MONETARY POLICY IN FIJI
Understanding Liquidity Management

Ariff Ali
Governor, Reserve Bank of Fiji
29 April, 2019
OUTLINE

• What is the role of central banks?
• What is the link between monetary policy and business cycle?
• How has monetary policy evolved in Fiji?
• What factors influence bank liquidity?
• How has liquidity trended in Fiji?
• What is the relationship between liquidity, interest rate and credit?
• Where is monetary policy stance heading?
• Summary
“Central Banking is a high impact organization. Its decisions or indecisions, its actions or inactions will have major and far reaching repercussions and consequences on the economic well being of the public at large and the entire spectrum of businesses. The responsibility and accountability is therefore immense........

Central banking is therefore not for the faint of heart.”

Zeti Akhtar Aziz
Former Governor, Bank Negara Malaysia
We Worry

The job of the Central Bank is to worry.
— Alice Rivlin —

We are accountable for our decisions and/or indecisions

Central banks don't have divine wisdom. They try to do the best analysis they can and must be prepared to stand or fall by the quality of that analysis.
— Mary Kay Ash —

Our mandate is bigger than to be liked

The governorship of the central bank is not meant to win one votes or Facebook “likes”. But I hope to do the right thing, no matter what the criticism.
### CENTRAL BANKS INFLUENCE COST OF FUNDS

*Interest rate or price of money*

<table>
<thead>
<tr>
<th>Loan Amount</th>
<th>$200,000</th>
<th>$200,000</th>
<th>$200,000</th>
<th>$200,000</th>
<th>$200,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Rate</td>
<td>5.00%</td>
<td>7.50%</td>
<td>10.00%</td>
<td>12.50%</td>
<td>15.00%</td>
</tr>
<tr>
<td>Term</td>
<td>25 years</td>
<td>25 years</td>
<td>25 years</td>
<td>25 years</td>
<td>25 years</td>
</tr>
<tr>
<td>Total Repayment</td>
<td>$350,754</td>
<td>$443,394</td>
<td>$545,220</td>
<td>$654,212</td>
<td>$768,498</td>
</tr>
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<td>Interest Repayment</td>
<td>$150,754</td>
<td>$243,394</td>
<td>$345,220</td>
<td>$454,212</td>
<td>$568,498</td>
</tr>
<tr>
<td>Ratio of Interest/Loan</td>
<td>75%</td>
<td>122%</td>
<td>173%</td>
<td>227%</td>
<td>284%</td>
</tr>
</tbody>
</table>

Illustrative example only
CENTRAL BANKS MANAGE THE VALUE OF ITS CURRENCY – Exchange Rate

A ROLL OF TOILET PAPER IS WORTH VEF 2,600,000 BOLÍVARS, OR $0.40 USD.
“Someone's sitting in the shade today because someone planted a tree a long time ago.”
— Warren Buffett
WHAT IS MONETARY POLICY?

Decisions on monetary policy are similar to decisions one makes in a chess game. **It is the process of selecting the best mix of policies for the future NOW.**

In a chess game, you make your current moves based on how you think your opponent will react. Good chess players plan a sequence of moves ahead. So it is with monetary policy. Central banks need to plan based on likely responses of financial markets and agents. Just like chess, these plans are under a cloud of uncertainty. If the response turn out as expected, you continue with the plan.

> Monetary policy is often likened to driving a car with a blacked-out windscreen, a wonky speedometer and a cracked rear-view mirror”

If, however, the response is a surprise then a new plan is required.”
Monetary Policy is forward-looking – operates with a lag.

Central banks are the first line of defence against economic instability.

Role is to try and manage/smoothen the major driving force of the economy - business cycle through credit.

During recession – central banks adopt an expansionary monetary policy whereby it lowers interest rates and increases liquidity.

When the economy performs above trend (overheats), the central banks adopt tight monetary policy to bring the economy back to trend growth rate by increasing interest rates and/or mopping-up liquidity.

CENTRAL BANK POLICY RATE
Fine tuning of policy rate in line with business cycle

Source: Bloomberg L.P.
**MONETARY POLICY IN FIJI**

*How have we evolved?*

<table>
<thead>
<tr>
<th>STAGE 1</th>
<th>STAGE 2</th>
<th>STAGE 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>RBF influenced economic activity through:</td>
<td>RBF influenced economic activity by targeting the short-term interest rate. Initially it was the 91-day RBF Notes rate and this was changed to the Overnight Policy Rate.</td>
<td></td>
</tr>
<tr>
<td>(i) Setting commercial bank interest rates</td>
<td>That is, influencing the <strong>PRICE</strong> of loanable funds available</td>
<td></td>
</tr>
<tr>
<td>(ii) Changes in SRD</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) Directed lending to certain economic/priority sectors</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iv) Interest rate on borrowing from RBF</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**STAGE 1**

- RBF influenced economic activity through:
  - (i) Setting commercial bank interest rates
  - (ii) Changes in SRD
  - (iii) Directed lending to certain economic/priority sectors
  - (iv) Interest rate on borrowing from RBF

**STAGE 2**

- RBF influenced economic activity by targeting the short-term interest rate.
- Initially it was the 91-day RBF Notes rate and this was changed to the Overnight Policy Rate.
- That is, influencing the **PRICE** of loanable funds available

**STAGE 3**

- RBF influenced economic activity by targeting the short-term interest rate.
- Initially it was the 91-day RBF Notes rate and this was changed to the Overnight Policy Rate.
- That is, influencing the **PRICE** of loanable funds available

Source: RBF
Credit ceiling was also used as an instrument.
LENDING RATES ARE AT HISTORICAL LOWS
Despite almost a decade of economic growth

Source: RBF
COST OF FUNDS HAS BEEN RISING
Not translated in increase in lending rate

Source: RBF
REAL ECONOMIC GROWTH

We are growing above trend, monetary policy needs adjusting.

5 year average

Historical average

<table>
<thead>
<tr>
<th>Year</th>
<th>Growth Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>-1.7</td>
</tr>
<tr>
<td>2001</td>
<td>1.9</td>
</tr>
<tr>
<td>2002</td>
<td>3.2</td>
</tr>
<tr>
<td>2003</td>
<td>0.8</td>
</tr>
<tr>
<td>2004</td>
<td>5.4</td>
</tr>
<tr>
<td>2005</td>
<td>-1.3</td>
</tr>
<tr>
<td>2006</td>
<td>1.9</td>
</tr>
<tr>
<td>2007</td>
<td>-0.9</td>
</tr>
<tr>
<td>2008</td>
<td>1.0</td>
</tr>
<tr>
<td>2009</td>
<td>-1.4</td>
</tr>
<tr>
<td>2010</td>
<td>3.0</td>
</tr>
<tr>
<td>2011</td>
<td>2.7</td>
</tr>
<tr>
<td>2012</td>
<td>1.4</td>
</tr>
<tr>
<td>2013</td>
<td>4.7</td>
</tr>
<tr>
<td>2014</td>
<td>5.6</td>
</tr>
<tr>
<td>2015</td>
<td>4.7</td>
</tr>
<tr>
<td>2016</td>
<td>2.6</td>
</tr>
<tr>
<td>2017</td>
<td>5.2</td>
</tr>
<tr>
<td>2018</td>
<td>3.2</td>
</tr>
</tbody>
</table>
WHAT IS BANK LIQUIDITY?
Difference between required and excess

Generally...
“the ease with which a person or organisation can convert its assets to cash to meet their immediate and short-term financial obligations”

From the Central Bank’s perspective...
“a measure to ensure that commercial banks have enough funds available to meet demand for loans and other financial commitments”

“Banking System Liquidity”
- Exchange Settlement Account (ESA), Bank Demand Deposit (BDD), Excess Reserves or simply Liquidity

“Prudential Liquidity”
- the level of liquid assets that are held by commercial banks which is considered satisfactory by the RBF.
  - Liquid assets to deposits
  - Liquid assets to total assets
  - Loans to deposit
WHAT FACTORS INFLUENCE LIQUIDITY?

Does the RBF have control over these factors?

Factors that influence Liquidity

\[ f(-CIC, -SRD, -\text{Govt. Central Acc.}, +FR, +\text{EFF Adv.}, +\text{Govt. Ways and Means Acc.}) \]

How can the RBF influence the level of Liquidity?

- Foreign Reserves
- Statutory Reserve Deposit (SRD) requirements
- Currency in Circulation
- Government’s Central Account
- RBF Investments in the Domestic Markets
- Statutory Reserve Deposits (SRD) requirements
- Open Market Operations (OMO)
- Lender of Last Resort
- Venting of Foreign Reserves/EC Policies
- Various Concessionary Funding Facilities
TREND IN EXCESS BANK LIQUIDITY

Current liquidity levels are well above historical lows

Source: RBF
BANK LIQUIDITY
Current & potential liquidity

$M

1800
1500
1200
900
600
300
0

Current

Plus SRD

$1,145

Plus SRD & Advances

$1,695

$363
IS THE CURRENT LEVEL OF LIQUIDITY ADEQUATE?

Liquidity ($m)

Private Sector Credit Growth (RHS)

High credit growth against relatively low liquidity

High liquidity but sluggish credit growth

High liquidity and strong credit growth

Source: RBF
TREND IN POLICY RATE
Tightening is associated with crisis
PUBLIC OPINION ALWAYS WANTS EASY MONEY
*That is, low interest rates*

What goes up must come down
Isaac Newton

Like a gardener I believe what goes down must come up
Lynwood Giacomini

Source: RBF
FOREIGN RESERVES
Sufficient buffer

Source: RBF
Central banks are the first line of defence against economic instability.

Role is to try and manage the major driving force of the economy, business confidence, or its close analogue - credit.

Monetary policy is forward looking – operates with a lag.

Interest rates are at historical low despite rising cost of funds.

There is no liquidity crisis – the level is consistent with where we want it to be. It is more than adequate to support economic activity.

The RBF can inject in excess of $1 billion in liquidity if the situation warranted.

The upward pressure on interest rates is because of robust growth in the economy and not a sign of crisis.
We Worry

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THANK YOU