Monetary Policy Statement December 2016

RESERVE BANK OF FIJI

Table of Contents

1.0 Monetary Policy Objectives, Formulation and Implementation

The Reserve Bank of Fiji (RBF) is responsible for the formulation and implementation of monetary policy to achieve the twin objectives of maintaining price stability and an adequate level of foreign reserves.

Monetary policy formulation is guided by both international developments and domestic economic considerations and their potential impact on the outlook for inflation and reserves.

Monetary policy is implemented through changes in the overnight policy rate (OPR), which is the RBF's main policy instrument. This rate is used by the RBF to communicate and signal its monetary policy stance. The OPR has been maintained at the current 0.5 percent since November 2011 in line with the stable outlook for inflation and foreign reserves.

2.0 Macroeconomic Assessment

A. Background

At the beginning of 2016, global growth for the year was projected at 3.6 percent. Domestically, the Fijian macroeconomic situation was expected to evolve broadly in line with the 3.5 percent gross domestic product (GDP) growth projection for 2016. The year-end outlook for the RBF's twin monetary policy objectives was more upbeat. Inflation was forecast at 2.0 percent while foreign reserves were expected to remain comfortable around the $2.0 billion mark.

Nonetheless, sizeable shocks on both the domestic and global fronts in the first three quarters of the year resulted in a re-assessment of macroeconomic forecasts for GDP, trade, balance of payments (BOP), fiscal balance, inflation and foreign reserves. Firstly, tropical cyclones (TCs) Winston and Zena substantially impacted domestic economic outcomes. Secondly, global risks increased significantly, as weaker prospects for external demand materialised for some of our major trading partners outside of the tightening in financial conditions and continued weaknesses in real sector and trade data to date.

B. Recent Developments

International Economic Update

More recently, despite the uptick in the economic performance of the United States (US) in the third quarter of 2016 and growth in emerging market economies particularly China and India remaining strong, the surprise 23 June vote by the United Kingdom (UK) to exit the European Union (EU) introduced much uncertainty – on the economic, political and institutional fronts – that represents a notable downside risk to global growth in 2016. Sentiments on the impact on global growth of the US November presidential elections outcome remain mixed. Even so, weaker growth prospects, unemployment, debt overhang and weak banks remain as salient crises legacies. Geopolitical tensions and bouts of financial volatility further complicate the uncertain outlook on future economic prospects.

Consequently, the International Monetary Fund lowered its global growth projection for this year to 3.1 percent in October (0.1 percentage point (pp) lower than the April forecast of 3.2 percent

and unchanged from the July projection).

Global growth remains below trend in the year to October as longstanding vulnerabilities persist from several years ago.

This reflected downward revisions in growth projections for most major economies from the July outlook, with the exception of the Euro zone[1] and India. In particular, the weaker-than-expected performance in the US during the first half of the year, a sharp Yen appreciation following 'Brexit' and relatively weak Chinese manufacturing dominated economic outcomes. In 2017, global growth is expected to be 3.4 percent (-0.1pp), contingent on China's successful rebalancing, stability in commodity exporting countries and lower uncertainty from the 'Brexit'. For most of Fiji's trading partners, growth outcomes for 2016 are projected to be subdued relative to trend with some recovery expected in 2017. Looking ahead, the extended low growth cycle also leaves the global economy exposed to further downside risks. In addition, prolonged softness in commodity prices and sizeable spare capacity across a wide range of economies are also keeping global inflation quite low.

Monetary policy, which is already set at unprecedented stimulatory levels, will therefore continue to be mostly accommodative. In fact, the readiness by both the Bank of England and the European Central Bank to immediately provide liquidity after 'Brexit' meant that confidence in market resilience has grown into July, despite the initial severe market reaction seen in late June. As a result of sizeable monetary accommodation, global interest rates remain at historical lows. More broadly, policymakers will need to be prepared for further near-term demand policies if the impact of higher uncertainty and continued softness in economic outcomes considerably weaken the current global economic outlook. Nonetheless, the current strengthening in the US economy has led to the recent rate hike by the US Federal Reserve and increased expectations for further rate increases in the near term.

[1] Strong domestic and investment demand were noted in the first quarter.

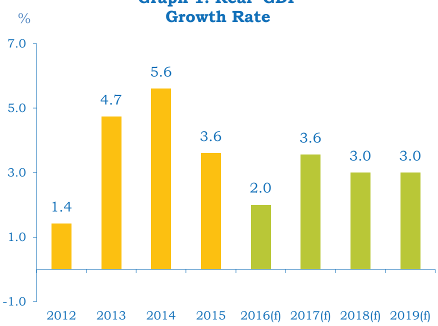
Domestic Economic Update

Despite a weaker global economy, the Fijian economy has grown quite strongly between 2013 to 2015, supported by a credit cycle upswing, strong remittance inflows, accommodative fiscal and monetary policies and improved consumer and investor confidence.

In 2015, the domestic economy is estimated to have recorded its sixth year of consecutive growth at 3.6 percent

(Graph 1), together with all-time high visitor arrivals, remittance inflows, tourism earnings and foreign reserve holdings. On the RBF's monetary policy objectives, inflation was at a modest 1.6 percent helped by lower global oil prices and improved terms of trade, which also helped reduce Fiji's import bill and consequently shored up foreign reserve assets to $1,943.7 million at the end of 2015. Moreover, lower costs generated a growth dividend especially in the key transport, tourism and retail sectors.

Graph 1: Real GDP Growth Rate



Sources: Fiji Bureau of Statistics and Macroeconomic Committee

However, in 2016, Fiji's economic growth projection was further revised down to 2.0 percent (from earlier anticipated forecasts of 2.4% and 3.5%). The lower growth reflected the larger-than-expected negative impact from the natural disasters (including TCs Winston and Zena in February and April this year). ***Growth is expected to recover to 3.6 percent in 2017.*** The key sectors negatively impacted by these natural disasters were agriculture, especially sugar cane; sugar manufacturing; utilities such as electricity and water and the forestry industry. Nevertheless, growth this year remains broad based led by the six leading growth sectors[2]. The adverse impact of these natural disasters on the tourism industry was initially estimated to be minimal as the cyclones mostly affected areas outside Fiji's main tourism belts and also occurred during the off-peak tourist season. Nonetheless, monthly visitor arrivals from our key market, Australia, have contracted on an annual basis from April to September this year, together with cumulative monthly arrivals from May to October. Overall Australian short term departures, cumulative to September 2016, increased by 5.4 percent, up from the 3.1 percent growth in the same period in 2015.[3] However, a general slowdown was noted in short term Australian departures to the Oceania region, underpinned by reduced departures to Papua New Guinea and Fiji. On a positive note, arrivals from New Zealand (16.5%) and China (24.3%) continued to grow on an annual basis in the ten months to October. In the same period, annual increases in visitor arrivals were also noted from the 'Rest of Asia' category (56.7%), South Korea (22.8%), India (18.6%), Continental Europe (2.2%), the US (1.1%), Pacific islands (1.6%) and the UK (0.6%).

Evidently, some sectors are benefitting from the impetus provided by rehabilitation efforts post-natural disasters. Consumption was strong into September this year, supported by the Fiji National Provident Fund's (FNPF) $275.0 million payout for post TC Winston rehabilitation, Government's $70.0 million 'Help for Homes' program, additional welfare payments made under the Social

[2] These are transport & storage, wholesale & retail trade, public administration & defence, construction, accommodation & food services activities and financial & insurance activities.
[3] Australian Bureau of Statistics.

Welfare Scheme, special loan arrangements and repayment holidays offered by commercial banks as well as the natural disaster rehabilitation facility provided by the RBF. The reduction in the valued added tax (VAT) rate to 9.0 percent from 15.0 percent in January 2016, remittance inflows, firm labour market conditions and relatively cheaper credit confirm the anticipated buoyant wholesale and retailing activity this year.

Investment remains firm boosted by Government's spending on infrastructure and post TC Winston reconstruction. The reconstruction work being carried out after the cyclone points towards further growth in residential investments apart from replacement of destroyed capital stock. Cumulative to June and October, annually higher values of work put-in-place (10.3%) and domestic cement sales (10.0%) reveal robust construction-led investment activity. Looking ahead, Government's planned capital spending for post cyclone reconstruction as announced in the 2016/2017 National Budget will help hold up investment in 2016 as well as next year. Overall, investment is estimated to have been around 22.0 percent of GDP in 2015 and is projected to be close to the Government's target of 25.0 percent of GDP in 2016.

Labour market conditions continue to improve from 2012, in line with Fiji's economic growth. Higher (9.5% cumulative to October) recruitment intentions as per the RBF's Job Advertisements Survey indicate favourable labour market conditions, particularly in the electricity & water; transport, storage & communication; construction and wholesale & retail trade sectors. Looking ahead, overall employment prospects are expected to remain favourable, supported by recovery efforts post natural disasters, the current outlook for growth and positive recruitment sentiments expressed in the June 2016 Business Expectation Survey (BES).

The credit cycle upswing from 2013 to 2015 is slowly unwinding, at least for commercial banks. Cumulative to October, the growth in commercial banks' new loans slowed to 5.1 percent ($99.4m) from a growth of 20.0 percent ($322.6m) in the same period in 2015. Outstanding credit growth decelerated to 9.3 percent ($500.2m) in October from 14.5 percent ($683.2m) in the comparable period in 2015. In fact, new housing loans contracted into the first ten months of 2016 by 6.5 percent. This is a welcome development given concerns on the sustainability of the credit cycle and the impact of credit growth in fueling house prices. In contrast, new lending by licensed credit institutions (LCIs) has picked up strongly with double digit growth of 31.5 percent ($45.7m)[4] noted in the year to October, reflecting competition by financial sector players to increase their market share.

The slowdown in bank credit growth and increased competition have been associated with lower interest rates. The commercial banks' weighted average outstanding lending rate decreased marginally over the year from 5.82 percent to 5.81 percent in October 2016. Similarly, the weighted average new lending rate also declined to 6.86 percent from 6.91 percent over the same period. In terms of the funding costs of banks, both the new

[4] The double digit growth is also linked to new entrants – Bank of South Pacific Finance and Kontiki Finance Limited into the market.

and existing time deposit rates rose over the year in October to 2.52 percent and 2.94 percent, from 2.26 percent and 2.59 percent, respectively, in October 2015. However, the savings deposit rate declined to 0.90 percent in October from 1.00 percent a year earlier. All in all, the financial system remains stable and sound.

Accommodative fiscal policy has supported economic growth and remains expansionary. Strong fiscal spending on infrastructure development, health, education and social programs remain key drivers on the Government's agenda to achieve sustainable and more inclusive growth. Specifically, higher spending allocation in the latest 2016/2017 National Budget was envisaged due to the national reconstruction efforts. The higher fiscal deficit for the 2016/2017 fiscal year reflects the afore-mentioned spending that coincides with Government's intention to further improve its capital/operating spending mix. Slower execution of infrastructure projects may yield a lower deficit, whereas underperforming privatisation proceeds could worsen Fiji's fiscal position. Nonetheless, the injection of around $200.0 million via two multilateral policy loans, $100 million of which has been received, will, at a minimum, further support domestic spending outside of the impact on import demand.

Fiji's nominal effective exchange rate remained largely unchanged on an annual basis, however higher domestic inflation outcomes have driven the appreciation in the real effective exchange rate (REER). Looking at bilateral nominal movements from January to November 2016, on an annual basis, the Fiji dollar (FJD) largely appreciated against the US dollar (USD) in the first eleven months of the year while generally weakening against the Australian and New Zealand dollars. The FJD has consistently depreciated against the Yen since January. Fiji is largely insulated from global financial markets developments. With foreign reserves consistently and strongly rising from 2009 and Fiji's improving terms of trade since 2014 due to low fuel costs and therefore import prices, internal equilibrium estimates suggest that Fiji's current REER is somewhat consistent with medium term fundamentals.

3.0 Monetary Policy Objectives: Outcomes and Outlook

Monetary policy has remained accommodative since November 2011, when the OPR was reduced to the current 0.5 percent.

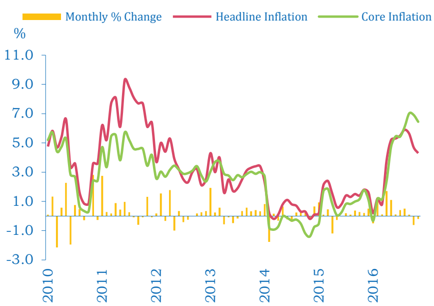
Inflation has been muted since 2014 due to subdued global oil and food prices and in line with restrained demand in Fiji's main trading partners.

In addition, strong earnings from tourism, remittances and positive foreign direct investment (FDI) against soft import demand have ensured a comfortable level of foreign reserves over the same period.

A. Inflation

Over the last three years, inflation has been generally low, averaging 1.7 percent annually, below a five year average of 2.8 percent and the ten year average of 4.0 percent. Inflationary pressures were notably subdued in 2014 and 2015, with year-end inflation at 0.1 percent and 1.6 percent, respectively (Graph 2). Below trend international oil and food prices and soft trading partner inflation have kept imported inflation low in recent years.[5]

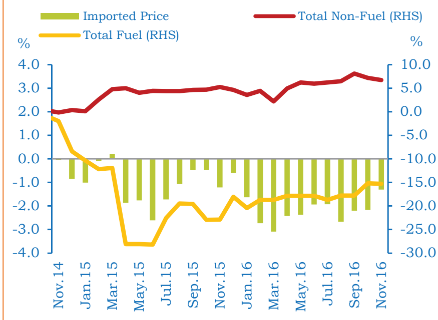
Graph 2: Inflation



Source: Fiji Bureau of Statistics

Fuel prices have subtracted from imported inflation since January 2015 (Graph 3). While this has yielded benefits for economy-wide consumption and investment, the trend of low oil prices has been unusual for policy making. Previously, imported inflation often reflected temporary price movements such as sharp spikes in global commodity prices, and therefore monetary policy has largely discounted these transient price developments to determine the underlying trend in inflation. However, subdued inflation outcomes have become the norm and expectations around softer inflation outcomes may have become embedded as a result.

Graph 3: Import Index, Fuel Index, Non-Fuel Index (y-o-y)



Sources: Fiji Bureau of Statistics and Reserve Bank of Fiji Estimates

One-off shocks from domestic structural changes – notably the fee-free primary and secondary education initiative in 2014 and the reduction in the VAT rate this year – in addition to the general appreciation of the Fiji dollar have kept inflationary pressures in check. Although varying in impact, these domestic policies had largely put downward pressure on inflation.[6] Price pressures from domestic demand have also been relatively muted as some sectors operate below potential, with the exception of the strong performing construction industry where capacity pressures may be building.

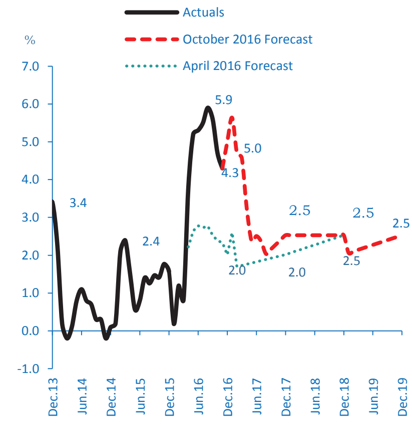
[5] As a result, the Fiji Commerce Commission began reflecting a general decline in domestic fuel and gas prices from April 2014.

[6] Apart from the usual increase in duties on alcohol and tobacco, Government in 2014 introduced a fee-free education policy as well as free school bus fares for both primary and secondary students. In 2016, the Government reduced the VAT rate from 15.0 percent to 9.0 percent, removed zero VAT on basic necessities, introduced an Environmental Levy (6.0%) and increased Service Turnover Taxes (from 5.0% to 10.0%).

Consequently, core inflation, as measured by the exclusion of volatile items and recent shocks – food and energy[7] - has followed a similar trend (Graph 2).

More recently, annual inflation rose significantly and remained above the 5.0 percent mark for five consecutive months. After peaking in August 2016 (5.9%), inflation fell to 4.3 percent in November. The recent spike in inflation was mainly due to supply shortages of agriculture market items such as vegetables and yaqona caused by the recent natural disasters. While prices of some vegetables and fruit have fallen since the price shock this year, prices of agricultural items with longer growth timeframes, particularly yaqona have not normalised as expected. In addition, certain fiscal measures[8] announced via Government's 2016/2017 National Budget will put upward pressure on prices for the rest of 2016. Consequently, due to the strong upward biases to price pressures, the 2016 year-end inflation forecast was revised upward to 5.0 percent (Graph 4). However, more recently (October and November), prices of food grew at a slower-than-expected rate suggesting some downward bias in the current year-end projection. In terms of risks, any significant rebound in global oil and food prices would fuel imported inflation. On a positive note, given expectations that domestic agricultural supply levels should normalise, global oil prices to trend below 2014 levels and low trading partner inflation to continue; currently high inflationary pressures are expected to wane over the medium term.

Graph 4: Inflation Forecast



Sources: Fiji Bureau of Statistics and Reserve Bank of Fiji

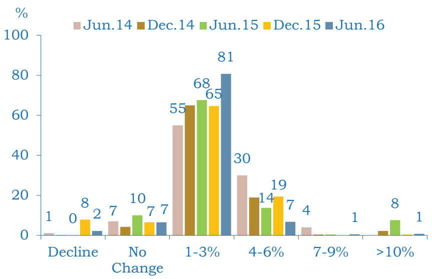
In line with our expectations for reduced inflationary pressures, the June 2016 BES results point to marked softening in inflation expectations over the next 6 to 12 months. The sizeable reduction in positive expectations (-12pp) for the 4.0 to 6.0 percent inflation range and considerable increase (+16pp) for the 1.0 to 3.0 percent inflation range from the previous survey (Graph 5) may point to increased anchoring of inflation expectations around the 3.0 percent range. For one, price developments for prominent items in the consumption basket influence expectations. In fact, prolonged low global oil prices and imported inflation are evidently influencing domestic expectations for continued softness in general price developments. The risk for effective monetary policy is that low inflation expectations affect future inflation by

[7] The free education policy and high yaqona prices were removed in the calculations to obtain a better picture of the underlying trend of inflation.

[8] These included an increase in duty (15.0%) on alcohol, tobacco and cigarettes and higher levy on sweetened drinks and duty on second hand vehicles.

raising real interest rates and therefore reducing the stimulatory effect of nominal interest rates on the economy. However, pent up demand and increased competition amongst financial institutions have meant that nominal lending rates remained competitive and have supported the credit cycle.

Graph 5: Inflation (Medium Term Expectations)



Source: Reserve Bank of Fiji

In addition, low inflation outcomes from 2014 to early 2016 have fed into the current inflation expectations, as households and firms have adapted their expectations accordingly despite the temporary hike in prices mid-year. Even so, expectations for inflation in the 7.0 to 9.0 percent and greater than 10 percent ranges have risen to 1.0 from 0 in the previous survey, which may reflect the short term impact of the recent natural disasters on prices, lagged sentiments and industry specific expectations.

For 2017, inflation is forecast at 2.5 percent. These projections account for the fallout of 2016 high prices from calculations in 2017 as well as a gradual recovery in global oil prices from 2017 which is reflected in recent Brent crude oil future prices. Currently, Brent future prices are forecast to average US$56.06 per barrel in 2017 and reach an average of US$56.40 per barrel in 2018. The anticipated continued recovery in the world economy; pick up in trading partner inflation and potential US Federal Reserve rate hikes are expected to put upward pressure on imported inflation. Risks to the outlook include prolonged supply-side shortages due to natural disasters, possible changes in domestic policies and larger-than-expected increases in global food and oil prices. In addition, although currency crosses at the moment have muted the impact of a stronger USD, continuous appreciation of the USD together with a bigger increase in commodity prices can present inflationary risks, leading to higher imported inflation passed through both exchange rates and commodity prices in the medium term.

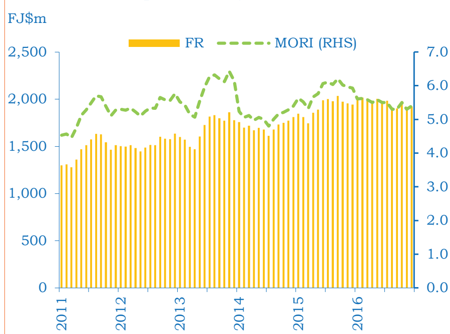
B. BOP and Foreign Reserves

Since 2013, foreign reserves have continued to trend higher on the back of improved performance in tourism earnings, remittance inflows as well as exports of sugar, mineral water, garments, gold, fish and timber. Foreign reserves remained comfortable at $1,896.7 million at the end of November 2016, sufficient to cover 5.3 months of retained imports (MORI) of goods and non-factor services.

For 2016, the current account deficit (excluding aircraft) is forecast to widen to around 3.3 percent of GDP, reflecting the deterioration in trade balances as well as slow growth in tourism receipts and inward remittances. Inward remittances are expected to increase further from a record $491.7 million last year as Fijians working offshore as well as friends and families living abroad continue to remit funds to assist in rehabilitation work following TC Winston. Additionally, foreign direct aid is expected to be higher to support the rehabilitation work in the economy. Higher receipts, albeit slower growth, from tourism and transport activities, especially after the introduction of direct flights to Singapore and San Francisco are also expected to support the current account balance. Nevertheless, the trade deficit (excluding aircraft) is expected to widen by 15.8 percent this year from 1.1 percent in 2015 led by the surge in imports for consumption and investment goods related to the rehabilitation activity following TC Winston. The increase in aid-in-kind from overseas donor partners coupled with the substantial FNPF payout this year and expected re-insurance inflows are also anticipated to boost import demand. Nevertheless, the prevailing lower crude oil prices at an average of US$45.91 per barrel (compared to US$96.90 in 2014 and US$52.60 in 2015) are expected to moderate overall import growth. In 2017, the current account deficit (excluding aircraft) is expected to widen further to 3.4 percent of GDP.

Tourism earnings performed consistently well since the devaluation in 2009 as visitors continued to capitalise on Fiji's relatively cheaper holiday packages. Earnings grew by 11.1 percent to a record $1,560.2 million last year, on account of higher visitor arrivals and per-diem expenditure. In 2016, tourism earnings are projected to rise further by 5.0 percent to $1,638.2 million supported by rigorous industry campaigns, promotions and marketing abroad following the natural disasters. Inward remittances grew by 28.3 percent to a record $491.7 million in 2015. As at October 2016, remittances were around $435.4 million, a 6.8 percent improvement from the corresponding period in 2015. In 2016 and 2017, remittances are forecast to rise by 8.2 percent and 5.2 percent, respectively.

Graph 6: Foreign Reserves



Source: Reserve Bank of Fiji

The current outlook on Fiji's external position remains stable. Foreign reserves are expected to hold at high levels this year, supported by earnings from tourism, remittances, mineral water, sugar, fish, gold, garments and other domestic exports which will be critical in cushioning the impact of TC Winston, especially with the expected higher import payments for food, machinery hardware and transport items. In addition, the anticipated loan drawdowns from the World Bank and Asian Development Bank for rehabilitation efforts amounting to around $200 million, half of which has been received, is expected to support Fiji's external position into the medium term. As at 30 December 2016 (Graph 6), foreign reserves were at $1,921.4 million (5.4 MORI) and similar levels are anticipated by year end.

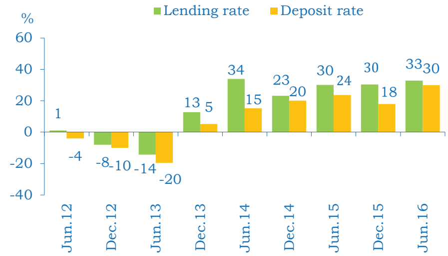
4.0 Monetary Policy Decisions and Expectations

For the period of sustained credit growth since 2013, internal analyses show that private sector credit to GDP has been growing below its long term trend. Hence, the current credit cycle is not deemed excessive nor a source for build-up in systemic risks. Nonetheless, anecdotal evidence points to high house price inflation that may have become more broad based outside the Suva-Nausori corridor as house prices in Nadi also remain elevated. Micro prudential supervision has consequently been enhanced and surveyed samples of loan-to-value ratios at origin for business and household lending have remained within safe margins.

Given the favourable outlook for our monetary policy objectives, the Reserve Bank has left its OPR unchanged at 0.50 percent in the first ten months of 2016.

Business sentiments on economic indicators provide useful insights into the RBF's monthly assessment on the economic outlook. While current interest rates continue to remain low, businesses' interest rate expectations have risen (Graph 7). The slightly higher expectation for an increase in commercial banks' lending rates may be reflective of businesses increasing their leverage in the credit cycle upswing from 2013 into late 2015. In other words, firms may already be pricing in a tightening in financial conditions as revealed in the marked rise in deposit rate expectations, which is also indicative of increased competition amongst financial system players.

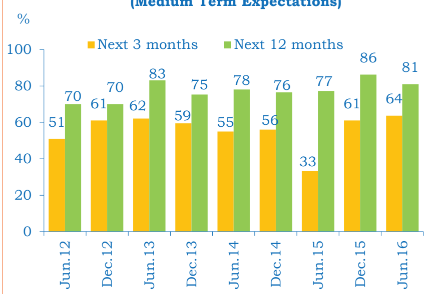
Graph 7: Expectations for Commercial Bank Interest Rates (Next 12 Months)



Source: Reserve Bank of Fiji

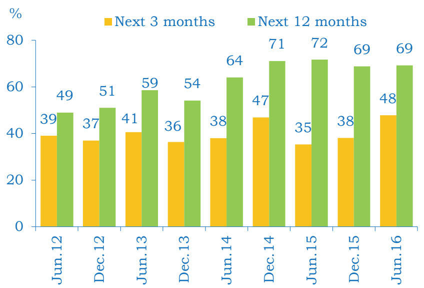
Consistent with the outlook for higher lending rates in the twelve months to June 2017, there was a reduced (-5pp) medium term investment intention for plant and machinery and flat profile for medium term building investment expectations (Graph 8 & 9). The higher short term expectation is consistent with post TC Winston rehabilitation.

Graph 8: Investment - Plant & Machinery (Medium Term Expectations)



Source: Reserve Bank of Fiji

Graph 9: Investment - Buildings (Medium Term Expectations)



Source: Reserve Bank of Fiji

Given the above-mentioned outcomes and projections for foreign reserves and inflation expected to remain stable for this year and into the medium term, the current accommodative monetary policy stance is deemed appropriate. Looking ahead, any changes to the current accommodative monetary policy stance, presently set to support cyclone rehabilitation and further investment in the domestic economy, will be determined by the outlook on the RBF's twin monetary policy objectives.

5.0 Balance of Risks

Though the medium term outlook remains stable and positive, the horizon is overshadowed increased downside risks of late.

Firstly, the slow recovery in the world economy and the uncertainty surrounding the UK's exit vote from the EU are causing negative effects on global financial markets, real activity, trade and confidence. Divergence in interest rate expectations as most central banks continue to ease monetary policy (with the exception of the US Federal Reserve), rising sovereign risk premiums and large currency exchange rate movements, will ultimately impact Fiji's terms of trade and the value of the Fijian dollar. Subdued external demand and further appreciation in the exchange rate will place pressure on export-driven sectors, with implications for the wider Fijian economy.

On a positive note, remittance inflows could strengthen from increased momentum in the seasonal worker program and by a strengthening in the US dollar.

For the entire tourism industry, increased connectivity via direct flights to Singapore and San Francisco and buoyant Chinese demand provide some upward biases to total tourist arrivals for the year. On the downside however, significant downgrades in growth in our source markets for tourism and remittance could dampen the outlook for these two key sectors.

Secondly, China's ongoing economic rebalancing is likely to have knock-on effects for Fiji and the region. The 'China effect' on Fiji's trading partners, especially as Australia rebalances away from mining, would have some negative income effects on Fiji's tourism export demand. The slowdown in the Chinese economy has also contributed partly to the overall decline in global demand and commodity prices, especially oil; benefiting oil importers like Fiji. In contrast, for New Zealand, another important source of Fiji's tourism, low dairy prices have depressed agricultural incomes and could reduce spending and investment.

Nonetheless, the current low trend in global oil prices is providing revenue gains to key domestic sectors such as transport, tourism and retail services.

Low international oil prices have also considerably improved Fiji's terms of trade which has consequently relieved some pressure on domestic prices and Fiji's balance of payments. In the near term, global oil prices are expected to remain low with gradual increases over the medium term, yielding for now, a stable balance of payments position for Fiji.

In addition, the Pacific region is susceptible to severe natural disasters. As witnessed earlier through TC Winston, the negative effects from such disasters including the loss of lives, extensive destruction to livelihoods, undermining of economic growth prospects and disruptions to fiscal sustainability, are significant. Moreover, extended supply shortages in agricultural market items following these disasters have resulted in the high inflation outcomes since May and altered the 2016 year-end inflation outlook.

Prolonged monetary policy accommodation could also lead to macroeconomic imbalances. These include rising current account and fiscal deficits and financial sector vulnerabilities as low interest rates, some easing in credit standards and elevated house prices extend into the medium term. Nevertheless, key policy considerations have included the recent unwinding of the credit upswing of previous years, enhanced micro and macro prudential surveillance, the effect of fiscal measures and supply-side developments on headline inflation, along with an assessment of the balance of both downside and upside global and domestic risks.

All in all, foreign reserves remain at comfortable levels and the temporary spike in inflation is expected to ease towards year end. As such, the Reserve Bank will continue to be vigilant about the potential impact of these risks and developments in the Fijian economy.

6.0 Conclusion

In summary, the forward path for monetary policy set by the RBF is determined by domestic and international developments and key assumptions for inflation and foreign reserves. Unforeseen events such as TC Winston and other surprise outcomes have the potential to alter the outlook and therefore the stance for monetary policy. There continues to be many uncertainties surrounding Fiji's macroeconomic outlook. Risks related to global growth, China's rebalancing, 'Brexit' and financial markets prospects, commodity prices and geo-political risks persist. On the domestic front, lower-than-expected outcomes in some primary industries and consistently high headline inflation outcomes could further hurt Fiji's economic growth in 2016. The Bank will continue its work to balance the impact of these divergent influences on the macroeconomic outlook of the Fijian economy.

Despite some significant one-off effects, the outlook for our monetary policy objectives remains stable. High headline inflation rates in recent months due to temporary supply - side factors should normalise into early next year. More importantly, medium term inflation expectations are well-anchored at around 2.0 to 3.0 percent. Comfortable foreign exchange earnings to date and projections for continued steady inflows indicate that foreign reserves will remain stable by year-end.

All these considered, monetary policy is expected to remain accommodative now and into the medium term, unless domestic and international developments alter the current macroeconomic outlook.

7.0 Fiji: Key Economic and Financial Indicators

KEY INDICATORS	2013	2014	2015	2016[1]
Money and Credit ($ million)				**Oct-16**
Broad Money Supply	5,723.0	6,317.9	7,199.4	7,472.5
Net Domestic Credit	4,837.6	5,742.3	6,522.4	6,874.6
Interest Rates				**Oct-16**
RBF Overnight Policy Rate	0.50	0.50	0.50	0.50
Lending Rate	5.86	5.72	5.89	5.81
Time Deposit Rate	1.79	2.15	2.71	2.94
Savings Deposit Rate	0.70	0.57	1.01	0.90
Consumer Price Index (Annual % changes)				**Nov-16**
Headline	3.4	0.1	1.6	4.3
				Dec-16
Foreign Reserves ($ million)[2]	1,778.1	1,810.7	1,944	1,921.4
Balance of Payments ($ million)				
Overall Balance	140.1	44.2	136.7	n.a
Fiscal Operations of the Government				
Net Deficit ($ million)[3]	-37.8	-352.3	-213.9	n.a
% of GDP	-0.5	-4.2	-2.3	n.a
Gross Domestic Product (Annual % changes)				
Real GDP	4.7	5.6	3.6	n.a

[1] Data for 2016 refers to monthly data, available at print time. Therefore, n.a refers to data/forecasts that are available only on an annual basis.

[2] Foreign reserves includes monetary gold, Special Drawing Rights, reserve position in the Fund and foreign exchange assets consisting of currency and deposits actually held by the Reserve Bank.

[3] The net deficit for 2015 is as per the Supplement to the 2016 National Budget address announced on 6 November 2015. The Government has now moved away from calendar year reporting to fiscal year reporting which runs from 1 August to 31 July.

Sources: Fiji Bureau of Statistics, Ministry of Economy and Reserve Bank of Fiji

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