total provisions increased by 2.9 percent over the quarter mainly due to a 5.6 percent increase in general provisions.

General provisions are expected to grow further over subsequent quarters corresponding to the increasing loan portfolio.

Capital Adequacy

Banks maintained a *strong* capital position with a capital adequacy ratio of 11.4 percent. The ratio improved from 10.8 percent in the previous quarter due to recording of profits in the tier 2 capital by all banks (Graph 36).

The current quarter's ratio was the same as the ratio recorded in the June quarter last year. Although total capital grew by 14.3 percent and banks' risk assets by 15.1 percent over the year, the overall ratio remained same.

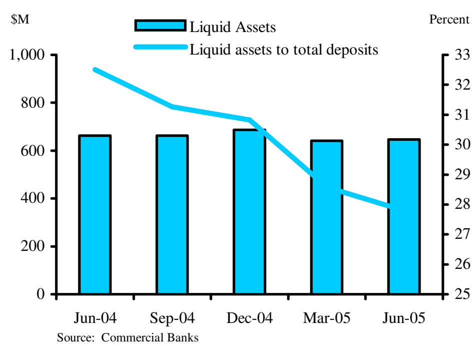
Liquidity

The banks' liquidity position is considered *satisfactory* in the June quarter.

Although the level of liquid assets increased over the quarter by 0.8 percent, banks' liquidity coverage for deposits further reduced from 28.8 percent in March to 27.8 percent. This was mainly the result of a rapid growth in deposits by 3.6 percent over the quarter (Graph 37).

Graph 37

Liquid Assets to Total Deposits



As a percentage of total assets, liquid

assets further reduced by 0.7 basis points from the previous quarter, to 24.7 percent.

The declining drift of liquidity ratios points out the usage of liquid assets by banks to fund their loan growth to some extent. While the total deposits increased by $81.0 million, loan portfolio grew by $88.9 million over the quarter.

Electronic Banking

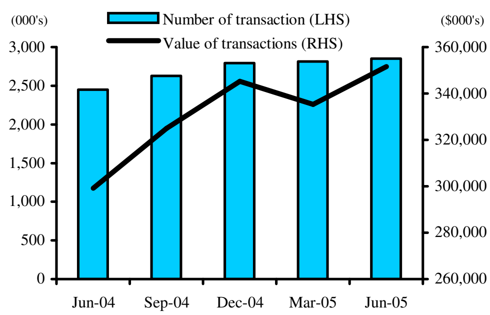
Usage of Electronic means of banking remained high. The value of transactions conducted through ATM's and EFTPOS recovered over the quarter, compared with the decline in the previous quarter (Graph 38).

The number of transactions conducted through ATMs and EFTPOS increased to 2.9 million from 2.8 million in the March quarter. In terms of value of transactions, it increased to $351.6 million compared to $335.2 million in March 2005.

Other non-traditional banking methods, namely Internet and phone banking services, are provided by the 2 major banks.

Graph 38

ATM & EFTPOS Transactions



Source: Commercial Banks

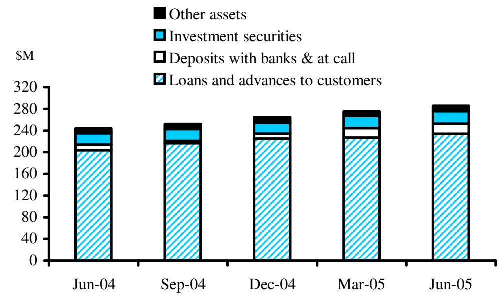
B. Credit Institutions

Balance Sheet

The combined balance sheet of credit institutions grew over the quarter by 4.1 percent to $286.0 million, mainly due to higher loans and advances to customers (Graph 39).

Graph 39

Structural Change and Growth in Credit Institutions' Assets

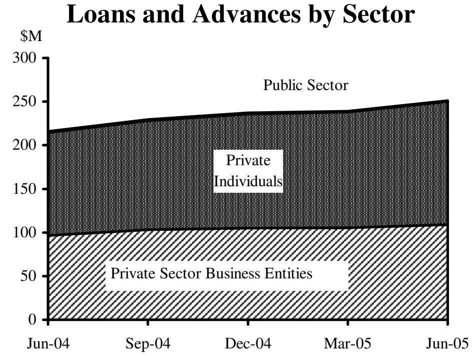


Source: Credit Institutions

Funding this growth on the liabilities side was an increase in borrowings, up by 15.9 percent and an increase in share capital. All other components registered downward movements. Term deposits declined over the quarter by 1.8 percent to $138.5 million but registered a slight growth of 0.6 percent from June 2004 (Graph 40).

Graph 40

Loans and Advances by Sector



Source: Credit Institutions

In line with the growth in funding, loans and advances grew by 3.1 percent to $233.6 million. New loans approved increased over the quarter by 3.3 percent to $38.2 million.

New loans issued during the quarter were mainly to the following 5 sectors: private individuals, transport and storage, real estate, wholesale, retail, hotels and restaurants and building and construction.

Earnings

Earnings of credit institutions' were $2.4 million compared to $2.8 million in the preceding quarter. The decline of 15.8 percent in net profit after tax for the quarter was caused by an increase in operating expenses and bad debts and provisions.

Aggregate Credit Institutions' Income Statement

	Jun-04	Mar-05	Jun-05	% Change Over Qtr	% Change Over Jun-04
		$M			
Interest Income	7.17	7.85	8.11	3.31	13.11
Interest Expense	2.04	2.33	2.44	4.72	19.60
Net interest income	5.13	5.52	5.67	2.71	10.52
Add: **Non interest income**	0.60	0.62	0.69	11.29	15.00
Commission	0.06	0.06	0.08	33.33	33.33
Fee Charges	0.25	0.35	0.25	-28.57	-
Other income	0.29	0.22	0.37	68.18	27.58
Equals **Total operating income**	5.74	6.14	6.36	3.58	10.80
Less: Operating expenses	2.26	2.31	2.86	23.80	26.54
Less: Bad Debts & provisions	0.73	0.45	0.53	17.77	-27.39
Equals: **Profit before tax**	2.74	3.38	2.96	-12.42	8.02
Less: Tax	0.50	0.54	0.57	5.55	14.00
Add Extra ordinary items					
Equals: **Net profit after tax**	2.25	2.84	2.39	-15.84	6.22

Source: Credit Institutions

Interest income recorded an increase over the quarter of 3.3 percent while interest expenses recorded a 4.7 percent increase. The increase in interest income is attributed to the increased lending activity, while the increase in interest expense can be attributed to an increase in the average deposit rate over the quarter by 12 basis points to 4.2 percent (Graph 41).

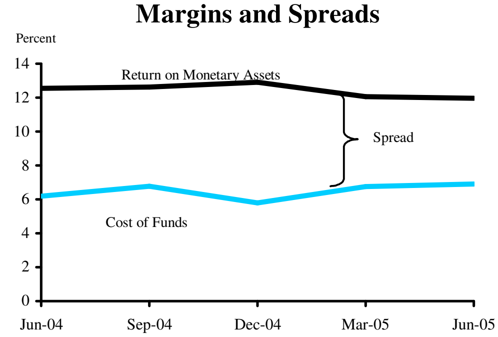
Operating expenses show a 23.8 percent increase over the quarter due to an increase in cost of employing management staff.

Returns on equity showed a 1.6 percentage points fall to 5.1 percent while returns on assets showed a 20 basis points fall to 0.9 percent.

Despite declines in earnings indicators over the quarter, the current ratios indicate a *satisfactory* earnings position for credit institutions.

Graph 41

Margins and Spreads



Source: Credit Institutions

Asset Quality

Credit institutions' asset quality recorded improvements over the quarter with falling past due levels and classified exposures while general coverage increased (Graph 42).

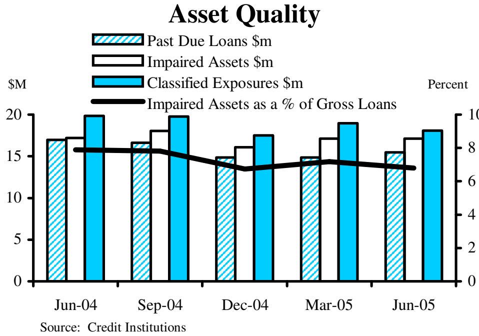
The level of impaired assets did not exhibit any movement over the quarter remaining at $17.1 million. Classified exposures, however, declined by 4.7 percent, showing further improvement as a percentage of total loans and falling 71 basis points to 7.2 percent.

With the fall in classified exposures for accounts classified substandard and loss, specific provisions decreased by 5.4 percent to $6.2 million. General provisions continued to steadily increase for all credit institutions, with a 10.5 percent increase to $8.1 million, taking total provisions higher by 3.0 percent to $14.4 million. General coverage has been consistent, remaining within 3 percent.

In spite of the positive changes Credit institutions' asset quality has been rated *marginal*. The rating has been influenced by several large and long outstanding non-performing loans.

Graph 42

Asset Quality



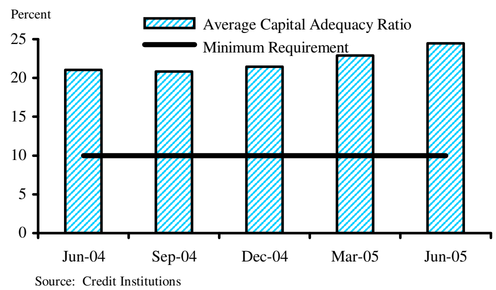
Capital Adequacy

Capital adequacy requirement for credit institutions is 10 percent of their risk-weighted assets. This has been kept above the requirement, and was recorded at 24.5 percent for the quarter under review. This represents a 1.6 percentage points increase over the quarter (Graph 43).

Credit institutions are expected to remain well capitalised and therefore capital is rated *strong*.

Graph 43

Capital Adequacy Ratio of Credit Institutions



Liquidity

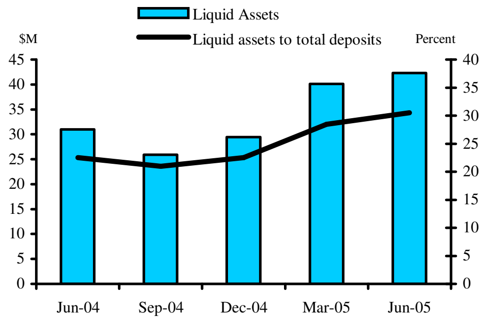
Credit institutions' liquid funds continued to increase (Jun 05: $42.3m; Mar 05: $40.1m) despite a fall in deposits. The increase is largely a result of a capital injection during the quarter. As a percentage of funding, liquid assets increased by 2.1 percentage points to 30.2 percent (Graph 44).

Total 15 largest depositors for credit institutions accounted for $49.2 million representing 116.3 percent of liquid assets. This is an improvement from the March quarter's 141.9 percent. Despite the improvement, liquid assets do not cover volatile liabilities.

The above ratios indicate an improved liquidity position. However, loan growth over the quarter was recorded for long-term assets such as real estate and personal housing. Continued growth in this area will tie up funds in the long term, while investors look for short term funding. Long-term liquidity will be closely monitored.

Graph 44

Liquid Assets to Total Deposits



Source: Credit Institutions

In this regard, the level of liquid assets available to cover total resources and deposits in crisis situations is considered marginal. This liquidity risk is however mitigated by stand-by arrangements with banks and parent companies.

Insurance Industry Quarterly Condition Report – March 2005

Overview of Insurance Industry Performance

Overall, a satisfactory performance was reported by the insurance industry for the March quarter of 2005. The surplus was up by 19.0 percent to $57.3 million from the corresponding quarter of 2004, with the life insurers accounting for majority of the surplus. The minimum required solvency margin of the industry increased also and was largely influenced by general insurers. Combined insurers assets recorded a growth of 6.0 percent to reach $677.6 million. The growth was driven by both the life and general sectors with life insurers accounting for 72.2 percent of the total industry assets.

The industry's overall net premiums rose by 2.1 percent to $39.5 million. After tax profit was $13.0 million for quarter ended March 2005 and was similar to that recorded for the same period in the preceding year. The life insurers accounted for 58.4 percent of the total profit.

A major development for the quarter ended March 2005 was the growth in solvency surplus and that came from the general insurers, where the surplus increased by 45.0 percent. This was due to the larger proportional increase in assets at 6.0 percent compared to liabilities of 0.5 percent. The increase in assets came mainly from the investment category, which increased by 11 percent.

Life Insurers

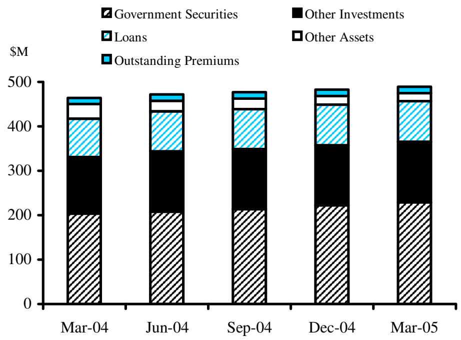
For quarter ended March 2005, the solvency surplus of life insurers recorded an increase of 8 percent to $37.0 million (2004: $34.3 million). The licensed life insurers met the solvency requirement of the Insurance Act.

The total life insurance assets amounted to $489.5 million, an increase of 6 percent over the year (2004: $463.9 million). The asset distribution for life insurers remained unchanged with government securities, property and loans remaining the dominant mode of investment (Graph 45).

The net insurance premiums for life insurance business increased by 7 percent to $16.6 million for the first quarter compared with $15.5 million for the corresponding period in 2004.

Graph 45

Distribution of Assets for Life Insurance Companies

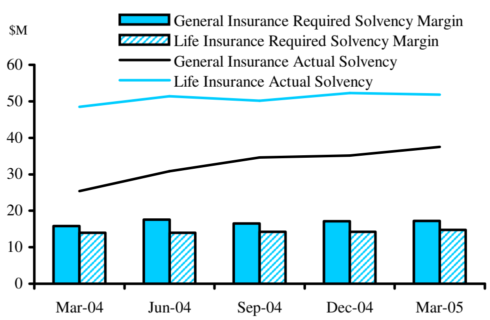


Source: Insurance Companies

Life insurers recorded a decrease in after tax surplus of $7.6 million from $8.7 million in 2004.

Graph 46

Actual Solvency & Required Solvency Margin



Source: Insurance Companies

General Insurers

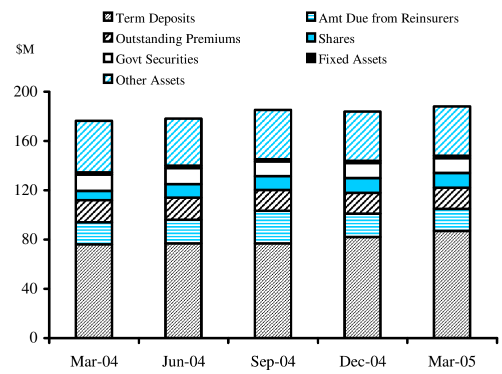
All general insurers met the solvency requirement of the Insurance Act for the quarter ended March 2005 (Graph 46). An increase of 26.0 percent in net admissible assets to $37.5 million (2004: $29.6 million) contributed to the increase in solvency surplus to $20.3 million (2004: $13.9 million).

Total assets for the general industry grew by 6.0 percent to reach $188.1 million. The majority of the assets continued to be tied up in investments, comprising 63.0 percent ($118.4 million). In the investment category, bank deposits accounted for the largest amount at $87.3 million compared to $76.1 million in 2004 (Graph 47).

General insurers posted a good underwriting result for the quarter and recorded an after tax profit of $5.4 million, from $4.4 million in the same period the preceding year. The growth in net earned premium income combined with a decrease in claims and an increase in investment income contributed to the after tax profit for the quarter.

Graph 47

Distribution of Assets for General Insurance Companies



Source: Insurance Companies

Insurance Brokers

For the first quarter of 2005, net profit after tax of insurance brokers recorded a growth of 15.0 percent to $0.7 million compared to $0.6 million in the same period in 2004. The increase in net profit after tax was a result of rising revenue and declining expenses for the quarter. Brokerage earned as commission increased by 12 percent or $0.3 million when compared to March quarter 2004.

The insurance broking account balance stood at $2.9 million for the quarter ended March 2005, compared to $2.7 million in the same period in 2004. Of the broking account balance, 67.4 percent was for amounts due to insurers less then 30 days.

The Reserve Bank continued to process offshore placement applications. For the quarter ended March 2005, a total of 85 applications were approved with premiums amounting to $4.6 million. In 2004, 89 applications were approved to the amount of $4.5 million.

STATISTICAL ANNEX

LIST OF TABLES

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).