RESERVE BANK OF FIJI

Monetary Policy Statement
May 2007

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1.0 Executive Summary

Following growth of 3.4 percent in 2006, the Fiji economy is expected to contract by 2.5 percent in 2007. The growth in 2006 was broad based across most sectors of the economy. In contrast, an economic decline is expected this year, largely due to anticipated weak performances across major sectors of the economy, such as building & construction; community, social & personal services; mining & quarrying; wholesale & retail trade and hotels & restaurants and transport & communication.

The trade deficit widened further in 2006, increasing to around $1.9 billion from $1.5 billion in the previous year. The outcome was largely influenced by a 14 percent increase in imports to around $3.1 billion, which more than offset a 0.8 percent increase in exports that totalled $1.2 billion. Latest indicators suggest that the trade deficit will continue to widen in 2007, in spite of some slow down in imports growth, on the back of the expected economic contraction.

The current economic environment has made the Reserve Bank's conduct of monetary policy to achieve its twin objectives, more challenging. Inflation, while still low, has risen in the first 4 months of 2007. In addition, foreign reserves, although currently at adequate levels, continue to fall, prompting the Bank to tighten credit and exchange controls. At the end of April, inflation was 5.4 percent while the foreign reserves level of $832.6 million was sufficient to cover 3.4 months of imports of goods.

In light of the underperformance of exports, the widening trade deficit and declining foreign reserves, the Reserve Bank continues to maintain a tightening bias as regards to its monetary policy stance. The policy indicator rate, however, has been maintained at 4.25 percent since June last year.

In line with the Reserve Bank's policy actions interest rates have risen, credit growth has slowed and anecdotal evidence on partial indicators suggest domestic demand is dampening.

Looking ahead, the Bank expects that economic conditions will remain weak for the remainder of the year, with pressure remaining on Fiji's external position. The weak Balance of Payments position has prompted the shift in policy focus of the Reserve Bank in its conduct of monetary policy from interest rates to a credit ceiling. It has also necessitated the tightening of access to domestic credit by non-resident controlled companies and individuals.

The major challenge for the economy at this stage and into the medium-term lies predominantly in correcting the trade imbalance via the promotion of exports. The Reserve Bank will continue to monitor economic developments closely and set policies to maintain macroeconomic stability and safeguard Fiji's financial position.

2.0 Monetary Policy Discussions

2.1 Monetary Policy Issues

The monetary policy objectives of low inflation and adequate level of foreign reserves were met in 2006. Year end inflation was 3.1 percent and foreign reserves were $880 million, sufficient to cover 3.7 months of imports of goods. Fiji's economic growth is estimated at 3.4 percent in 2006. Finance, insurance, real estate & business services; community, social & personal services and building & construction were the major sectors estimated to have driven growth last year.

This year, the economy is projected to fall by 2.5 percent, largely as a result of the reduction in tourist arrivals, a contraction in the building & construction sector, anticipated lower government operational expenditure and the cessation of gold production due to the closure of the Emperor Gold Mining Company Limited (EGM).

Recent information on domestic activity suggests that economic conditions have weakened over the past few months in line with the economic contraction projected for the whole year. Latest business expectation surveys indicate below average trading conditions for the economy in the short-term, when compared to the sentiments expressed in earlier surveys. Consumer demand is also relatively lower as suggested by partial indicators. For instance, net Value Added Tax (VAT) collections, cumulative to April 2007 fell, when compared with the corresponding period in 2006. The weak consumer demand is also underpinned by lower employment prospects and the relatively subdued income growth expected for the year as suggested by results of the latest Fiji Employers Federation Survey conducted by the Bank.

The results of the business expectations survey, however, had also revealed that the medium-term outlook for investment in plant & machinery remained positive, despite the pessimistic outlook for the short-term. At the same time, imports of investment type goods rose in the first 2 months of this year together with lending to the building & construction and real estate sectors. Overall, anecdotal evidence suggests that while short-term prospects remain bleak, firms appear to be expecting a turnaround in economic conditions towards the end of the year.

In terms of external balances, Fiji's current account remained in a deficit in the third quarter of 2006 totaling $303.5 million, following a deficit of $330.7 million in the previous quarter. The trade and income account recorded deficits, while the services and current transfers were in surplus. The balance on the capital account in the third quarter of 2006 also recorded a deficit of $2.5 million, driven largely by capital outflows.

In light of the tightening of monetary policy and the imposition of the credit ceiling, money and credit aggregates developments moved in line with expectations. In the year to March, broad money supply rose by 14.9 percent to $3.0 billion but declined by 1.5 percent compared with the end of 2006. The more recent outturn was largely attributed to the decline in demand deposits and currency in circulation. Time deposits, however, grew by 2.7 percent in March over the end of last year to $1.3 billion. The build-up in time deposits during the year was largely due to higher interest rates that were offered across all maturities.

Latest data indicate that the annual growth in domestic credit is now slowing after peaking at around 30.7 percent in April last year. In the year to March 2007, domestic credit growth slowed to around 16.7 percent to $2.9 billion after an expansion of 23.6 percent in December 2006. The deceleration in credit was similar across the private sector, government and statutory authorities. Loans by commercial banks and credit institutions have also slowed in the first few months of this year.

Interest rates generally trended upwards in 2006 in line with the Reserve Bank's contractionary monetary policy. The commercial bank weighted average lending rate rose by 127 basis points to 7.89 percent while the time deposit rate rose by 702 basis points to 9.05 percent at the end of last year, compared with the end of 2005. More recently, however, the weighted average new time deposit rates have fallen from 12.41 percent in December to around 8.38 percent at the end of March, largely as a result of better liquidity conditions in the market.

For this year, as per the revised 2007 National Budget, the Interim Administration is expected to maintain a slightly expansionary fiscal stance given its budgeted underlying deficit of $106.7 million, equivalent to 2.1 percent of Gross Domestic Product (GDP), for 2007. This compares with the 2006 underlying deficit of $193.1 million, or 3.8 percent of GDP.

The conduct of monetary policy has become increasingly challenging in the current economic environment. The sluggish performance of our exports, escalating imports, subsequent drop in foreign reserves and the current slump in economic activity continues to be of concern and pose challenges for policy formulation.

2.2 Monetary Policy Stance

The Reserve Bank will continue to devise and implement policies aimed at protecting Fiji's Balance of Payments (BOP) position. Maintaining an adequate level of foreign reserves will be the primary focus of monetary policy given its importance for international trade and the smooth functioning of the domestic economy. This objective is now much more pronounced, against the outlook for lower tourism earnings and foreign investment.

In order to dampen credit and import demand, the Reserve Bank has imposed a credit ceiling and raised interest rates on its lending facilities to commercial banks following the events of December 2006. To stem capital outflows, exchange control measures were tightened with the delegation authority of commercial banks on some transactions now withdrawn. Additionally, non-resident businesses' borrowings from domestic sources will be gradually reduced and lending to non-resident individuals to purchase properties will be restricted from January 2008.

Despite the tightening measures, the Reserve Bank is also mindful of the current slowdown in economic activity. Against this backdrop, the Reserve Bank has taken steps to encourage commercial banks to prioritise lending to export oriented businesses, investment related projects and small to medium enterprises within the credit ceiling. Moreover, if credit has reached the ceiling, lending for such purposes will be considered outside of the credit ceiling. The Reserve Bank has also reduced the statutory reserve deposit ratio that commercial banks hold with the central bank from 7 percent to 6 percent, from May 1st. This should inject liquidity into the banking system, put downward pressure on interest rates and facilitate investment and growth.

The economy has largely been consumption driven over the last few years, which has been reflected in the widening trade deficit. As such, the policies implemented by the Reserve Bank during 2006 and so far this year is principally aimed at preserving our external position. The interest rate hikes, tight liquidity conditions coupled with the imposition of the credit ceiling and downturn in economic activity has led to a slowdown in lending activities by institutions in our financial system. Partial indicators and anecdotal evidence also suggest aggregate demand has dampened. While these developments were anticipated, policy focus remains on protecting foreign reserves.

3.0 Developments and Expectations

3.1 International Developments

After growing vibrantly by an estimated 5.4 percent in 2006, the world economy is expected to grow at a slower pace of around 4.9 percent this year. Global growth is expected to moderate as a slowing housing sector cools the US economy, while the gradual withdrawal of monetary and fiscal stimulus eases growth in the Euro region. During the first three months of 2006, world economic conditions remained upbeat, with the US and China continuing to be the key drivers of the expansion. Despite the recent slowdown of the US economy, the overall contribution towards global growth remains significant. This is further complemented by the consistently vigorous growth rates of China and India.

The **US economy** is expected to slow to a 2.2 percent growth this year, after a robust growth of 3.3 percent in 2006. The lower growth projection reflects recent slowdowns in the housing sector and business investment. The economy, however, is expected to gather some momentum during the course of the year, as the drag from the housing sector dissipates. Conversely, the expected resilient personal consumption and improved net exports are expected to ward-off any full blown recession. Against the backdrop of weakening growth, the Federal Reserve has kept the key interest rate unchanged at 5.25 percent, after four rate hikes in 2006.

The **Australian economy** is forecast to grow by 2.6 percent this year, following a growth of 2.7 percent last year, supported by resilient domestic demand, business investment and exports. Economic indicators over the current quarter are also supportive of positive economic growth. Consumer and business confidence rose in March, while retail sales rose in February, after a mining and construction boom created jobs and buoyed consumer spending. The Reserve Bank of Australia (RBA) kept its benchmark interest rate unchanged at 6.25 percent so far this year, after three rate hikes last year.

New Zealand's economic growth is expected to pick up to 2.5 percent this year, from a 1.5 percent growth in 2006. Growth is expected to be driven by private consumption, business investment and exports. Latest data releases affirm that the economy is on track for a stronger growth this year. Business confidence continued to improve in February, while retail sales picked up in January. In line with the current economic upturn, the Reserve Bank of New Zealand hiked interest rates by 25 basis points in both March and April this year taking the official cash rate to 7.50 percent this year.

The **Japanese** economy is forecast to grow by 2.3 percent, supported by exports and business investment. This follows growth of 2.2 percent in 2006. The economy remains on track for positive growth this year, evident by recent economic data. The trade surplus surged in the first two months of the March quarter, due to an increase in exports to China and the US. Consumer confidence also gathered momentum in February, and pushed up household spending. The Bank of Japan raised its benchmark interest rate from 0.25 percent to 0.5 percent in the March quarter of this year, after the economy grew strongly in the final quarter of 2006.

Euro-zone economic growth is expected to fall to 2.3 percent this year, from 2.6 percent growth in 2006. Growth is expected to ease, reflecting the withdrawal of monetary policy accommodation and further fiscal consolidation. Nevertheless, latest indicators show encouraging economic activity so far this year. Positive results were driven by the Euro-zone's two largest countries, Germany and France. The Euro-region's manufacturing output expanded in February, led by a surge in exports. Retail sales picked up in March, after German consumer spending recovered from a tax increase at the beginning of the year. Consumer confidence also rose in March after increased investment and hiring by companies reduced the unemployment rate. In line with inflationary pressures, the European Central Bank (ECB) raised its benchmark interest rate by 25 basis points to 3.75 percent in March. This follows four rate hikes last year.

Crude oil prices have been volatile in the year to date. Prices initially fell in the early part of the year but have since recovered. Over recent weeks, prices have hovered around US$69 per barrel. This compares to a historical high of US$79 per barrel in early August last year. While prices are still lower than last year's highs, they are at relatively high levels. Concerns of strong demand and possible disruptions to supply have placed large upward pressure on oil prices this year. Adding to the pressure is heightened geo-political uncertainty, in particular, Iran's rejection of US and European demands to suspend nuclear research.

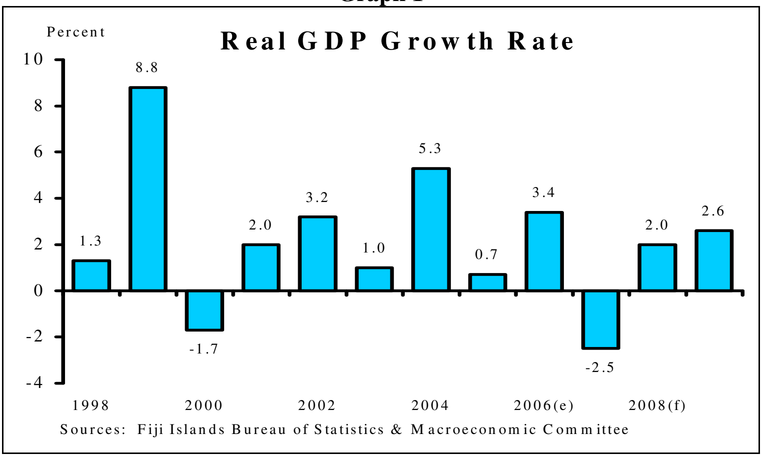
World market sugar prices have eased to around US11.08 cents early this year, after rising to a peak of around US19.00 cents in the first quarter of last year. Prices fell on speculation of increased production from Brazil and India. Higher energy costs had buoyed sugar prices last year, on speculation that the demand for ethanol, an alternative fuel produced from sugar, would increase.

3.2 Domestic Economic Conditions

The domestic economy is estimated to have grown by 3.4 percent (Graph 1) in 2006. The finance, insurance, real estate & business services; community, social & personal services and building & construction sectors are estimated to have underpinned growth last year. Also estimated to have contributed positively to growth were the agriculture, forestry, fisheries & subsistence; wholesale & retail trade and hotels & restaurants; electricity & water and manufacturing sectors. In contrast, the mining & quarrying and transport & communication sectors were a drag on the economy.

For 2007, the economy is forecasted to contract by 2.5 percent. Contributing to this year's projected decline are the building & construction; community, social & personal services; mining & quarrying; wholesale & retail trade and hotels & restaurants and transport & communication sectors. On a brighter note, the finance, insurance, real estate & business services; agriculture, forestry, fisheries & subsistence; manufacturing and electricity & water sectors are forecasted to contribute positively to this year's growth.

Graph 1



In 2008 and 2009, the economy is projected to expand by around 2.0 percent and 2.6 percent, respectively. Growth in 2008 is anticipated to be led by the finance, real estate & personal services; wholesale & retail trade and hotels & restaurants; transport & communication; manufacturing; agriculture, forestry, fisheries & subsistence and electricity & water sectors. For 2009, the finance, real estate & personal services; agriculture, forestry, fisheries & subsistence; manufacturing; transport & communication; wholesale & retail trade and hotels & restaurants and electricity & water sectors are forecasted to lead growth. The community, social & personal services; building & construction and mining & quarrying sectors are expected to contribute negatively to growth in both 2008 and 2009. Should positive developments arise in the mining and quarrying sector, in particular with the resumption of gold production, this could result in a growth in the sector in 2008 and beyond.

3.3 Sectoral Development

In line with the expected contraction of 2.5 percent in the economy this year, recent developments in partial indicators suggest weak domestic demand. Cumulative to April, net VAT collections amounted to around $134.5 million, a decline of around 7.9 percent over the corresponding period in 2006. In addition, growth in household income appears to be slowing somewhat as Pay As You Earn collections rose only slightly, by 0.1 percent, over the corresponding period in 2006, in contrast to the 11.8 percent annual growth registered in the comparable period last year.

On the investment front, latest partial indicators have shown mixed signals. Cumulative to February 2007, imports of investment type goods rose by 10.4 percent when compared with the corresponding period in 2006. Lending to private individuals for housing purposes and to the construction sector also rose. Nonetheless, domestic cement sales, a partial indicator for construction activity, declined cumulative to April this year on an annual basis. Additionally, as per the revised 2007 National Budget, capital construction by the Government is expected to fall by 0.7 percent over 2006 levels. Coupled with this, the stalling of several key projects is likely to result in a decline in investment levels this year. Consequently, investment is forecast at around 14.0 percent of GDP in 2007, much lower than the 19.0 percent of GDP provisionally estimated for 2006.

On a sectoral basis, the tourism industry continues to remain weak as evident in the lower number of visitors to Fiji. According to provisional data from the Fiji Islands Visitors Bureau (FIVB), visitor arrivals in the first three months of 2007 totalled 108,287, an annual decline of 5.5 percent over the corresponding period in 2006. For 2007, the FIVB had initially expected visitor arrivals to be lower than last year's level by 5.7 percent, at around 514,000. Some revision to these forecasts could occur, given the continued soft occupancy rates and forward bookings registered in the industry so far this year.

The sugar industry fared well in the 2006 season[1], with around 3.2 million tonnes of sugarcane crushed, representing a significant growth of 15.7 percent over the previous season's outcome. Cane harvests produced approximately 310,000 tonnes of sugar, around 7.0 percent more than the previous season. For the 2007 season, the sugar industry is expected to register a contraction of 4.5 percent. In addition, the February flash floods and the start of the crushing season in June, as opposed to the earlier target of May, is likely to affect the performance of the sugar industry.

In 2006, the building & construction sector registered notable growth. Latest statistics from the Fiji Islands Bureau of Statistics (FIBOS) revealed that cumulative to December 2006, the sector grew by around 16.9 percent on an annual basis with $316.7 million worth of work put-in-place by the private and public sector. Nevertheless, the sector is expected to register a contraction this year due to the completion of major projects and as certain projects are currently on hold, as a result of political uncertainties.

In contrast, latest data from the FIBOS indicated poor performance in the garment industry last year. Cumulative to September 2006, a little over $34.3 million worth of garments was produced. This represents a contraction of around 59.2 percent, when compared with the corresponding period in 2005.

[1] The 2006 crushing season lasted from 31 May 2006 to 11 January, 2007.

3.4 Balance of Payments

The current account deficit improved in the third quarter of 2006 amounting to around $303.5 million, following a deficit of $330.7 million in the previous quarter. The improvement in the current account deficit was due to a lower deficit recorded in the trade account and a higher surplus in the services account.

The balance on the capital account in the third quarter of 2006 also recorded a deficit of $2.5 million, driven by capital outflows. The financial account (excluding reserve assets) recorded a surplus during the review period, led by an increase in foreign investment into Fiji mainly due to the Fiji Government's debut issue of US$150 million of bonds in the international capital market.

The improvement in the financial account (excluding reserve assets) resulted in the overall BOP recording a surplus of around $297.3 million in the third quarter of 2006[2].

The trade deficit widened further in 2006, increasing to around $1.9 billion from $1.5 billion in the previous year. The outcome was largely influenced by a 14 percent increase in imports to around $3.1 billion which more than offset a 0.8 percent increase in exports that totalled $1.2 billion.

In the first 3 months of the year, merchandise imports declined by around 4.1 percent to total $655 million. This compares with a growth of around 24.3 percent in the corresponding period in 2006. While all categories of imports declined, the main drivers were consumption goods (-2.3 percent) and intermediate goods, predominantly mineral fuels (-1.4 percent). Investment goods (-0.4 percent) also contributed to the decline but to a lesser extent.

The slow down in outflow for consumption goods was attributed to the lower payments for manufactured goods, miscellaneous manufactured articles and beverages & tobacco. The decline in payments for intermediate goods was led by mineral fuels and crude materials, while lower payments for investment goods were largely underpinned by chemicals. Excluding mineral fuels, imports fell by 3.5 percent.

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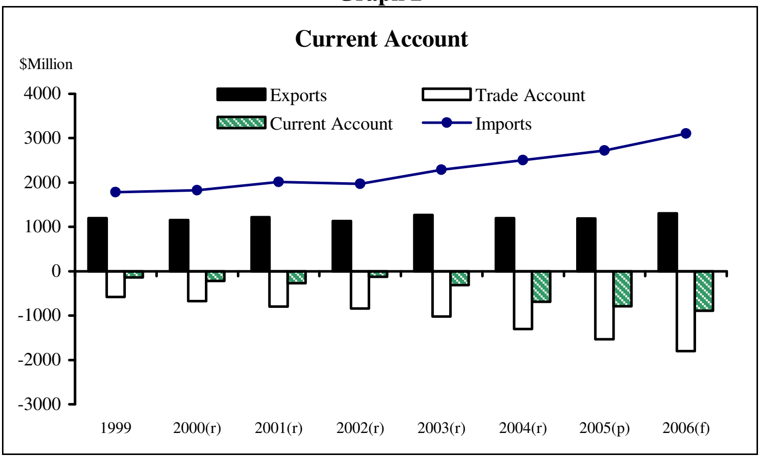
[2] Actual BOP data released by the FIBOS is up to quarter 3, 2006.

During the same period, merchandise exports declined by around 7.5 percent, compared with a growth of around 5.2 percent in the corresponding period last year. Domestic exports also declined by 7.4 percent. Leading the decline in domestic receipts were gold, molasses, garments, sugar, textiles and footwear & headgear. These more than offset the gains recorded in other sectors, such as fish, lumber, fruits & vegetables, coconut oil, yaqona, mineral water and others exports. With imports at $655.0 million and exports at a mere $231.7 million for the first quarter of this year, the resulting trade deficit of $423.3 million remains a concern.

This year, exports (excluding aircraft) are forecast to decline by 3.4 percent. Molasses, sugar, garments and footwear & headgear are expected to post declines while no gold production is projected. These are anticipated to more than offset the expected increase in earnings from coconut oil, timber, fruits and vegetables, fish and mineral water. Imports (excluding aircraft) on the other hand, is projected to grow by 5.7 percent. In particular, imports of machinery & transport equipments, chemicals and mineral fuels are expected to rise.

Graph 2



The current account deficit is expected to widen in 2007 to 25.0 percent of GDP. However the magnitude of the current account deficit is likely to be considerably less, given the large surplus errors and omissions figure equivalent to 19.3 percent of GDP which shows unaccounted inflows. The larger current account deficit reflects a higher trade deficit, compounded by lower surpluses for services and current transfers. The capital account is also forecast to be in deficit, at 0.3 percent of GDP, reflecting higher capital transfer outflows, mainly in the form of migrant transfers and non residents transfer of funds upon departure from Fiji. Reflecting these figures, the overall BOP deficit is projected to widen to 6.0 percent of GDP this year.

Growing imports amidst subdued exports underpin the large trade imbalance resulting in the significant current account deficit. This situation continues to place pressures on Fiji's foreign reserve levels. Gross foreign reserves at the end of April 2007 stood at $832.6 million, sufficient to cover 3.4 months of imports of goods. This compares to around $880 million of foreign reserves in December last year.

3.5 Fiscal Operations Of the Government

In line with its commitment to protecting and stabilising Government finances and building a solid platform for fiscal and economic sustainability through responsible financial management and increasing exports in the medium to long term, a revised 2007 National Budget was announced in March 2007, by the Interim Administration.

In the Revised National Budget, an underlying deficit of $106.7 million, equivalent to 2.1 percent of GDP has been announced. An asset sales projection of $6.0 million is expected to take the net deficit to $100.7 million, or 2.0 percent of GDP. This compares with the 2006 underlying deficit of $193.1 million, or 3.8 percent of GDP, and a headline deficit equivalent to 3.1 percent of GDP, taking into account the $36.0 million worth of asset sales realised last year.

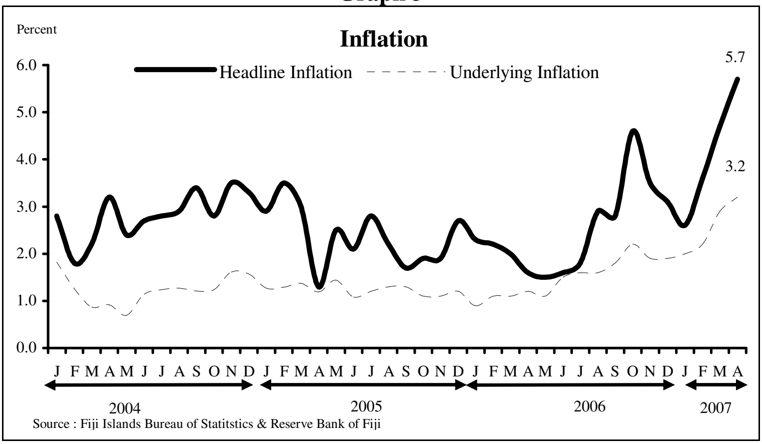
Government's outstanding debt for this year is projected at $2,979.2 million, equivalent to 58.5 percent of GDP. This compares with the 2006 debt level of $2,872.5 million, or 57.1 percent of GDP.

3.6 Inflation

In December 2006, inflation stood at 3.1 percent, generally in line with the projection of 3.5 percent. Inflationary pressures in 2006 were partly driven by institutional policy changes such as the Commerce Commission's approval of the introduction of electricity fuel surcharges as well as increases in fiscal and excise duties outlined in the National Budget announced in November 2006.

This year, consumer prices have been rising during the first four months, supported by higher prices of market items as a consequence of flash floods and adjustments to fiscal and excise duties announced in the revised 2007 National Budget (Graph 3). Inflation ranged between 2.6 percent in January to 5.7 percent in April 2007. The underlying measure of inflation, the trimmed mean, rose to 3.2 percent in April.

Graph 3



In the coming months, price pressures are likely to remain on the upside as prices of market items are anticipated to remain high for a few more months, given the usual time lag before normal supply is restored. Moreover, it has been noted that global oil prices have been rising again over recent months and may be reflected in domestic fuel prices in future local fuel price reviews by the Prices and Incomes Board. Presently, international crude oil prices are hovering around US$67 per barrel mark, compared to an average of US$58 per barrel recorded during the January-

March period.[3] Some cushioning effects, however, are expected to emanate from low average trading partner inflation, which stood at 2.1 percent in April.

However, incorporating the expected contraction in the economy this year, the 5.0 percent wage reduction in the civil service and subdued employment growth across some sectors, price pressures are likely to be contained to some extent. Furthermore, the Reserve Bank's monetary policy tightening measures last year are likely to impact household and business decisions this year, restraining demand and tempering upward pressures on prices. Considering the many developments and assessing expectations, 2007 year end inflation is forecast at 3.5 percent.

Potential risks to the inflation forecast are, *inter alia*:

Externally:
- Unanticipated increases/decreases in international crude oil prices;
- Adverse currency movements; and

Domestically:
- Natural disasters; and
- Changes in import duties and tax rates.

3.7 Labour market

Employment conditions deteriorated for certain sectors of the economy during the last two months of 2006. According to the Fiji Employers' Federation (FEF) Employment Disruptions Survey, political tensions during the review period caused a decline in tourist arrivals forcing some major resorts and hotels to lay off casual and part-time employees. This was further exacerbated by the closure of the EGM and the ensuing loss of employment for 1,615 individuals in December last year. However, the fall in employment appears to have been largely contained within the hotel and mining sectors. This was reflected in overall taxpayer registrations, (a partial indicator of employment) which rose by around 20.0 percent in 2006, over 2005 levels.

In 2007, cumulative to April, around 6,500 employees were registered as new taxpayers, representing an annualised increase of around 33.0 percent. The community, social & personal services sector is the leading sector in

[3] This is based on the Brent crude oil futures price.

terms of the number of new taxpayers registered so far. This is followed by the wholesale & retail trade and restaurants & hotels; finance, insurance, real estate & business services and manufacturing sectors. The current increase of new taxpayers is not necessarily reflective of new employment but possibly of current positions left vacant due to migration and natural attrition. Nevertheless, a partial indicator it suggests some improvement in employment conditions since December 2006.

Looking ahead, labour market conditions are expected to remain soft in some sectors, given the flow-on dampening effects of the economic contraction forecasted for this year.

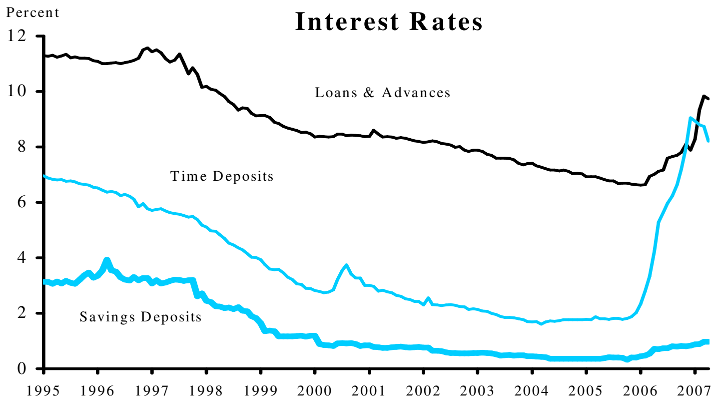
3.8 Monetary and Financial Market Developments

The Bank maintained its monetary policy tightening stance in the first 5 months of this year, with the policy indicator rate maintained at 4.25 percent. In addition to the interest rate hikes and increase in statutory reserve deposit ratio announced last year, the Reserve Bank took pre-emptive measures following the events of December 2006 to safeguard the financial system and stem capital outflows. The policies put in place included the tightening of exchange control measures, increasing interest rates offered by the Reserve Bank on lending facilities to commercial banks and the imposition of a credit ceiling on commercial banks lending activities.

The widening trade deficit and subsequent pressures on foreign reserves continue to be the main consideration of policy formulation and implementation. From a monetary policy perspective, the recent policies implemented by the Reserve Bank are mainly aimed at dampening consumption spending and to rein-in imports.

Following the interest rate hikes in 2006 and other monetary policy measures, market interest rates have generally trended upwards (see Graph 4). At the end of April, the commercial banks' weighted average lending rate had increased by 272 basis points to 9.73 percent from 7.01 percent at the end of the corresponding period in 2006. During the same period, the savings deposit rate rose by 26 basis points to 0.98 percent while the time deposit rate increased by 396 basis points to 8.20 percent. Interest rates on loans and deposit products offered by credit institutions and some Non-Bank Financial Institutions also increased during this time.

Graph 4



Source: Reserve Bank of Fiji

Similarly, interest rates on new loans offered by commercial banks also increased during this period rising by 382 basis points to 11.19 percent from 7.36 percent in the same period last year. More recently however, both lending and deposit rates have begun to fall as a result of improved liquidity conditions in the market.

Liquidity was tight in the third quarter of 2006 reaching as low as $39 million and subsequently triggering significant upswings in interest rates. Nevertheless, as liquidity conditions improved towards the end of last year and into the early months of this year, interest rates on deposits began to fall.

New time deposit rates fell from 12.41 percent in December 2006 to around 6.29 percent at the end of April of this year. During the same period, the weighted average outstanding time deposit rates declined from 9.05 percent to around 8.20 percent. In contrast, the weighted average lending rates as at the end of April, compared with the end of 2006, was higher, indicating that commercial banks cost of funds may be still high after locking up on high interest rates on term deposits towards the end of last year. However, once these term deposits with high interest rates mature, it should allow banks room to review lending rates. Latest data indicate that lending interest rates are coming down, with the weighted average lending rate at the end of April falling by 11 basis points to 9.73 percent over the previous month.

In line with interest rate developments in the banking sector, interest rates also rose in the money and capital markets. The yield on 91 Day T-Bills rose by 469 basis points to 8.63 percent from 3.94 percent in the corresponding period last year. However, compared with December 2006 where T-Bills rate were around 12.80 percent, yields have declined to 5.44 percent at the end of April this year. There were issues of 5, 10 and 15-year Government bonds in April, with weighted average interest rates of 7.73, 8.79 and 12.71 percent respectively.

Broad money supply declined by 1.5 percent in the year to March to $3.0 billion, compared with the end of 2006. The recent outturn was largely attributed to the decline in demand deposits and currency in circulation. On an annual basis, broad money rose by 14.9 percent largely due to significant increases in time deposits. In the year to April, time deposits rose by 67.8 percent to $1.3 billion over the same period last year largely as a result of high interest rates that were offered across all maturities.

Latest data indicate that the annual growth in domestic credit is slowing compared with a year ago. In the year to December 2006, domestic credit rose by 23.6 percent, down from a high of around 30.6 percent in April of the same year. In March this year, annual growth in domestic credit slowed further to around 16.7 percent. The deceleration in credit was similar across the private sector, government and statutory authorities.

Private sector credit rose by 17.5 percent in March, lower than the 30.7 percent in April of 2006, fuelled by higher commercial bank lending to private individuals and major sectors such as the wholesale & retail trade, manufacturing, real estate and building & construction.

The majority of advances to the private individuals sector were for housing purposes, making it the single largest sub-sector to which commercial bank lending is directed. Lending for housing purposes, at around $627.8 million at the end of April, accounts for 78.8 percent of total loans to private individuals and 25.7 percent of total outstanding loans in the banking system.

The Reserve Bank, in recognizing the importance of the Housing sub-sector to the stability of the financial system, has requested commercial banks to assist customers who may be facing financial problems in servicing their loans in the current economic environment.

Since the implementation of tightening monetary policy measures and the credit ceiling towards the end of last year, a notable slowdown in credit has been observed. Growth in commercial bank credit has slowed to around 12.9 percent at the end of April, down from a high of 29.0 percent in May of last year. On a monthly basis, credit growth has been less than 1 percent averaging around 0.2 percent in the first 4 months of this year. This outturn is in line with the Reserve Bank's expectations.

The monetary policy tightening bias together with the current credit ceiling is expected to slow credit growth in the months ahead.

3.9 Exchange Rate

Bilateral movements in the exchange rate at the end of April showed that the Fiji dollar had strengthened against the Yen and US dollar but weakened against the New Zealand and Australian dollars as well as the Euro. Recently, the US dollar has been weakening against major currencies.

The Fiji dollar has risen by 3 percent against the US dollar increasing from US$0.6009 at the end of 2006 to US$0.6191 at the end of April this year. The general appreciation of the Fiji dollar was also reflected in the rise of the Nominal Effective Exchange Rate (NEER) by 0.3 percent at the end of March. During the same period, the Real Effective Exchange Rate Index (REER) of the Fiji dollar, which adjusts the NEER for inflation differentials across Fiji's major trading partners, also rose by 2.8 percent, implying a deterioration in our competitiveness externally.

The movement of the domestic currency, under the current exchange rate arrangement has been relatively stable and is expected to remain so with no significant fluctuations envisaged in the near future.

4.0 Fiji: Key Economic and Financial Indicators

Table 1

INDICATOR ($m)	2003	2004	2005	2006	Mar-07
Broad Money Supply	1,980.5	2,185.7	2,513.8	3,012.3	2,968.1
Domestic Credit	1,662.9	1,871.2	2,368.6	2,927.6	2,960.0
Private Sector Credit	1,326.4	1,565.8	1,949.3	2,411.5	2,435.4
Net Credit to Government	236.4	178.1	277.5	356.1	349.6
Net Foreign Assets	897.3	1,010.1	753.0	806.2	714.4

Table 2

INTEREST RATES	2003	2004	2005	2006	Apr-07
RBF Policy Indicator Rate	1.25	1.75	2.25	4.25	4.25
Lending rate	7.39	7.03	6.63	7.89	9.73
New Lending Rate	7.92	6.91	6.62	9.75	11.19
Time Deposit Rate	1.70	1.77	2.03	9.05	8.20
New Deposit Rate	0.76	1.43	2.23	12.41	6.29
Savings Deposit Rate	0.45	0.36	0.40	0.84	0.98
Credit Growth	17.7	19.3	22.8	21.4	12.9

Table 3

INDICATOR	2004	2005	2006	2007(f)
CONSUMER PRICE INDEX (annual % changes)				
Headline	3.3	2.7	3.1	4.0
Trimmed mean	1.6	1.2	1.9	-
BALANCE OF PAYMENTS (F$M)				
Current account	-618.3	-621.1	-1084.2	-1281.1
Financial account	273.5	196.9	453.6	312.5
Overall balance	-78.4	199.6	-57.4	304.8
Gross Int. Reserve	1045.6	822.4	879.9	n.a
Import Cover (Goods)	5.6	4.0	3.7	n.a
FISCAL OPERATIONS OF THE GOVERNMENT				
Underlying Deficit (F$M)	-146.6	-168.6	-193.1	106.7
% of GDP	-3.3	-3.5	-3.8	-2.1
GROSS DOMESTIC PRODUCT (annual % growth)				
Real GDP	5.3	0.7	3.4	-2.5
Nominal GDP	7.9	3.4	5.9	1.0