Inflation in Fiji

The Reserve Bank of Fiji (RBF), like many central banks, aims to maintain low and stable inflation – or *price stability* - as one of its key monetary policy objectives.

In this article, we talk about inflation and why the RBF considers it important to maintain low and stable inflation in the economy.

What is inflation?

Inflation is defined as the rise in the *overall level* of prices of goods and services in an economy over time.

Causes of inflation

Prices that consumers pay for goods and services are influenced by the cost of producing or supplying them – that is the cost of input – such as wages, raw materials, utility bills, imports and rent.

Prices also reflect the demand for goods and services. For example, if demand for a good or service is high but its supply is low, prices will tend to rise.

Therefore, prices reflect the interaction between the demand and supply of goods and services.

How is inflation measured?

Inflation is a broad measure and is normally calculated as the annual percent change in the Consumer Price Index (CPI).

The CPI is an index that takes into account the price of a standard basket of goods and services consumed by a typical Fijian family for a given period. This basket contains consumer items such as food, beverages, clothing & footwear, fuel, electricity & water and education whose price movements are *weighted and combined* to determine the overall change in the CPI or inflation rate.

The specific goods and services that make up the CPI basket are derived from the Household Income and Expenditure Survey results and are periodically revised by the Fiji Bureau of Statistics (FBOS) to reflect changing consumption habits of Fijian households over time. The current CPI basket is based on the survey conducted in 2008/2009.

Each month, the FBOS collects and records prices of the typical goods and services that an average Fijian consumer purchases. An average is calculated from the changes in these prices: the prices of goods on which consumers spend more money are *weighted* more heavily in the calculation while goods on which the consumer spends less money are given a lower weight

Why Is Inflation Important?

Inflation is both good and bad, depending on how much there is.

A little inflation helps the wheels of an economy turn. For example, a producer may see an increase in prices as a way to earn more income. As such, the producer is encouraged to invest more and hire more people to increase production.

However, too much inflation is not good for an economy. The main concern is that inflation reduces our *purchasing power – what we are able to buy with a fixed amount of money*. As prices rise rapidly, people's wages, salaries and savings will buy less goods and services. High inflation also makes a country's exports expensive, which can lead to lower demand for its exports.

Therefore, it is better to keep inflation at an acceptable level that not only encourages businesses and individuals to make longer term investments and savings plans with confidence, but also safeguards everyone's wealth and capital value. Similarly, an acceptable level of inflation supports a stable cost environment for earning steady profits and promoting business expansion.

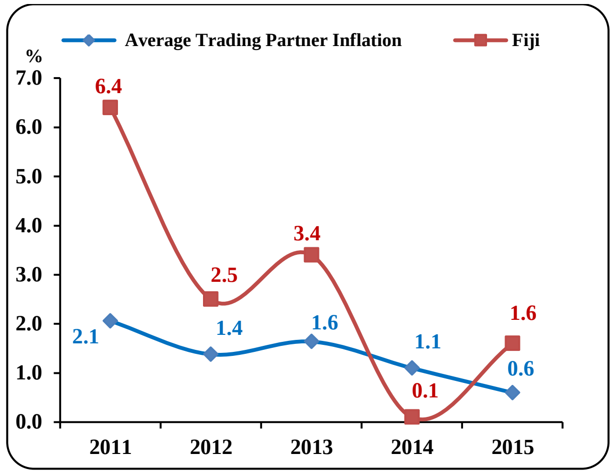
Factors Affecting Inflation in Fiji

Like other developing open economies, most goods and services demanded in Fiji are not produced locally and have to be purchased from the global market. Therefore, when prices in other countries go up, the prices we pay for imports also go up.

For example, if world oil prices go up, this increase will be passed on to Fijian consumers through higher domestic fuel prices. In addition, given that oil is an important input for production (e.g. to run machines and vehicles to transport goods), any oil price increase will raise the cost of production for firms and be indirectly passed on to prices of other domestic goods and services.

Inflation is also influenced by the exchange rate. A weaker Fiji dollar against other foreign currencies makes Fiji's imports expensive, causing prices paid by consumers to increase as well. Inflation in Fiji also indirectly reflects the inflation rates of the countries whose currencies the Fiji dollar is pegged to in the currency basket.[1] Therefore, low and stable inflation rates in these countries help to keep Fiji's inflation low and stable as well (Figure 1.0).

Figure 1.0: Fiji and Average Trading Partner Inflation



Sources: Fiji Bureau of Statistics, Consensus Forecast & Asia Pacific Consensus Forecasts and Bloomberg.

Inflation is also influenced by domestic factors. For example, when there is an increase in wages and salaries without a corresponding rise in productivity, firms are likely to pass the added costs onto consumers in the form of higher prices. Moreover, disruptions to domestic supply caused by natural disasters can also lead to short term price increases. Following a hurricane or drought, the prices of vegetables and fruit usually increase temporarily due to lower supply in the market. In addition, delays resulting from significant damage in the economy such as to infrastructure, can also affect the prices for goods and services that depend on these factors.

How Does the Reserve Bank of Fiji Assist in Managing Inflation?

The Reserve Bank does not have a formal inflation target rate compared to countries such as Australia and New Zealand, but it is broadly comfortable with an inflation rate of

[1] The Fiji dollar is pegged to the Australian and New Zealand dollars, Euro, Japanese Yen and US dollar.

around 3.0 percent, consistent with price stability – a key objective of monetary policy.

The Reserve Bank conducts monetary policy to achieve its inflation objective while ensuring foreign reserves are maintained at adequate levels (our other objective of monetary policy). Specifically, the RBF reviews the outlook for inflation and foreign reserves every month to determine its policy stance. For instance, if inflation is expected to rise sharply and deviate substantially from its acceptable level, the Reserve Bank will consider tightening liquidity conditions or raising interest rates in order to dampen demand for goods and services and reduce any pressure on prices. Tighter liquidity or higher interest rates raises the cost of borrowing and consumption while encouraging savings, therefore helping to reduce inflation.

Nevertheless, the Reserve Bank does not have absolute control over inflation, as there are other factors that also impact prices. These include, as alluded to earlier, costs of imported items which are determined in the international market and natural disasters whose impacts are beyond the influence of the Bank's monetary policy. Such situations sometime lead to deviations in actual inflation from its acceptable level. The Reserve Bank issues a press release every month following the decision by its Board, to communicate its monetary policy outcomes and stance which will help maintain inflation and reserves at adequate levels. The Bank also meets with relevant stakeholders to help manage inflation expectations.

Conclusion

Low and stable inflation is good for any economy. It safeguards people's wealth, encourages sound planning and investment, allows the efficient allocation of resources and improves productivity. Overall, it contributes to achieving sustainable economic growth.