

RESERVE BANK OF FIJI

QUARTERLY REVIEW

June 2004

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OVERVIEW

International economic and financial conditions improved further into the June quarter, driven largely by favourable prospects for the United States (US) and Japanese economies. This has been complemented by strong performances by Asian economies, particularly China. For the world economy as a whole, GDP growth is forecast at a relatively robust 4.6 percent in 2004.

However, this year's world growth outlook is vulnerable to two factors. They include high crude oil prices - propelled by concerns of terrorism - and the continuing geopolitical conflict in the Middle East and Iraq.

The economic outlook for our trading partner economies remains positive for this year. Remarkably, the New Zealand economy continues to show persistence despite recent monetary tightening by the central bank. The Australian economy is expected to remain on its strong growth path of recent years.

The US and Japanese economies are expected to improve significantly on last year's growth results. A rebound in domestic demand, new capital expenditure and hiring of workers are some of the key factors contributing to the broad based expansion of the US economy in 2004. Japan's GDP growth continues to be supported by private consumption. The Euro-zone, through higher exports, is also envisaged to grow strongly in the second half of this year.

During the quarter, the performance of global financial markets remained generally

mixed. In the foreign exchange market, the US dollar largely rose against all our major trading partner currencies. Equity markets rallied while bond prices fell.

The domestic economy is estimated to have grown by around 5 percent last year. This year, the economy is expected to expand by around 4.7 percent led by favorable performances in the building & construction; wholesale & retail trade and restaurants & hotels sectors. Strong contribution from the manufacturing; and community, social & personal service sectors is also envisaged in 2004. However, contraction in the non-cane agricultural output is expected following the flash floods in April.

Inflation rose to 2.7 percent, in the year to June, from 2.2 percent in March. The trimmed mean, which measures underlying inflation, was 1.1 percent. Inflation is anticipated to remain at current levels in the coming months. However, the global economic recovery could place some upward pressure on future inflation. For now, the 2004 year-end inflation forecast remains at 3 percent.

Labour market conditions improved during the June quarter as evident from partial indicators for employment and survey data. Newly registered taxpayers recorded an increase of around 6 percent over the corresponding period in 2003. According to survey results, overall employment, both in the temporary and permanent categories, is expected to increase over the next half of the year. However, wage growth is expected to remain moderate.

Following the buoyant activity in the building and construction sector, Fiji's investment levels are holding up well. Lending to private individuals for housing purposes and to the construction sector was higher on an annual basis during the review period.

Provisional figures cumulative to April revealed that Government recorded a budget surplus of \$9.6 million, equivalent to 0.6 percent of GDP. This was underpinned by a decline in net expenditure (excluding loan repayments) coupled with a 0.3 percent increase in revenue.

On the external front, latest trade data showed that cumulative to May, merchandise exports and imports fell

respectively by around 5 percent and 12 percent, when compared with the same period last year.

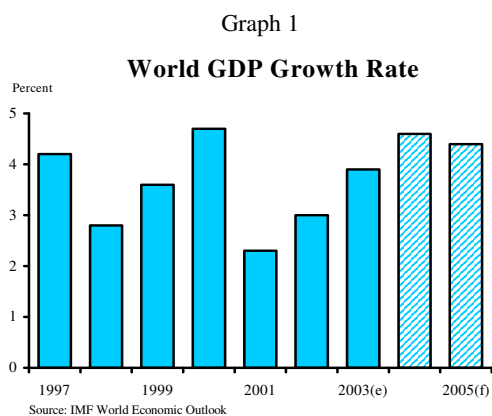
Foreign reserves at the end of June were around \$731 million, sufficient to cover 3.2 months of import payments of goods and non-factor services or 4.8 months of imports of goods only.

At the end of May, to curb the buoyant credit growth, the Reserve Bank tightened its monetary policy by raising the policy indicator rate by 50 basis points from 1.25 percent to 1.75 percent. A full discussion on the interest rate hike is in the monetary policy statement, which is under "For the Record" section of this Quarterly.

THE INTERNATIONAL ECONOMY

International Economic Conditions

International economic and financial conditions improved further in the June quarter. The better global economic outlook was largely driven by favourable prospects for the US and Japanese economies. This was also complemented by strong performances by Asian economies, particularly China. Although the Euro-zone grew marginally in the first quarter of this year, it is expected to rebound strongly in the second half of this year. For the world economy as a whole, GDP growth is forecast at a relatively robust 4.6 percent in 2004 (Graph 1).



While global economic prospects have improved, a few risks can undermine this year's growth outlook. First, China's deliberate efforts to soften its economy may negatively impact US and Japanese exports and thus their economic recovery. Second, high crude oil prices, driven by concerns of terrorism and increasing global oil demand, could disrupt the growth momentum. Finally, geo-political risks, such as the escalating Israeli-Palestine conflict and

insurgence against the US-led coalition in Iraq could also adversely affect the world economic recovery.

In response to the upswing in growth across countries, central banks in the US, England and New Zealand raised their official interest rates during the quarter. The tightening of monetary policy was aimed at containing potential inflationary pressures that are typically associated with a strengthening economy.

Over the June quarter, the performance of financial markets remained mixed. In the foreign exchange market, the US dollar generally rose against all our major trading partner currencies. However, bond prices fell as equities recorded a strong performance during the quarter.

Growth prospects for our major trading partners remains positive for this year (Graph 2). The outlook for Australia and New Zealand is also promising. The New Zealand economy, especially, continues to show persistence. Recent monetary tightening by the central bank has only resulted in modest slowdown in economic activity.

The US and Japanese economies, on the back of a rebound in domestic demand, are expected to improve significantly on last year's growth results. Moreover, the Euro-zone - through greater exports - is anticipated to expand strongly later in the year.

Graph 2



The **Australian** economy grew by a less-than-expected 0.2 percent in the March quarter, underpinned by the slowdown in the housing boom. However, consumption remained strong in the first quarter.

Recent data showed that the domestic economy is slowing down. In June, consumer confidence declined, on the back of lower-than-expected growth in the first quarter. Higher gasoline prices also contributed to the fall in consumer confidence. Moreover, business confidence fell to a 3-year low and manufacturing fell to a 16-month low in May. On the external front, the March quarter trade deficit widened, as imports of consumer goods increased and prices of rural exports fell.

Nevertheless, service activities rose in May, driven by higher demand for communications, property and business service companies. Furthermore, the index of leading economic indicators, a gauge of growth for the next 6 months, rose for the second consecutive month in April.

As inflationary pressures remained subdued, the Reserve Bank of Australia (RBA) left its key interest rate unchanged at 5.25 percent for the sixth consecutive month in June.

For this year, the Australian economy is

anticipated to grow by 3.5 percent, a relatively stronger growth than the 3.0 percent last year. Consumer prices are expected to be around 2.4 percent this year, within the RBA's target range of 2-3 percent.

New Zealand's economy expanded by 2.3 percent in the first quarter, the fastest per-quarter-rate in 4-years. The economic strength was derived from the housing boom and buoyant consumer spending.

However, in the June quarter, economic indicators were generally weak. In April, manufacturing expanded at a slower rate, while the trade deficit widened, as exports grew at a lower-than-expected pace.

On a positive note, business confidence rose for the second consecutive month in May. This was after the Kiwi dollar extended its slide against the US dollar from a 7-year high.

In line with expectations, the Reserve Bank of New Zealand (RBNZ) increased its key interest rate twice during the June quarter, by 25 basis points each in April and June, to 5.75 percent. These moves were prompted by inflationary pressures, associated with the risk of imported inflation, falling Kiwi dollar and the housing boom.

The economy is forecast to expand by a slower rate of 3.3 percent this year, compared to 3.5 percent in 2003. Consumer prices are expected to be around 2.2 percent this year i.e. within the RBNZ's target of 1-3 percent.

The **US economy** grew by 3.9 percent in the March quarter, led by increased business investment, higher government expenditure and the accelerated pace of home construction.

Other recent indicators were also positive. Consumer confidence rebounded in June, amid increased hiring. May data for employment showed the ninth consecutive month of job creation. Moreover, in May, manufacturing was close to a 2-decade high and retail sales increased for the seventh time in the last eight months. The federal budget deficit also narrowed in May, as the strengthening economy boosted tax revenue.

Furthermore, the index of leading economic indicators, a gauge of economic performance in the next 3 to 6 months, rose for the second consecutive month in April.

However, the trade deficit unexpectedly widened to an all-time high in April as imports of cars and consumer goods rose to a record high. In addition, consumer prices rose to 3.1 percent in May, due to a surge in crude oil prices.

Consequently, to ward off inflationary pressures induced by the strong recovery, the Federal Reserve increased its key interest rate by 25 basis points to 1.25 percent in June.

In 2004, the US economy is expected to grow by 4.7 percent compared to 3.1 percent last year. Inflation is expected to remain moderate, at 2.4 percent this year.

The **Euro-zone** economy grew by 0.6 percent in the first quarter, mainly attributed to stronger private consumption and buoyant exports.

Economic activity for the June quarter was generally positive. In May, Euro-zone manufacturing expanded for the ninth consecutive month, led by a surge in demand from the US and China.

Moreover, prospects for Germany, France and Italy, which account for half of the Euro-zone economy, improved in the June quarter. In June, German investor confidence rose for the first time in 6-months, while French consumer spending rose in May, the fastest pace in 4-years. In addition, Italian consumer confidence rose in June, the first time in 3-months.

However, Euro-zone consumer prices rose to 2.5 percent in May, above the European Central Bank's (ECB) target of 2 percent. Nevertheless, the ECB left its benchmark interest rate unchanged at 2 percent in the June quarter as the outlook for consumer prices in the medium term remained favourable.

This year, the Euro-zone economy is expected to expand at a faster pace of 1.7 percent, compared with 0.5 percent in 2003. Year-end inflation is forecast at 2.0 percent, based on a moderate outlook for domestic and import prices.

The **Japanese** economy grew by 1.5 percent in the first quarter, led by higher domestic demand and rising exports.

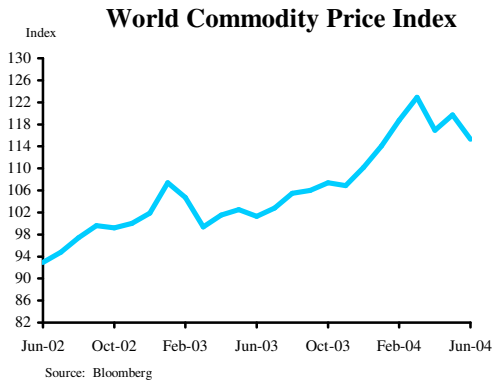
Economic activity remains buoyant in Japan. Consumer confidence rose in the first quarter, the highest since December 2000 and the jobless rate fell to a 3-year low in March. In May, the trade surplus reached a 4-year high, while corporate bankruptcies fell. All of these factors point to a strong recovery of the Japanese economy.

Furthermore, service activities expanded in May, led by the wholesale, retail, telecommunications and financial sectors. However, despite higher gasoline prices, core consumer prices declined by 0.3 percent in May.

In line with the strengthening economic fundamentals, the Japanese economy is expected to grow by 4.1 percent this year, compared to 2.5 percent last year. Inflation is forecast at -0.1 percent this year, higher than -0.3 percent recorded last year.

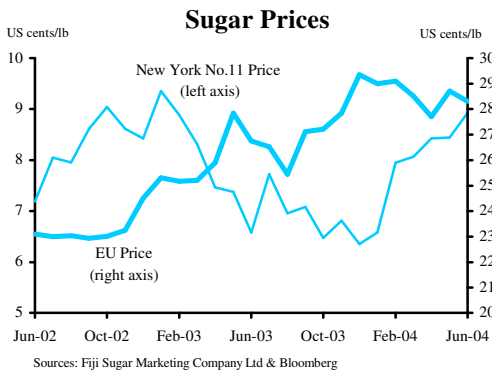
World commodity prices fell by around 6 percent during the June quarter, largely underpinned by lower gold prices (Graph 3).

Graph 3



World market sugar prices rose by around 11 percent over the June quarter (Graph 4), on speculation that China will increase sugar imports, following a shortage in the domestic market.

Graph 4



However, in the months ahead, sugar prices

are anticipated to decline, as higher supplies from Brazil, Thailand and Australia are expected to more than offset the increased demand expected from China.

At the end of June, the European Union (EU) sugar price was around US28 cents per pound. Over the quarter, the EU sugar price fell by around 1 percent, largely due to a weaker Euro against the US dollar.

Gold prices fell by around 7 percent over the June quarter (Graph 5). In April, gold prices fell, as a stronger US dollar lowered demand for the US dollar-indexed metal from non-US buyers. However, prices rose slightly in the last two months of the quarter on increased concerns of terrorism in the Middle East. Thus, raising the demand for the metal as a safe haven investment.

Graph 5



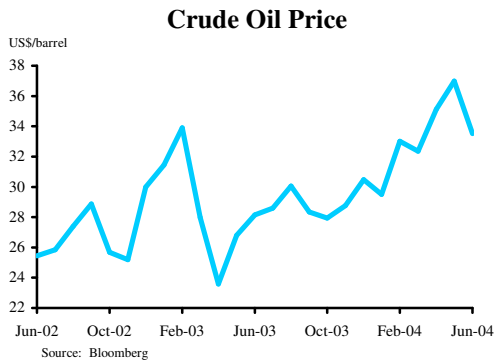
In the approaching months, amid terrorism concerns, gold prices are expected to remain high at around US\$400 per fine ounce.

At the end of June, the **Brent crude oil price** was around US\$34 per barrel, 4 percent higher than at the end of March (Graph 6).

In the first two months of 2004, crude oil

prices rose, reaching a 14-year high in May. This was largely due to concerns of supply disruptions - following terrorist attacks in Saudi Arabia - and low US crude oil supplies. However, prices fell in June, after the Organisation of Petroleum Exporting Countries (OPEC) decided to increase crude oil production (by 2 million barrels per day) in an effort to prevent high oil prices from curbing global economic growth.

Graph 6

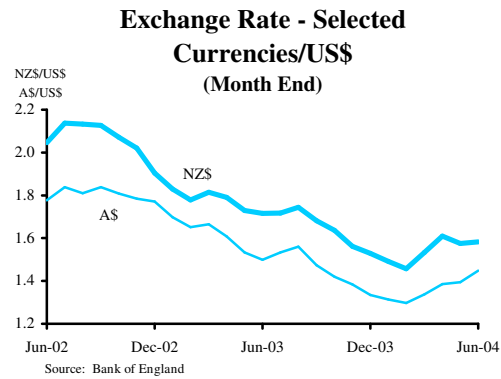


In the coming months, crude oil prices are expected to remain above OPEC's US\$22-\$28 target band on concerns of terrorism, particularly in Saudi Arabia. Increased global oil demand, fuelled by the strengthening global economic recovery, is also expected to keep crude oil prices above OPEC's target band.

International Financial Markets

Over the June quarter, the US dollar generally strengthened against all of Fiji's other major trading partner currencies (Graph 7).

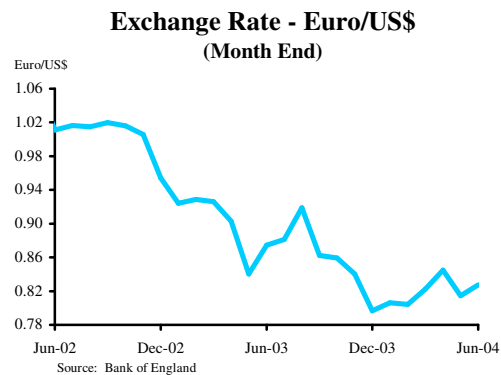
Graph 7



During the quarter, the Australian and New Zealand dollars weakened against the US dollar, after speculation of an interest rate hike in the US attracted investors into US dollar-denominated assets.

The Euro generally weakened during the quarter (Graph 8). In April, the Euro weakened against the Greenback, on speculation of an interest rate rise by the Federal Reserve in the next quarter, after US consumer prices rose in March.

Graph 8



However, in May, the Euro strengthened, after terrorism concerns against the US,¹

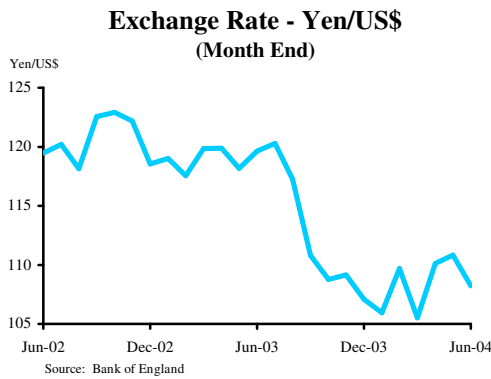
¹ The US dollar weakened after the assassination of the head of Iraqi's interim governing council

prompted investors to switch to Euro-denominated assets. Nevertheless, in June, the Euro depreciated, after an improved labour market outlook in the US, added to signs of a strengthening economy, boosting demand for US dollar-denominated assets and thus the currency.

During the quarter, the Yen generally depreciated against the US dollar (Graph 9). The Yen weakened in the first two months of the quarter, as prospects of a US interest rate hike prompted investors to move into US dollar-denominated assets.

However, the Yen strengthened in June, on optimism that economic growth in Japan will lure investors to the nations assets thus increasing demand for the yen.

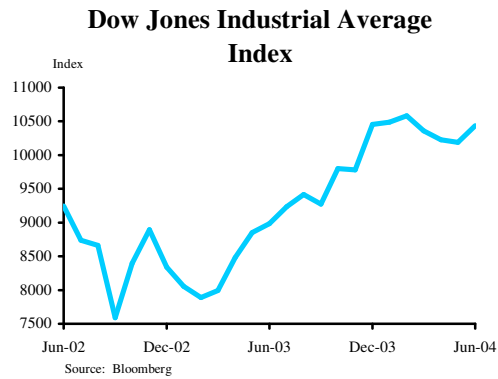
Graph 9



Equity prices generally rose during the three months to June.

Over the June quarter, the Dow Jones Industrial Average Index rose by around 1 percent (Graph 10).

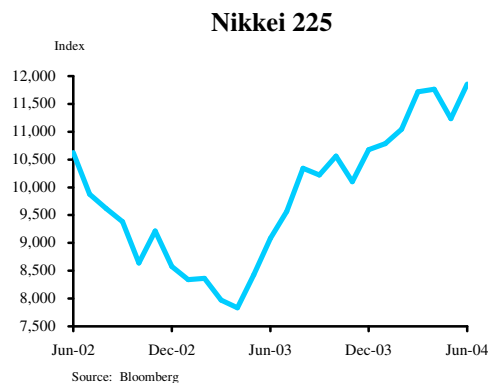
Graph 10



The Dow fell in the first two months, after higher crude oil prices and speculations of a US interest rate hike increased concerns about the outlook for corporate profit growth. However, in June, crude oil prices fell and the Dow rallied.

Over the three months to June, the Nikkei 225 Stock Average Index rose by around 1 percent (Graph 11).

Graph 11

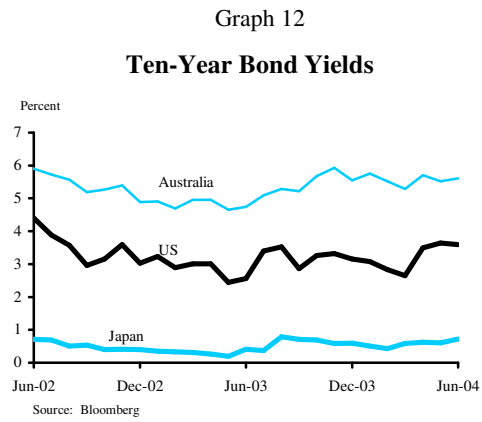


The Nikkei rose in April, after first quarter sales of technology-related companies, surpassed initial estimates. However, the Nikkei index fell in May, on concerns of corporate profit outlook for Japanese exporters, prompted by expectations of

Izzedine Salim, who was killed in a bomb attack in Baghdad.

interest rate hikes in the US and China, two of Japan's largest export markets. Nevertheless, the Nikkei rallied in June, after Japan's services industry expanded, fuelling optimism about a positive outlook for the economy.

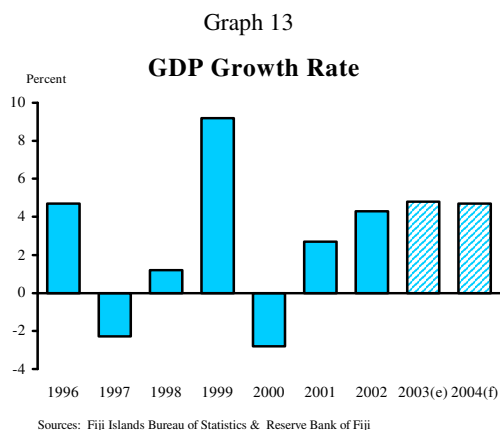
During the June quarter, 10-year bond yields for the US, Japan and Australia generally rose, as their strengthening economies encouraged investors to demand stocks rather than bonds (Graph 12).



THE DOMESTIC ECONOMY

Domestic Economic Conditions

Fiji's economy is estimated to have grown by around 5 percent last year (Graph 13). This year, the economy is on track to expand by around 4.7 percent, led by favourable performances in the building & construction; and the wholesale & retail trade and restaurants & hotels sectors. Strong contributions are also anticipated from the manufacturing; and community, social and personal services sectors.



Consumer Spending

In the second quarter, **consumer spending** remained buoyant. Cumulative to April, Value Added Tax (VAT) collections from other domestic categories - a partial indicator of consumer spending - rose by around 11.0 percent on an annual basis. Moreover, currency in circulation rose strongly in April when compared with the previous year, while lending to households for consumption purposes was also higher in the same period. The good growth in consumption continues to be

supported by improving labour market conditions.

Production

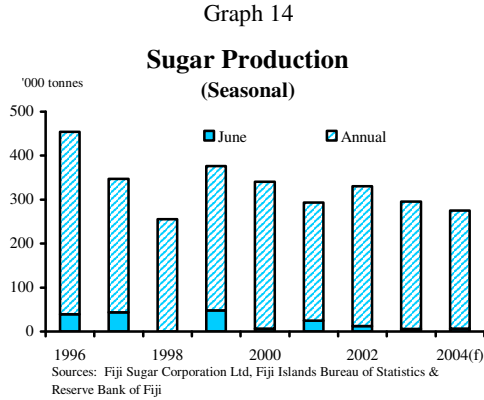
On a sectoral basis, economic performance during the quarter was mixed. A strong and steady growth in visitor arrivals suggests that the tourism industry is on track for a new record performance in 2004. In addition, the construction industry continues to perform robustly, thus supporting the gradual pickup in investment activity.

However, the April flash floods experienced in the Rakiraki, Tailevu and Navua areas caused significant damage to agricultural produce in the area. This is expected to cause a slowdown in the growth of non-cane agricultural output this year. Gold production was also lower during the review period, due mainly to the low quality ore extracted at the mine.

The output in the **cane** and **sugar** industries are likely to contract slightly in the 2004 season, when compared with production in the previous period (Graph 14).

This year's crushing season started on 16 June, with operations commencing at the Rarawai mill. The Lautoka and Labasa mills commenced crushing on 22 June, while Penang mill started crushing on 6 July. According to Fiji Sugar Corporation, total cane crushed in June 2004 amounted to 90,000 tonnes, a

marginal improvement over the levels attained in June last year. In line with the higher cane output, sugar production amounted to 6,400 tonnes, an increase of 14 percent over the comparable period last year.

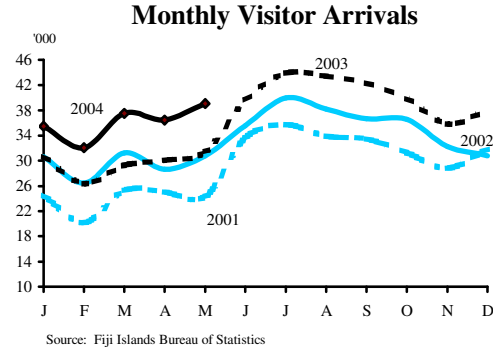


Although production was slightly higher in June, the sugar mills continued to face setbacks in the form of mill breakdowns.

The **clothing and footwear** industry's performance also declined marginally in the first five months of this year. Cumulative to May, garment export receipts totalled \$110.3 million, representing a marginal decline (0.1 percent) over the comparable period in 2003. However, industry liaison suggests that overall production in the industry for this year is expected to be stronger than the 2003 levels.

The **tourism** industry has been performing exceptionally well since the start of this year (Graph 15). Latest visitor arrivals data from the Fiji Islands Bureau of Statistics indicate that visitor arrivals cumulative to May amounted to 181,000. This represents a significant increase of around 22 percent over the comparable period last year.

Graph 15



With the exception of Continental Europe, visitor arrivals from all our other major markets rose during the review period. The largest increase in arrivals was recorded from New Zealand (48 percent) followed by Australia (32 percent), Canada (32 percent), US (21 percent), Japan (14 percent), Others¹ (12 percent) and the United Kingdom (3 percent).

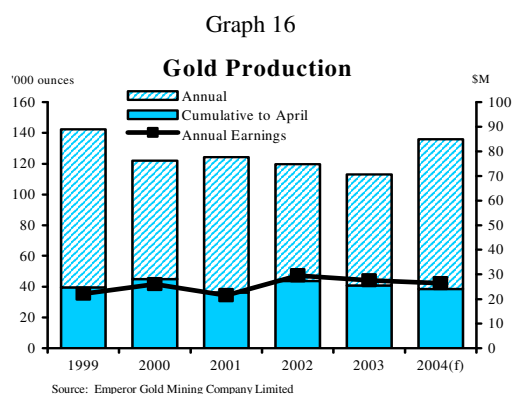
Looking ahead, visitor arrivals are expected to pick up further as the customary peak season for the industry commenced in May. In order to meet this seasonal pick-up in tourism activity, Air Pacific Limited introduced seven additional weekly flights on its international routes. In particular, weekly flights have been introduced on the Canberra/Nadi routes, while services from Christchurch have also resumed.

Visitor arrivals from Australia is expected to be boosted further by the commencement of flights by Virgin Blue. Virgin Blue, through its subsidiary, Pacific Blues Airlines Limited was granted approval for an operating licence (in June 2004) to initially operate three

¹ 'Others' includes Pacific Islands, South Korea, Malaysia, Taiwan, rest of Asia and other remaining countries.

services a week from Melbourne and Brisbane. This follows Freedom Air making its inaugural once-a-week flight from Hamilton, New Zealand to Nadi in late April.

The **mining and quarrying** sector, as yet, has not performed according to expectations. Cumulative to April, total gold production amounted to just over 38,000 ounces (Graph 16), around 6 percent lower than output in the comparable period last year. According to Emperor Gold Mining Company Limited (EGM), the decline is largely due to the recovery of lower quality ore at the mine.



Consistent with lower gold production, gold earnings in the review period totalled \$26.4 million, a decline of around 4 percent. However, industry liaison suggests that performance will improve in the second half the year.

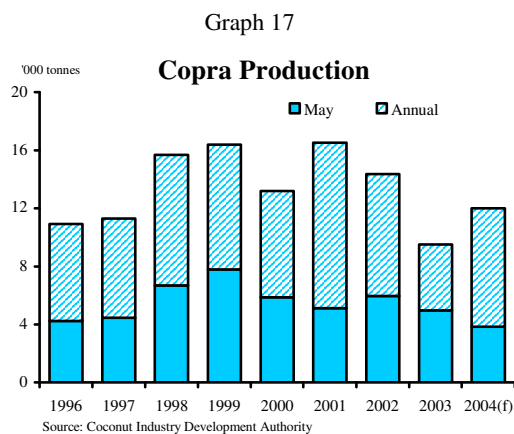
In addition, Durban Roodepoort Deep (DRD), a South-African based mining company, has recently revised its bid for a takeover of EGM shares. Following rejection of the earlier bid by the independent directors of EGM, which was placed at one DRD share for every five Emperor shares, DRD has now offered a

more attractive 1:4.4 bid.

Production of **other crops** (according to revised date) grew slightly in 2003. The marginal growth was led by higher output of peanuts, maize, vegetables, rice and immature ginger. Although a very strong growth was initially forecast for the sector for this year, the flash floods in April have somewhat ruined expectations. This is particularly so as the floods affected the largely agrarian areas of Rakiraki, Tailevu and Navua.

On other developments in the industry, representatives of the Fiji and the Chinese Governments have in June signed an agreement on plant quarantine. The agreement aims to enhance co-operation between the two countries in areas of pest prevention, protection of agricultural produce and exchange of scientific technology.

The performance of the **copra** industry was weak in the first five months of this year. Cumulative to May, copra output totalled around 4,000 tonnes (Graph 17), a significant decline of approximately 23 percent over the comparable period in 2003.



The minimum mill gate price for copra in May was around \$520, slightly higher than the price in the previous months.

The fish and timber sectors reveal mixed results. In the first five months of the year, the **fisheries** sector's performance remained subdued. Fish export receipts amounted to around \$28.7 million, a decline of around 15 percent in comparison to last year.

Cumulative to May, receipts from **timber** exports amounted to around \$16 million, an increase of 16 percent over the previous year.

Electricity production this year has fared consistently with the rise in economic activity. Cumulative to May, total **electricity** production increased by 3 percent over the corresponding period of 2003.

In order to cater for the medium term increase in demand for electricity, the Fiji Electricity Authority (FEA) has several investment projects lined up. Construction works on the \$10 million Wainikasau hydro dam is expected to be completed by the end of July this year. Other major projects anticipated to come online between 2005 and 2008 include the construction of the \$8 million Vaturu hydro dam, \$100 million Sigatoka/Ba hydro dam and the \$29 million Butoni wind farm. The Authority also has long-term plans for solar and geothermal projects.

The **building & construction** sector showed signs of further improvement this year. Latest statistics from the Fiji Islands Bureau of Statistics revealed that the value of work put-in-place in the March 2004 quarter totalled \$33.7 million, an

increase of around 14 percent over the comparable quarter last year. Importantly, the value of work put-in-place by the private sector rose significantly by around 64 percent on an annual basis, while on the contrary, a 33 percent decline was recorded for the public sector.

Notable projects that were completed during the quarter include the Fiji Government Pharmaceutical Warehouse in Vatuwaqa, Suva and the Ambassador Apartments in Nailuva, Suva. As for other capital projects, work on the Rewa Bridge, Suva Central project, Colonial Centre and the Fiji Public Servants Association Shopping complex continued smoothly into the second quarter.

In line with the buoyant activity in the building and construction sector, Fiji's **investment** levels are holding up well. This is also evident by higher lending (on an annual basis) to private individuals for housing purposes and to the construction sector over the June quarter.

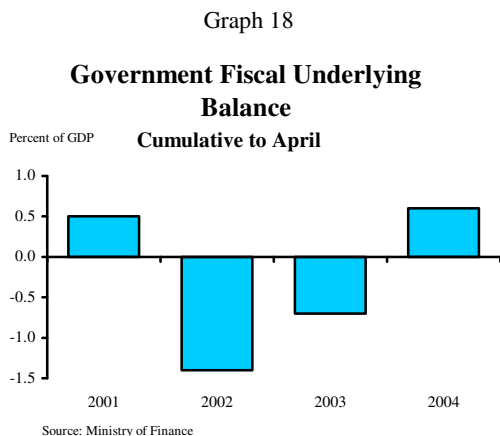
Public Finance

On the fiscal front, provisional figures from the Ministry of Finance² indicate that, cumulative to April, Government recorded a budget surplus of \$9.6 million, equivalent to 0.6 percent of GDP (Graph 18). Underpinning the surplus was a 5.2 percent decline in net expenditure (excluding loan repayments) coupled with a 0.3 percent increase in revenue.³ Compared with forecasts, total expenditure was lower by 22.1 percent while net revenue collections surpassed

² Sourced from the State of Government Finances.

³ There were no asset sales recorded in the review period.

projections by 6.2 percent.



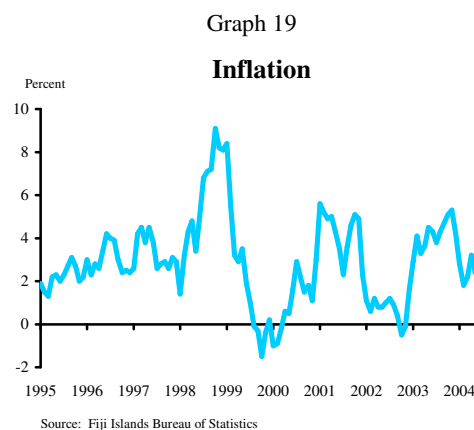
On the expenditure side, the fall in Government spending was underpinned by a 43.5 percent year on year decline in capital spending. It is envisaged that capital expenditure will increase in the approaching months as Government progresses on its capital works for the year.

On the other hand, direct taxes increased by 15.0 percent, while indirect tax revenue collections recorded a 2.4 percent annual growth. The growth in indirect tax collections was led by increases in excise duty (25.2 percent) and fiscal duty (17.2 percent) collections. Notably, both direct and indirect tax collections surpassed targets by 18.9 percent and 4.7 percent, respectively.

In the first five months of 2004, net domestic borrowing by Government was only \$10 million, against \$64.7 million in the comparable period last year. As at the end of May 2004, total outstanding domestic debt was \$1,974 million, 11.9 percent more than that recorded a year ago. This represents 42.2 percent of GDP.

Inflation

In the year to June, inflation stood at 2.7 percent, compared with 2.2 percent recorded in March (Graph 19). Over the quarter, consumer prices rose by around 1.5 percent. The prices of food, housing, heating & lighting, alcoholic drinks & tobacco, transport and miscellaneous items rose. This was partly offset by a fall in the prices of services. The prices of durable household goods remained unchanged over the quarter.



The underlying measure of inflation, the trimmed mean, was 1.1 percent in June, up from 0.9 percent in the previous quarter.

In the coming months, inflation is anticipated to remain around current levels. However, in the third quarter some adverse base-related effects could briefly push inflation higher. On the whole, domestic price pressures seem to have dissipated given the faster-than-expected recovery in the supply of market items, following the floods in early April. On the external front, the global economy is expected to gain further momentum. This

could place some upward pressure on future inflation. For now, the 2004 year-end inflation forecast remains at around 3 percent.

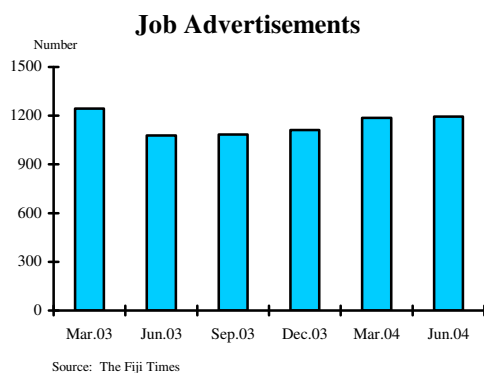
Labour Market

Conditions in the labour market improved during the June quarter, as indicated by partial indicators of employment as well as survey data.

Newly registered taxpayers, a partial indicator for employment, continued to improve over the first half of the year. Cumulative to June, around 7,700 new taxpayers were registered with the Fiji Islands Revenue and Customs Authority (FIRCA). This is an increase of around 6 percent over the corresponding period in 2003. The community, social and personal services sector recorded the most number of new taxpayers, followed by the wholesale & retail trade, restaurants & hotels; finance, insurance, real estate & business services; and others sector.

Moreover, the Reserve Bank's June Survey of Job Advertisements reported a rise in firms' recruitment intentions (Graph 20).

Graph 20



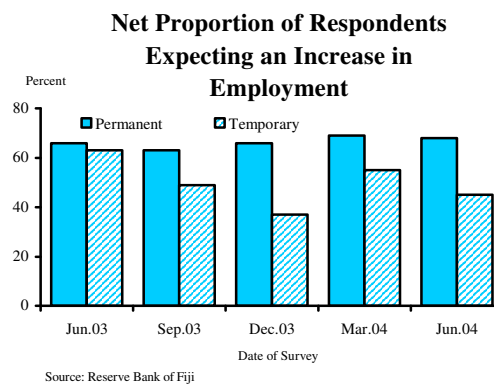
Over the year, the number of advertised

positions rose by around 11 percent. Demand for workers were high in the finance related fields and businesses operating in the services industry.

Looking ahead, the results of the Reserve Bank's Fiji Employers Federation (FEF) Expectations Survey, conducted in June, revealed a general optimism for employment over the next twelve months.

According to the survey results, overall employment is expected to increase over the next half of the year. A net of around 68 percent of respondents expect permanent employment to increase, while a net of around 45 percent of respondents expect a rise in temporary employment (Graph 21).

Graph 21

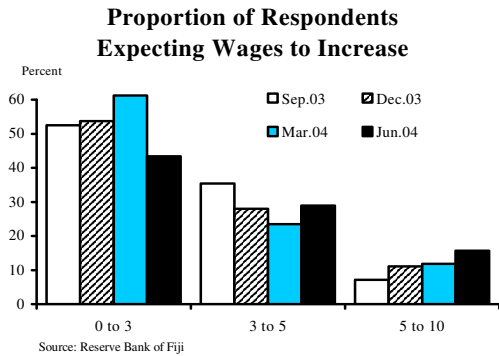


Wage growth has been modest over the quarter. A few private sector companies have paid out 4-5 percent wage increments, while there were no movements in wage levels for the public sector.

Expectations for wage growth in the medium term are also modest (Graph 22). The FEF Expectations Survey revealed that around 43 percent of the respondents expect wage increases in the 0 to 3

percent range, while around 29 percent expect increases of between 3 to 5 percent range.

Graph 22



Emigration over the year fell slightly. Cumulative to May, around 2,400 people emigrated, representing a decline of 9 percent.

During the review period, fewer workers under the professional & technical and clerical, sales & services categories migrated relative to last year. However, this was partially offset by an increase in the number of agriculture & production and administrative workers leaving Fiji.

The External Sector

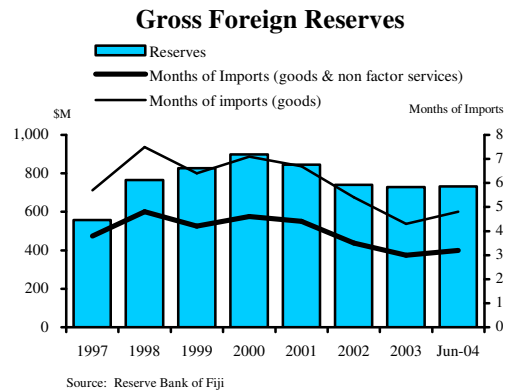
On the external front, recent trade data showed that cumulative to May, merchandise exports fell by around 5 percent. This compares with an 8 percent growth in the corresponding period last year. The decline in exports is largely attributed to negative contributions from re-exports, sugar, fish, mineral water and garments, which more than offset the positive contributions from other exports and timber.

Cumulative to May, merchandise imports fell by around 12 percent, when compared

with the corresponding period last year. The decline was largely underpinned by lower import payments for intermediate and investment goods, which more than offset higher payments for consumption goods. The decline in intermediate goods was led by lower payments for mineral fuels and oils & fats, while the decline in investment goods was led by machinery & transport equipment and chemicals. The positive contribution from manufactured goods, miscellaneous manufactured goods and beverages & tobacco, largely contributed to the increase in payments for consumption goods.

Foreign reserves at the end of June were around \$731 million, sufficient to cover 3.2 months of import payments of goods and non-factor services or 4.8 months of imports of goods only (Graph 23).

Graph 23



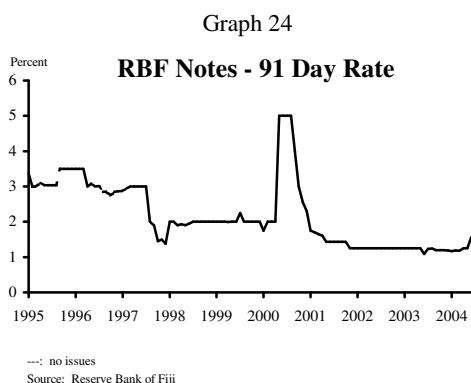
Domestic Financial Conditions

Money Markets

There was a slowdown in inter-bank activity during the June quarter. Turnover in the market fell to \$74.7 million from \$78.1 million in the previous quarter. This slowdown in inter-bank trading

reflected sufficient liquidity held by commercial banks arising from net inflows of foreign reserves and a fall in RBF Notes outstanding. The inter-bank lending rate rose marginally to 0.82 percent in the June quarter from 0.80 percent in the March quarter.

At the end of May, the Bank tightened its monetary policy. As a result the Bank's policy indicator rate was raised by 50 basis points from 1.25 percent to 1.75 percent (Graph 24).⁴



As part of open market operations, around \$305.7 million of RBF Notes were allotted in the June quarter, compared with \$307.5 million issued in the previous quarter. The yield on the 91-day RBF Notes during this period averaged 1.36 percent, 39 basis points below the policy indicator rate.

During the same period, Government made 4 issues of Treasury Bills totalling \$43 million, compared with 5 issues made

in the previous quarter amounting to \$48 million. The weighted average yields for almost all maturities of Treasury Bills increased marginally.

Of the statutory corporations, the Fiji Development Bank, Fiji Sugar Corporation and Public Rental Board also raised funds in the market through the issue of promissory notes during the quarter.

Capital Markets

The Government was the principal issuer of long-term debt instrument in the market during the June quarter. It raised \$74 million through bonds with maturities ranging between 3 and 15 years to finance part of its fiscal deficit. As for the government bond yields, the continuing high demand for longer-term securities and investors competing for the investments, has led to the decline in the bond yields across all maturities.

The Fiji Development Bank also raised around \$3 million in bonds during the quarter. Yields on their different bond maturities issued were similar to those of Government bonds.

In the secondary market for bonds, a slow down in trading was noted over the quarter. There were 6 trades amounting to \$2.5 million during the review period compared with 11 trades amounting to \$4.4 million during the March quarter. The slow down in trading is partly due to the reluctance of current holders of bonds to sell as there are limited reinvestment opportunities for them.

At the South Pacific Stock Exchange there were 3.7 million shares traded over the quarter, amounting to \$4.3 million. The

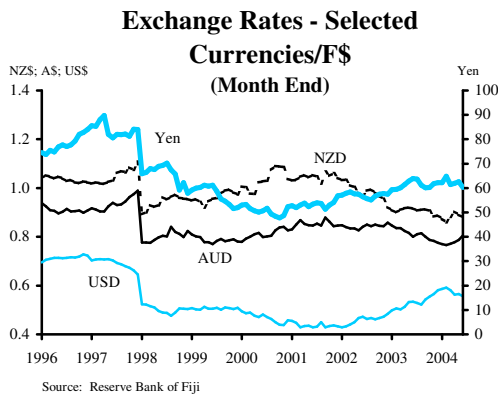
⁴ A more detailed record of some of the reasons for the tightening stance is contained in the Monetary Policy statement listed under "For the Records" section of this Quarterly Review.

number of shares traded increased from 2.4 million shares, recorded in the first quarter while the value of shares declined marginally from the \$5 million traded in the first quarter.

Exchange Rate

Movements in the exchange rates were generally mixed over the quarter. Compared with the end of March 2004, the Fiji dollar strengthened against the Australian dollar (4.5 percent), while the local currency weakened against the US dollar (4.2 percent), Euro (3.6 percent), Japanese Yen (1.9 percent), as well as the New Zealand (0.4 percent) dollars over the quarter (Graph 25).

Graph 25

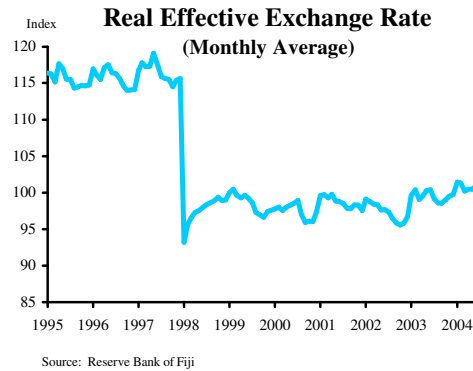


The Nominal Effective Exchange Rate Index (NEER), which reflects aggregate exchange rate movements between the Fiji dollar and currencies of major trading partners, rose marginally in the year to June. This indicates an appreciation of the Fiji dollar against the basket of currencies.

During the same period the Real Effective Exchange Rate Index of the Fiji dollar,

which adjusts the NEER for inflation differentials across Fiji's major trading partners, rose by 0.8 percent. This indicates a deterioration in Fiji's international competitiveness (Graph 26).

Graph 26



Financial Intermediaries

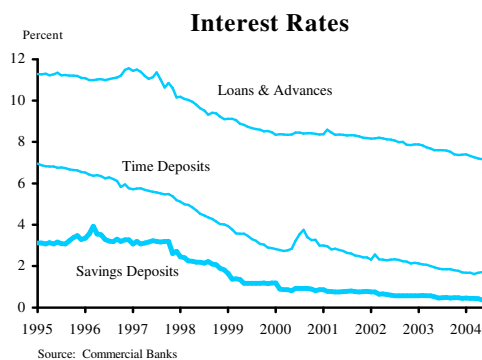
Latest movements in commercial bank interest rates generally revealed a mixed trend.

The weighted average lending rate on commercial bank outstanding loans and advances when compared to the end of March quarter fell by 10 basis points to 7.17 percent in May.

In the same period, the saving deposit rate fell by 7 basis point to 0.36 percent. In contrast, the interest rate on outstanding time deposits rose by 11 basis point to 1.72 percent (Graph 27).

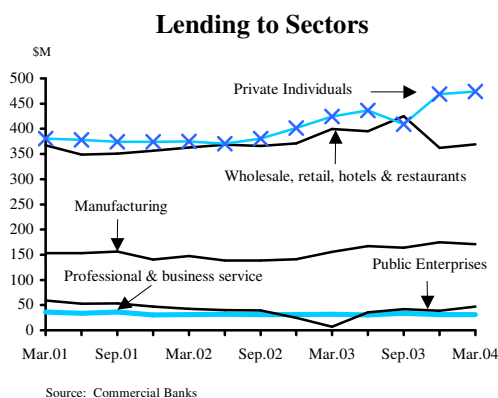
Broad money grew by 1.3 percent from March to April. The expansion was underpinned by a rise in cash held by the public and local bills payable as well as a rise in demand deposits of private individuals and business.

Graph 27



During the review period, private sector credit rose by 1.8 percent, driven by higher commercial bank lending to the wholesale, retail, hotels & restaurants, private individuals, public enterprises, manufacturing as well as to professional & business services sector (Graph 28).

Graph 28



However, commercial bank lending to the agriculture, electricity, gas & water, non-bank financial institutions and transport & storage sectors declined during the same period.

Total outstanding loans and advances by Licensed Credit Institutions (LCIs)⁵, rose

⁵ LCI's include Merchant Finance Investment Company Limited, Credit Corporation (Fiji) Limited and Home Finance Company Limited.

by 4.3 percent in May over the March quarter, driven largely by higher lending to private individuals, transport & storage, real estate, agriculture, wholesale, retail, hotels & restaurant, as well as to the manufacturing sectors. The weighted average lending rate on LCIs' outstanding loans fell by 3 basis points to 11.87 percent during the same period.

Banking Industry Quarterly Condition Report – March 2004

The following is a summary of aggregate information derived from the quarterly statistical returns submitted by licensed financial institutions for March 2004.

Overview – Commercial Banks

The banking sector exhibited an overall satisfactory performance for the first quarter of 2004. However, there was a one off reduction in the size of the balance sheet, the liquidity position and a decline in asset quality.

The combined balance sheet of the banking industry contracted over the quarter following a decline in deposits and profit remittances by banks. The reduction in deposits was attributed to a substantial drop in deposit balances of non-bank financial institutions. The out-turn was underpinned by active open market operations undertaken by the RBF which resulted in institutional investors switching from deposits to holding RBF Notes.

On the assets side, the contraction in the balance sheet of banks was mainly reflected in the reduction in cash and settlement account balances.

Loans grew over the quarter despite the

balance sheet contraction. The growth in loans was led by an increase in lending to the wholesale, retail, housing and building and construction sectors.

Commercial bank profits rose during the quarter. Improvement in profits resulted from an increase in interest income, lower interest expenses and a rise in fee and commission income. These more than offset the higher operating costs, and bad debts and provisions expense.

Assets and Liabilities

Total assets of the banking industry declined by 7.6 percent over the quarter to \$2,280.4 million, a turnaround from the 8.3 percent growth in the same period in 2003.

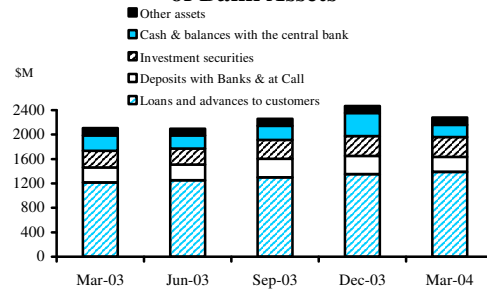
Net loans grew by 2.5 percent over the quarter to \$1,386.9 million, substantially lower than the 14.2 percent expansion recorded from March 2003.

Deposits with banks and at call, cash and balances with the central bank, and investments, narrowed over the quarter, contributing to the drop in assets. Cash and settlement account balances declined by \$178.1 million and deposits with banks and at call declined by \$48.6 million. Liquid assets for the banking industry declined over the quarter by \$227.3 million, largely due to the result of open market operations by RBF (Graph 29).

Liabilities dropped over the quarter, following a decline in deposits and unappropriated profits by \$130.8 million and \$35.7 million, respectively.

Graph 29

Structural Change and Growth of Bank Assets



The movement in deposits was attributed to a substantial drop in deposit balances held by non-bank financial institutions. The drop in un-appropriated profits was attributed to the remittance of profits by some banks. However, on an annual basis, liabilities increased by 8.3 percent due to a build-up in deposits and balances due to banks and at call.

Private individuals hold the largest share of deposits of the banking industry (40.8 percent) followed by private sector business entities (26.0 percent) and public enterprises (8.8 percent). Compared to March 2003, the deposit share held by private individuals has reduced from 41.4 percent while there were notable increases for deposits held by private sector business entities (from 23.7 percent) and public enterprises (from 3.2 percent). The major change in the deposit structure was noted for non-bank financial institutions, declining from 13 to 6 percent over the quarter, 14.1 percent over the year. Deposits held by non-residents, public enterprises and private sector business entities, rose marginally over the quarter.

Loans and Advances

Approximately half (\$728.6 million or 52.1 percent) of the total loans portfolio is provided to the business sector (Graph 30). There has been little change in the share of loans to this sector over the latest quarter, as well as over the past twelve-month period.

The majority of the loans outstanding to the private business sector were to the following sub-sectors: wholesale, retail (57.4 percent), manufacturing (23.8 percent) and real estate (9.9 percent). Lending to the following sub-sectors grew over the quarter:

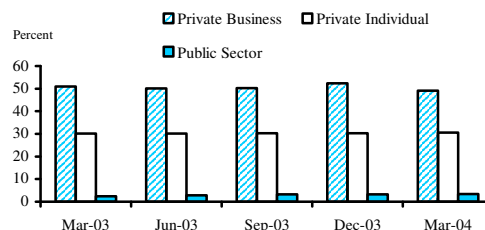
- Building & Construction (up 36.4 percent) – strong growth was fuelled by increased lending for building of hotels and tourism related buildings;
- Agriculture (up 6.5 percent) – lending grew for farm purchases, forestry & logging and fisheries; and
- Mining & Quarrying (up 2.2 percent) – growth was noted for sand & gravel.

Loans to private individuals stood at \$427.6 million (or 30.6 percent of total loans), a marginal increase compared to that recorded in December 2003. The majority (77.6 percent) of loans to private individuals were for housing, while the balance was for personal transport and other purposes (including credit card receivables).

Lending to the housing and personal transport sub-sectors expanded over the quarter, by 5.0 and 4.8 percent, respectively.

Graph 30

Loans and Advances by Sector as Percentage of Total Loans



Loans to the public sector made up 3.4 percent of total loans (\$46.8 million), a slight increase compared to the previous quarter and for the same period last year. Outstanding loans to non-residents constituted 11.9 percent of total loans indicating a declining trend over the previous year.

Profitability

Net profit before taxes for all banks increased by \$0.6 million over the quarter to \$20.1 million. However, compared to March 2003 this represents a decline of \$1.0 million. The decrease in profits was a result of banks recording bad debts and provision expense of \$2.1 million, compared to a write back of \$1.7 million in March 2003. The efficiency ratio of banks, measured as overhead expenses as a percentage of operating income, improved to 50.8 percent from 54.3 percent in March 2003 and 51.3 percent in the previous quarter.

Net interest income increased by \$1.0 million over the quarter and by \$2.7 million over the year.

Non- interest income increased by \$0.7 million over the quarter, with fees and commission up by \$1.5 million. Compared to March 2003, non-interest income increased by \$0.2 million.

Operating expenses increased by \$0.6 million over the quarter, with personnel expenses the major contributor. Banks also reported an increase in bad debts and provision expense of \$0.4 million.

**Bank Profitability
(\$'000)**

	Mar-03	Dec-03	Mar-04	% Change	
				Over Qtr	Over Mar-03
Net interest income	23,597	25,321	26,306	3.89	11.48
Add: Non interest income	18,550	18,047	18,746	3.87	1.06
Income from overseas exchange transactions	8,022	6,889	6,874	-0.22	-14.31
Commission	3,114	2,159	2,727	26.31	-12.43
Fee Charges	6,791	8,484	8,935	5.32	31.57
Other income	623	515	210	-59.22	-66.29
<i>Equals</i>					
Total operating income	42,147	43,368	45,053	3.89	6.89
<i>Less: Operating expenses</i>	22,879	22,246	22,885	2.87	0.03
<i>Less: Bad Debts & provisions</i>	-1,743	1,693	2,115	24.93	221.34
<i>Equals:</i>					
Profit before tax	21,009	19,429	20,053	3.21	-4.55
<i>Less: Tax</i>	6,565	5,407	7,187	32.92	9.47
<i>Equals:</i>					
Net profit after tax	14,444	14,022	12,866	-8.24	-10.92

In average asset terms, the banks' annualised return on assets declined over the quarter from 2.4 percent to 2.2 percent. For the same quarter last year, the return on assets was 2.8 percent.

Profitability as a Percentage of Average Total Assets

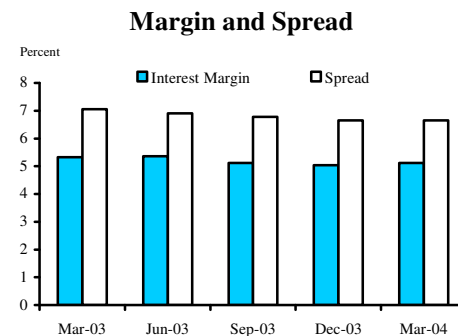
	Mar-03	Dec-03	Mar-04	Change	
				Over Qtr	Over Mar-03
Net Interest Income	1.14	1.07	1.11	0.04	-0.03
Charges for Bad & Doubtful Debts	-0.08	0.07	0.09	0.02	0.17
Non-Interest Income	0.90	0.76	0.79	0.03	-0.11
Operating Expenses	1.11	0.94	0.96	0.02	-0.15
Profit Before Tax (annualised)	4.08	3.28	3.36	0.08	-0.72
Net Profit After Tax (annualised)	2.80	2.36	2.16	-0.20	-0.64

Interest Margin and Spread

Over the quarter, the annualised interest margin⁵ improved by 8 basis points to 5.1 percent; it however, deteriorated by 20 basis points over the year (Graph 31).

The interest spread⁶ contracted by 41 basis points over the year as lending rates declined although the position was unchanged over the quarter. The average cost of funds showed a similar trend.

Graph 31



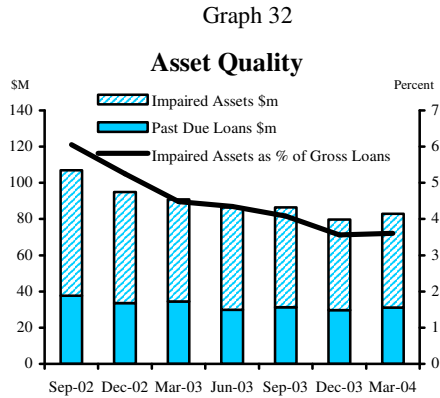
⁵ Interest Margin = ratio of net interest income to average interest-bearing assets.

⁶ Interest Spread = difference between the average rate on interest earning assets and the average rate on interest bearing liabilities.

Asset Quality

Asset quality of the banking industry declined over the quarter with an increase in the level of impaired and past due assets. However, asset quality improved when compared to March 2003 as shown by the decreasing impaired and past due assets (Graph 32).

Impaired assets of the banking industry stood at \$51.9 million as at end of March 2004. This is an increase of 3.8 percent over the quarter and a decrease of 8.2 percent from March 2003. As a percentage of gross loans, impaired assets increased slightly to 3.6 percent over the quarter, but was lower than the 4.5 percent in March 2003.

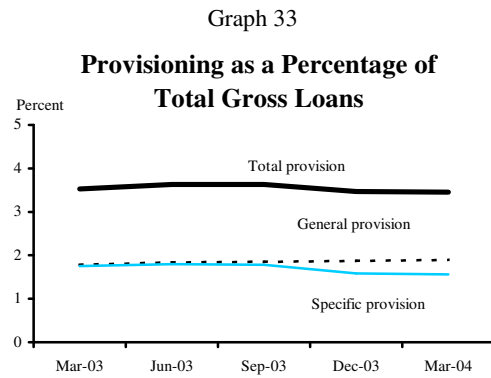


Total past due assets⁷ as at end March 2004 stood at \$31.1 million, a decline of 9.8 percent over March 2003 but increased by 4.5 percent over the quarter. Almost half the total past due assets lie in the over 2 years time-band.

Total classified loans exhibited an overall

decrease over the quarter as well as over the year by 3.5 percent and 11.7 percent respectively, to \$64.2 million. Of total classified loans, doubtful loans account for 56.1 percent, followed by loss loans (22.1 percent) and substandard loans (21.8 percent).

Specific provisions increased by 0.5 percent over the quarter and by 2.2 percent over March 2003. However as a percentage of loans, specific provisions decreased by 2 basis points over the quarter to 1.6 percent and by 19 basis points over March 2003 (Graph 33).



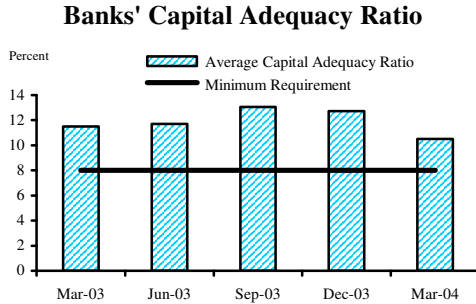
General provisions also increased over this period. Over the last 8 quarters, the average quarterly growth rate in general provisions stood at 9.2 percent. As a percentage of loans and advances, general provisions stands at 1.9 percent.

Capital Adequacy

The capital adequacy ratio for the industry declined over the quarter and over March 2003 (Graph 34).

⁷ Excludes the 1 – 3 month period.

Graph 34



As at March 2004, the industry capital adequacy ratio stood at 10.5 percent from 12.7 percent at the end of the previous quarter and 11.5 percent at the end of March 2003. The core capital ratio also decreased by a similar margin over the same period.

The fall in the ratios over the quarter was due to the decline in total capital and reserves. Over the quarter, capital decreased by 29.6 percent. The reduction was caused by a fall in disclosed reserves and audited interim retained profits.

Total risk weighted assets declined over the quarter by 2.1 percent. The fall was not enough to mitigate the decline in total capital, leading therefore to a decline in the capital ratios. Over the 12-month period, risk weighted assets increased by 11.2 percent attributing to the decline in capital ratios for the period. The major contributors to the increase in risk-weighted assets were the 100 percent and 50 percent categories owing to the increase in loans and advances.

Liquidity

Industry liquid asset levels declined over the quarter. This was largely a result of a decline in cash and settlement accounts and deposits with banks and at call. The

same is true for the trend over 12 months.

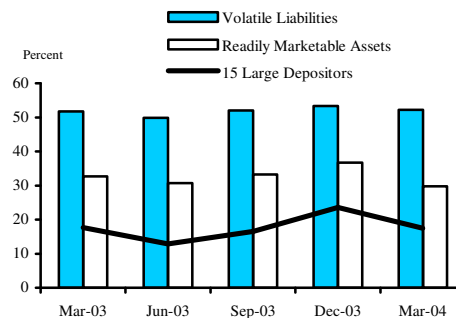
Liquid assets for March 2004 stood at \$679.0 million declining by 25.1 percent over the quarter and by 1.3 percent over March 2003. The level of liquid assets was 33.8 percent of deposits in March 2004, lower than the 42.4 percent at the end of the preceding quarter and 37.0 percent a year ago. As a percentage of total liabilities, liquid assets were 29.8 percent.

Volatile liabilities decreased by 9.6 percent to \$1,189.8 million over the quarter, but increased by 9.4 percent over 12 months (Graph 35). The quarterly movement reflects the decline in deposits held with banks. As a percentage of total liabilities, volatile liabilities comprised 52.2 percent, lower than that registered over the quarter but marginally higher over 12 months.

The maturity mismatch analysis of banks (outstanding loans minus deposits) shows negative maturity mismatches of \$250.6 million in the next 1-24 months. Liquid assets remain strong and will cover the projected cash outflows for the next 24 months.

Graph 35

Volatile Liability Coverage



The balances of the 15 largest depositors

of the banking industry declined by 31.6 percent to \$397.9 million. As a percentage of total liabilities, it stood at 17.5 percent as against 23.6 percent at the end of the December quarter.

Other Matters

Banks have introduced specialised category deposits for the public. These included categories for senior citizens, primary and secondary school children and young adults. These products have lower fee structures and act as an incentive to those in the respective categories.

The number of automatic teller machines (ATMs) continues to grow, with an addition of 19 ATM machines over the year. The current number of ATMs stands at 104. The number of EFTPOS terminals, however, declined by 41. The number of branches and agencies as at December 2003 stood at 47 and 57 respectively.

Paper based transactions continued to increase in number, with 844,437 in 2003 an increment of 287,117 over 2002.

CREDIT INSTITUTIONS

Overview - Credit Institutions

Indicators for all credit institutions also showed satisfactory conditions in the first quarter of 2004. Conditions are considered stable with growth in lending, improvements in asset quality, required capital levels held and steady liquid asset levels. Profits, however, declined over the quarter.

The combined balance sheet of credit institutions expanded over the quarter due

to an increase in loans. The growth in loans is attributed to an increase in lending to private individuals as well as to private sector business entities. The majority of credit institution loans were to private individuals, a shift from the previously private sector business entity concentrated portfolio.

Credit institutions' profits declined over the quarter as a result of increases in interest costs, following increased reliance on holding company advances and bank overdrafts. In addition, they also recorded a decline in their non-fee and commission income.

There were improvements in asset quality noted for credit institutions. The overall trends indicate that past due assets, impaired assets, as well as classified exposures, are declining.

The liquidity position of credit institutions remains stable. This is mainly portrayed in the decreasing level of volatile liabilities. The decreased level of liquid assets over the quarter is not expected to pose a threat to the overall liquidity of the industry.

Assets and Liabilities

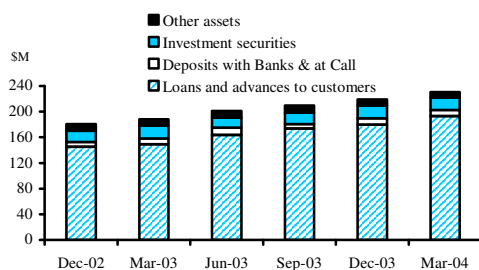
As at March 2004, total assets increased by 5.7 percent to \$230.7 million (Graph 36). Over the year, the increase in total assets was more pronounced (22.5 percent). The growth in total assets over the quarter, as well as over the year was mainly attributed to the growth in loans and advances.

On the liabilities side, term deposits held by credit institutions decreased over the quarter by \$9.9 million to \$119.5 million. However, there was a marginal increase (\$1.4 million) in term deposits held by

credit institutions over the year.

Graph 36

Structural Change and Growth of Credit Institution Assets



The trend over the quarter and over the year shows increasing reliance of the credit institutions on advances from their parent companies. Balances owing to holding company increased by \$19.8 million to \$64.9 million. Over the year growth from this source was \$38.7 million.

Loans and Advances

Credit institutions continued to build up lending over the quarter in the private individuals sector. Private individual loans increased by \$7.7 million from \$104.6 million. When compared to the same period last year, loans outstanding to private individuals increased by \$32.2 million.

As a percentage of gross loans, total loans outstanding to private individuals represented 51.6 percent, while loans to private sector business entities was 46.9 percent in March 2004 (Graph 37).

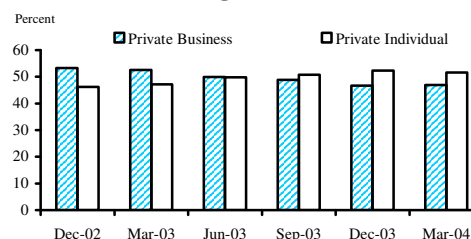
As at March 2003, credit institutions loans and advances were concentrated on

private sector business entities (52.5 percent) rather than private individuals (47.2 percent).

Loans and advances extended to private sector business entities had also increased over the quarter by \$6.4 million to \$102.0 million. Over the year, loans to this sector increased by \$11.2 million.

Graph 37

Loans and Advances by Sector as Percentage of Total Loans



Profitability

Profit before tax of credit institutions decreased over the quarter by \$0.6 million to \$2.5 million. However, over March 2003 credit institutions reported an increase in profits of \$0.4 million.

Net interest income decreased by 5.6 percent over the quarter from \$5.1 million to \$4.9 million. This was a result of growth in interest expenses of \$0.4 million and in interest income by \$0.1 million. A \$1.1 million growth in net interest income was reported over March 2003.

Non-interest income declined over the quarter by \$0.1 million due to a decrease in non-fee and commission income.

Credit Institution Profitability
(\$'000)

	Mar -03	Dec-03	Mar-04	% Change	
				Over Qtr	Over Mar-03
Net interest income	3,758	5,133	4,846	-5.58	28.96
<i>Add: Non interest income Equals</i>	596	592	511	-13.65	-14.26
Total operating income	4,354	5,725	5,357	-6.42	23.04
<i>Less: Operating expenses</i>	1,512	1,943	2,015	3.75	33.24
<i>Less: Bad debts & provisions</i>	748	710	878	23.59	17.28
<i>Equals: Profit before tax & extraordinary items</i>	2,093	3,072	2,464	-19.78	17.73
<i>Less: Tax</i>	318	647	414	-36.02	30.20
<i>Equals: Net profit after tax</i>	1,775	2,425	2,050	-15.45	15.49

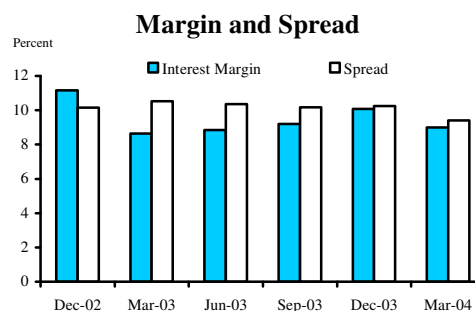
Over the year, operating expenses increased by \$0.5 million to \$2 million due to increases in other miscellaneous expenses. Personnel or staff expenses accounted for the bulk of operating expenses.

Interest Margin and Spread

Over the quarter, the annualised interest margin was 9.0 percent, a decline of 108 basis points (Graph 38). However, it improved over the 12-month period by 36 basis points.

The interest spread for credit institutions contracted over the quarter and over 12 months to 9.4 percent from 10.2 percent and 10.5 percent respectively.

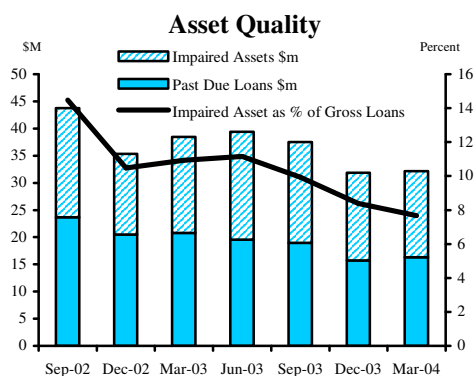
Graph 38



Asset Quality

Asset quality of credit institutions continued to improve over the quarter and over the year as the level of impaired assets fell (Graph 39). Provisions allocated for impaired assets and gross loans are considered adequate and above regulatory requirements.

Graph 39



Impaired assets decreased over the quarter by \$0.3 million to \$15.8 million. Over the year, impaired assets fell by \$1.8 million.

As a percentage of gross loans, impaired assets continued to decrease over the year from 10.9 percent and over the quarter

from 8.4 percent to 7.6 percent. This has been caused by the growth in loans.

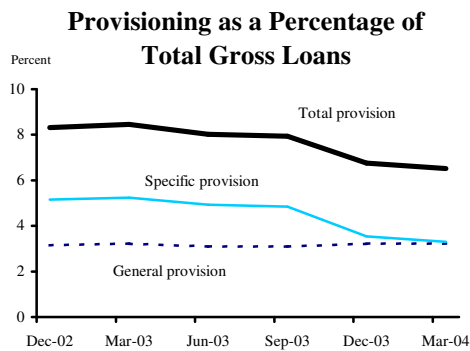
Classified exposures, on the other hand, increased over the quarter by \$0.4 million and decreased over the year by \$4.1 million to \$19.1 million. The increase over the quarter was due to a \$0.6 million increase in accounts classified as loss.

As a percentage of classified exposures, substandard accounts represent 30.1 percent (\$5.8 million), doubtful 18.9 percent (\$3.6 million) and loss 51.0 percent (\$9.7 million) as at March 2004.

Although there was a \$0.6 million increase over the quarter past due loans continued to trend downward from \$20.8 million in March 2003 to \$16.3m.

Specific provisions over gross loans decreased over the quarter from 3.5 percent and over the year from 5.2 percent to 3.3 percent. This downward trend is related to the general reduction in impaired assets over the period (Graph 40).

Graph 40



Credit institutions general provisions level was at 3.2 percent of gross loans level over the quarter and over the year. Over the last 8 quarters, the average quarterly

growth rate in general provisions has been 9.2 percent.

Capital Adequacy

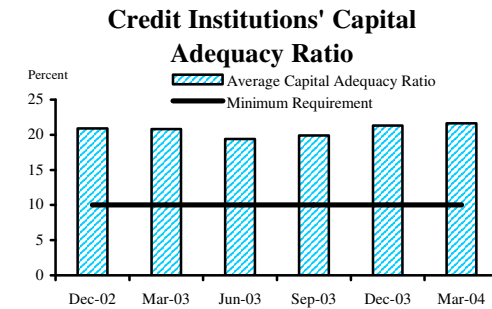
The capital adequacy ratio of all credit institutions increased over the quarter and over the year.

As at March 2004, the capital adequacy ratio stood 30 basis points above December 2003 (21.3 percent) and 50 basis points above March 2003 at 21.6 percent.

The capital base of credit institutions grew over the quarter by \$2.3 million and over the year by \$7.0 million to \$35.6 million underpinning the marginal growth in the capital adequacy ratio for March 2004.

All credit institutions maintained capital adequacy levels well above the 10 percent minimum RBF capital adequacy ratio requirement.

Graph 41



Liquidity

The credit institutions' liquidity position continued to improve over the quarter and on an annual basis.

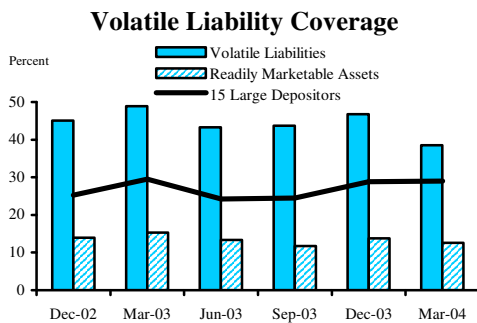
Volatile liabilities of credit institutions

decreased over the quarter by 11.2 percent to \$88.9 million. When compared to March 2003, volatile liabilities also decreased by 3.5 percent from \$92.1 million.

In March 2004, volatile liabilities represented 38.6 percent of total liabilities. This has decreased over the quarter from 46.8 percent and over the year from 48.9 percent. The decrease in volatile liabilities is indicative of the changing nature of credit institutions funding base.

Total deposits held by the 15 largest depositors for credit institutions decreased over the quarter by \$9.4 million (14.8 percent) to \$53.7 million. Over the year, deposits from this source decreased by \$1.8 million (1.0 percent).

Graph 42



Readily marketable assets (liquid assets) decreased over the quarter by 3.5 percent to \$29.1 million. Over the year, there was no significant movement in liquid assets.

Liquid assets as a percentage of total assets reduced from 13.8 percent over the quarter, and from 15.3 percent over March 2003 to 12.6 percent.

Insurance Industry Quarterly Condition Report - December 2003

Overview of Industry Performance

The insurance industry in the quarter ending 31 December 2003 recorded an improved performance when compared with the comparable period in 2002. The combined solvency surplus during the review period was \$29.9 million, up from \$23.0 million in 2002. By category, life insurers accounted for the major share of the aggregate surplus. During the same period, the after tax surplus of the industry rose to \$12.1 million from \$11.2 million.

Combined insurers assets recorded a growth of 9.1 percent to reach \$620.1 million. The growth was driven by both the life and general sectors.

All underwriters met the solvency requirement of the Insurance Act.

Solvency Position (\$M)

Quarter Ended 31 December	Admissable Assets	MRSM*	Solvency Surplus
2003	General	26.9	11.6
	Life	31.9	18.3
	Total	58.8	28.9
2002	General	21.9	10.0
	Life	26.1	13.0
	Total	48.0	23.0

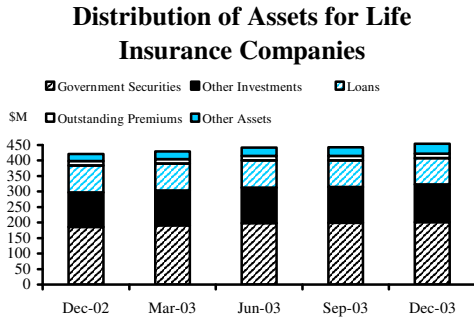
* MRSM - Minimum Required Solvency Margin

Life Insurers

The life insurance industry recorded a solvency surplus of \$18.3 million as at 31 December 2003, a notable increase when compared to the \$13.0 million in 2002. As

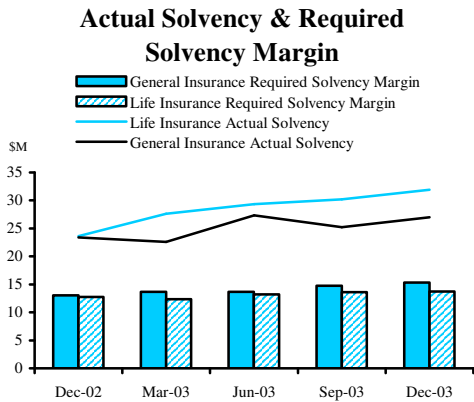
anticipated, both the life insurers recorded increases in their solvency surplus over the year. Combined life insurers assets rose by 7.8 percent to \$454.2 million, or 73.2 percent of total industry assets. The asset distribution for life insurers remained unchanged as Government Securities, property and loans remained the dominant instruments of investment.

Graph 43



Despite the higher solvency surplus, the life insurance industry registered a decline in its net after tax surplus. The reduced after tax surplus of \$10.5 million in December 2003 from \$11.8 million in 2002 was underpinned by higher benefit payments and taxation expense during the quarter.

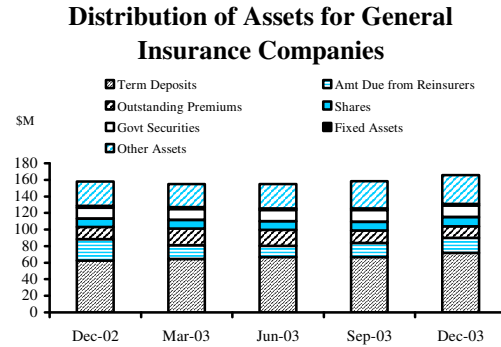
Graph 44



General Insurers

An increase of 22.9 percent in net admissible assets to \$26.9 million as at 31 December 2003 contributed to the increase in the solvency surplus of general insurers to \$11.6 million. All insurers met the solvency requirement of the Insurance Act.

Graph 45



The assets of the general insurance industry are mainly concentrated in term deposits, government securities and outstanding premiums. The underwriting surplus of insurers improved by \$0.7 million to \$1.9 million. The improvement was mainly driven by an increase in net earned premiums, which rose by 48 percent. Overall, together with an increase in investment income during the quarter, the general insurers recorded an after tax surplus of \$1.6 million, a turnaround from the after tax loss of \$0.6 million in the same period in the preceding year.

Insurance Brokers

Insurance brokers recorded a net after tax profit of \$0.8 million in the December 2003 quarter, less than half the \$1.8 million realized in the same 3-month

period in 2002. The marked reduction in performance was due to one of the brokers writing off \$0.9 million in goodwill. Similarly, for the 12 months ended December 2003, net profit after tax declined to \$3.8 million from \$5.4 million in the year ending December 2002. All

brokers continue to comply with Section 7 of the Insurance Act with the bulk of \$4.2 million brokering account balance being under 30 days. Meanwhile, 60 offshore applications (2002: 88) were approved with premium remittance of \$10.0 million during the quarter (2002: \$10.2 million).

For the Record**REVISED ECONOMIC PROJECTIONS**

Statement by Governor, Mr S Narube, 11 May 2004.

The Chairman of the Macroeconomic Policy Committee and Governor of the Reserve Bank of Fiji, Mr Savenaca Narube, today announced that Fiji's economic growth forecast for this year has improved to 4.7 percent, compared with 4.1 percent released in November 2003. Although the forecast reflects some technical adjustments arising out of the 1995 re-base of GDP, there has been an overall improvement in this year's economic outlook. The forecast also reflects the impact of the recent floods. According to Mr Narube, the better forecast for this year reflects a healthier outlook for several industries/sectors of the economy, such as tourism, building & construction, non-cane agriculture and livestock, which were not anticipated earlier.

According to Mr Narube, this year's growth is expected to be led by the buoyant activity in the building & construction sector, followed by good performances of the wholesale & retail trade and restaurants & hotels; and manufacturing sectors. Moreover, positive contributions are also projected from the community, social and personal services; and transport & communications sectors. This year's growth is anticipated to be broad based across most sectors, except for the sugar industry, which is anticipated to record a small contraction.

Mr Narube said that foreign reserves are projected to remain at adequate levels at the

end of the year. As expected, inflation had fallen since January 2004, as the effect of last year's higher Value Added Tax rate abated. As at March, inflation was 2.2 percent and is expected to be around 3.0 percent by year-end. The labour market is also anticipated to perform favourably this year, in line with improving domestic economic conditions.

Looking back at 2003, Mr Narube explained that despite the adverse events of last year, such as Cyclone Ami, the Iraq conflict and the SARS virus, the economy had done extremely well. It is estimated that the economy grew by around 5.0 percent, led by strong contributions from the finance, insurance, real estate and business services; wholesale & retail trade and restaurants & hotels; building & construction; and manufacturing sectors.

In concluding, Mr Narube highlighted that although investment was picking up, this was still below Government's target. At the same time, the sluggish growth in exports continue to be of concern. Therefore, it is critically important for investment and exports growth to gain further momentum, so that the current level of economic performance could be sustained into the medium term. At the same time, Mr Narube emphasised the need to press ahead with planned reforms to ensure further gains in Fiji's productivity and competitiveness.

For the Record

MONETARY POLICY STATEMENT

*Statement by the Governor and Chairman of the RBF Board of Directors, Mr S Narube,
14 May 2004.*

The Board of the Reserve Bank of Fiji in its monthly meeting on 27th May 2004, decided to raise the official interest rate from 1.25 percent to 1.75 percent.

In making this decision, the Board had taken into account the robust economic growth achieved last year on top of the growth in 2001 and 2002. Another good growth of close to 5 percent is projected this year. The four years of consecutive growth at historically higher levels is a very commendable performance. The country has achieved its objective of turning the economy around from the decline in 2000.

To support this recovery, the Reserve Bank has, since late 2000, maintained an accommodative stance of monetary policy. This has kept interest rates low and allowed a strong recovery in demand for loans from financial institutions. Up to now, the Bank has allowed credit to grow as a natural correction from the low demand conditions after 2000. This buoyant credit growth has helped support consumer demand in recent years. The Bank has noted the rise in investment spending, which reflect the full restoration of confidence in the economy. However, the four years of economic growth has been largely on the back of consumption spending.

The Board after considering all relevant economic indicators is now of the view that the economy, under existing conditions, may be reaching its growth potential. Clearly, a

growth built on consumption spending for a small open economy like Fiji, cannot be sustained. The pressures of this higher spending are clearly being felt in some sectors of the labour market, the budget deficit and the balance of payment. We can only enlarge this growth potential if we undertake structural reforms, improve productivity and raise exports. It is extremely important that we be forward looking and initiate measures now to protect our long term position.

It is the Board's view that a tightening of monetary policy at this stage is therefore necessary.

Fiji's economy is expected to grow this year on the back of strong growth in the building & construction and wholesale and retail sectors. However, the recent floods across the country is likely to adversely affect production of primary produce like dalo and vegetables. Sugarcane and sugar output is also likely to contract as a result. Production in the clothing, textile and footwear industry remains weak. Latest data indicate that visitor arrivals cumulative to March recorded a significant increase of around 22 percent over the comparable period last year. Emigration statistics up to March show that emigration of skilled workers has declined for the third consecutive month.

The inflation rate rose 1 percentage point to 3.2 percent in April. Rises in the prices of food contributed to the higher inflation rate

for April. The forecast for year-end inflation, however, remains at around 3 percent. The risk to this inflation projection from the high international oil prices will depend on how long prices remain at the current high level or if they increase further. Foreign reserves at the end of April were around \$752 million, sufficient to cover 3.3 months of imports of goods and non-factor services or 5 months of imports of goods only.

The Bank's outlook for economic growth, inflation and foreign reserves, therefore, remains favourable in the short to medium term. Indeed, the Bank wishes to stress that our macroeconomic fundamentals are firm.

However, the Bank is of the firm view that we now need to build growth on exports of goods and services and not on consumption spending. This export led growth will

provide a lasting foundation for long term prosperity. Up to now, the growth in commodity exports has been inadequate. Sugar exports continue to decline. Commercial production of mahogany, which is mature for harvest, is yet to begin. Our traditional resource-based exports like fish and timber have yet to realise their full potential. This needs to change. At the same time, we need to diversify our exports and continue to encourage new industries like ICT, audio-visual and mineral water.

The Bank is raising its policy indicator rate by 50 basis points. This means that the interest rate on 91-day RBF Notes will rise from 1.25 percent to 1.75 percent. In the coming months, the Board will continue to closely assess the economic outlook and make further interest rate adjustment as needed to foster sustained and balanced growth.

ECONOMICS ASSOCIATION OF FIJI FORUM
19th MAY 2004

“TERRORISM: THE RISK TO PACIFIC ISLAND ECONOMIES”

Mr Greg Urwin, Secretary General to the Pacific Islands Forum Secretariat, was the guest speaker at the first Economics Association Forum for 2004. Mr Andrew Hughes, Commissioner of Police, facilitated discussion on the topic as the Chairperson. The theme of the meeting was terrorism and the risk it posed for Pacific Island countries. Mr Urwin’s full speech is provided below.

Forum Leaders believe the Pacific region can, should and will be a region of peace, harmony, security and economic prosperity, so that all its people can lead free and worthwhile lives. We treasure the diversity of the Pacific and seek a future in which its cultures and traditions are valued, honoured and developed. We seek a Pacific region that is respected for the quality of its governance, the sustainable management of its resources, the full observance of democratic values, and for its defence and promotion of human rights. We seek partnerships with our neighbours and beyond to develop our knowledge, to improve our communications and to ensure a sustainable economic existence for all.

To achieve this vision, the Secretariat has been asked to concentrate its work on four key goals:

- Economic Growth
- Sustainable Development
- Good Governance and
- The Maintenance of Security (including Terrorism)

As now seems to be generally, and rightly acknowledged, you can’t have economic growth and sustainable development without good governance. And it is extremely difficult to achieve economic growth, sustainable development and practice the principles of good governance, without peace and security. Peace and security can no longer be seen in the narrow sense of defending a state from external threats of a military nature. It is now understood that peace and security are closely linked with generating conditions that in the words of the Forum Vision “allow people to lead free and worthwhile lives”, and the capacity of states to implement effective, efficient and equitable economic and political governance at all levels. It is against that general background and on the basis of that broad philosophy, that the Forum goes about its security-related work.

The Risk to the Region of Transnational Organised Crime and Terrorism.

All of that said, what kind of security environment do we live in here in the Pacific? The report on which the Leaders based their recent decisions made the point: “For years, the Pacific was romanticised internationally as a peaceful, content and rather sleepy backwater, somehow removed from – even immune to – the stresses faced by the rest of the developing and post-colonial world. This picture was, of course, a misrepresentation of a diverse, widespread and vibrant region facing unique

development challenges”.¹ In other words, what affects the rest of the world, affects us.

If the caricature ever contained a scintilla of truth – and in some respects, at some points in the region’s history, it might have – it has been put paid to well and truly, by the phenomenon we call globalisation.

Although, as a frequent user of the region’s aviation services, I sometimes have reason to doubt this, improved transport and communications systems mean that it is easier to interact within the region and by extension potentially easier for criminal individuals and groups to exploit Forum Island Countries or use them as safe havens or transit points. And as other countries and regions strengthen their efforts to combat terrorism and transnational organised crime, without our region doing likewise, it risks becoming a weak link in the global effort against such groups and it may become at risk itself as a focus for such activities.² These dangers have long been recognised in the region.

Since 1992 when Forum Leaders adopted the Honiara Declaration on Law Enforcement Cooperation, the region has recognised terrorism per se as a threat to the political and economic security of the region, but in fact the region has in the decade or so since 1992 focused its efforts on combating the threat that transnational crime in general poses for the sovereignty, security and economic integrity of Forum members.

To that end the Forum Secretariat aims to help Forum Island Countries create the

¹ Report of the Eminent Persons Group which reviewed the Forum and its Secretariat

² 31st South Pacific Chiefs of Police Conference in 2002

necessary legal and law enforcement framework to combat transnational crime. This includes the development of model legislation, formation of Combined Law Agency Groups (CLAGS), strengthening the sharing of information by law enforcement, the development of the Pacific Financial Intelligence Unit Project, the establishment of Transnational Crime Units and the Pacific Transnational Crime Coordination Centre.

Since the attacks in the USA on 11 September 2001 (9/11), there has obviously been a much more focussed response globally to terrorism per se. In addition to the immediate universal condemnation of the attacks and the specific actions taken in Afghanistan and elsewhere, the UN Security Council has adopted resolutions and other international organisations such as the International Maritime Organisation (IMO) and International Civil Aviation Organisation (ICAO) to name a few, have strengthened their requirements.

Forum members also endorse the concept of an “international civilised society” which is characterised at the international as well as the domestic level, by established and respected institutions, norms and practices including public international and transnational law. Terrorism attacks that kind of world. Forum members are, in any event, obliged as a matter of international law to implement internationally agreed anti-terrorism measures, a number of which are recognised by our own regional Nasonini Declaration, adopted in August 2002 by Forum Leaders. The Declaration commits Leaders to combat terrorism, links their commitment to previous Declarations and the implementation of courses of action within a certain time frame.

It must be said that given the challenges

faced by many Forum Island Countries including the delivery of basic services such as health care, education and the management of scarce resources; providing employment for the fast-growing youth population; HIV/Aids; vulnerability to climate change; natural resources being threatened by over-exploitation; increasing problems of pollution and waste disposal; natural disasters, particularly cyclones as an almost annual occurrence; weak telecommunications and transport infrastructure; and challenges to governance; combating terrorism has not been a top priority for Forum Island Countries, partly one suspects, because it is seen as something new, distinct, different. In a global sense, that is, of course, far from true. And more importantly, perhaps, terrorism needs to be seen as part of the general fabric of transnational crime. The motivations may be different, but if you have established the methodology for transnational crime you have in essence established the methodology for terrorism.

I think it fair to say that many within the region would not consider the risk of a terrorist attack as a high likelihood. But, as the Chair of the Forum, Helen Clark, said recently

*“The problem to be confronted in our region is not so much that terrorists will seek to attack the citizens or institutions of Pacific countries. It is rather that the Pacific might present a tempting target, either for an attack like the one in Bali, or as a base from which terrorist cells might undertake the planning and groundwork for an attack somewhere else”.*³

In other words, good preparation is better

³ Statement at the Regional Countering-Terrorism Roundtable, 10 May 2004, Wellington

than reaction. And there is growing evidence that transnational organised crime in the region is evolving to meet new needs and activities. Transnational organised crime groups are flexible and where there is a market, involving a variety of commodities and activities such as drugs, people, weapons, money laundering, fraudulent schemes they have the capability to diversify their activities in all these areas of illegal activity.

Such groups are utilising the opportunities which come from globalisation, including advances in technology such as the internet, to commit crime on a wider scale, and increases in trade and travel volumes within the region to stretch the resources of law enforcement.

Let there be no doubt that our region is being targeted for criminal activities such as the transit of illicit drugs, people smuggling, money laundering, and identity fraud. We are being targeted because of our lack of strong uniform legislation and inadequacies in human, financial and technical resources. For example, there is a lack of trained staff and technology support, in areas such as detection systems for explosives, drugs, fraudulent documents and forensic analysis and capability.

The challenges to governance in our region e.g. corruption, increasing poverty and lawlessness, also make parts of it attractive to transnational organised crime. Organised crime will also target individuals in both the public and private sectors where they know conditions of service are poor and remuneration is low.

And as I have said, the vulnerability of our region to transnational organised crime means that it is also vulnerable to terrorist activities as the networks that establish and

maintain transnational criminal activities can also maintain and fund terrorist activities.

The Secretariat, together with Forum members, the regional specialist law enforcement agencies and its international partners has developed model legislation to combat terrorism and transnational organised crime and drafting assistance is available. The regional law enforcement frameworks that have been put in place for combating transnational crime will also be extended to combat terrorism.

Tourism, Trade and Terrorism

Most Forum Island Countries are dependent on tourism and trade and a safe environment, to achieve economic growth and sustainable development. Where tourism is concerned, perception is everything, whether it be in relation to the environment, the people or security conditions.

In the Pacific, we are aware of the effect of the resumption of nuclear testing in French Polynesia, for example, and a number internal crises.

The dependence of the region's economies on trade and tourism makes it imperative that we do all we can to face the challenges, without creating additional fear in our societies. A principle aim of terrorist groups is not only physical attacks on people or infrastructure but also the instilling of fear of the possibility of an attack. Such fear, once it is abroad, can have very serious effects on the people living in the region and the people who may want to visit the Pacific. A change in the perception of the Pacific as a safe destination could seriously affect the numbers visiting our shores. After all, that is one of the main

things we sell as a destination.

The mix of factors in this is complicated. The events of 11 September reduced the number of visitors from the US and Europe because many airlines reduced the frequency of their services, and people declined to travel. The Bali bombing had an impact of a different sort. Tourists changed destinations and although tourist arrivals in Bali and Indonesia fell dramatically, visitor numbers in the Asia/Pacific region continued to climb. Australians and New Zealanders, Bali's main market, came to South Pacific destinations or went to Queensland instead. Depending on how it presented, however, a "Bali attack" or the fear of such an attack could destroy that market. In all the principle of someone's misfortune being another's gain does not seem to be a reliable basis for planning where this subject is concerned.

To state what is surely the obvious, the perception that a State may be in some way "soft" in its attitude to terrorism or compliant with it, will also have negative consequences for the way a State deals with the world. The perception that a country is allowing the laundering of terrorist funds, for example, could cause a financial backlash e.g. the prohibition of banking transactions (especially by US banks) with that country (and not necessarily just with the offshore centre).

New Airport and Port Security Requirements

In this connection, I will conclude with a few words about an immediate issue that confronts us, the changing security requirements at our ports and airports. New IMO and ICAO security procedures are required to be in place soon. The deadline for compliance with IMO's International

Ship and Port Facility Security Code (ISPS) is 1 July 2004. The Code is part of a new global security regime for international shipping and obliges countries to take preventative measures against security incidents that affect international shipping.

The latest ICAO measure to increase security of hold baggage will come into force 1 January 2006. The effect of these measures will be felt in all countries, not only on those which are members of ICAO or IMO, but also on their trading and tourism partners.

Tourism depends on air services and cruise ships. If international airlines are unable to land at Pacific entry points because ICAO security requirements are not met, and if for parallel reasons Pacific airlines were prevented from landing in Australia, New Zealand, Guam or Hawaii, the impact on the Pacific's tourism sector would be potentially devastating.

The economic implications of the regions' exports not being accepted by its major markets outside the region would be equally devastating.

Every country which wants to avoid the risk of serious disruption to trade and tourism will need to face the issue of compliance. The alternative is to risk serious and sustained economic damage.

Unfortunately, many of the smaller island countries are dependent on imports so the cost increases brought about security measures, insurance, freight, documentation, procedures, will increase the costs of our exports and imports.

Australia has announced that it is providing A\$500,000 (US\$352,100) to help Pacific

port security in Pacific Island countries and implement port and ship security plans. The assistance will be provided to administrators, port operators and shipping companies in Pacific nations to meet the 1 July deadline for compliance. Briefings from the Secretariat of the Pacific Community (SPC), ICAO, Australian Agency for International Development (AusAID), the New Zealand Maritime Safety Authority (MSA), and the New Zealand Civil Aviation Authority (CAA) have demonstrated that extensive preparatory work to improve maritime and aviation security was already underway throughout the region. Training being provided through the SPC, AusAID and NZMSA means most countries will be in a position to carry out their ISPS Code requirements. We now need to put in place legislative structures to ensure full compliance. I hope that Forum Island Countries will take early advantage of such assistance in order to meet the IMO requirements and deadline. This is an urgent matter.

Conclusion

The Economies of Forum Island Countries are faced with a wide variety of risks. These range from natural disasters, environmental degradation, climate change and rising sea levels to food security and the economic impact of globalisation. Terrorism is yet another one to add onto the list. But while many may not be convinced that it should be given a high priority, it is imperative that we act now, to avoid future costs for our economies, to say nothing of our futures.

Inability to meet the shipping and aviation security requirements may result in loss of markets for exports, increasing the costs of imports and loss of tourism receipts.

Although, the increasing demands for safety and security measures for airports and ports of entry places additional financial burdens on Pacific Island countries, failure to act may lead to more negative consequences in the future.

In short, the beauties of the region cannot

blind us to these important issues we face in the here and now. Security is a multi-faceted notion, it takes many local forms but there is no use in our denying the need to respond adequately and appropriately to what is going on in the wider world. We have done this many times in the past. We must do it again.

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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).