



RESERVE BANK OF FIJI

ECONOMIC REVIEW

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OVERVIEW

Economic prospects for the international economy remain firm, with global growth for 2006 projected at 4.3 percent. While this projection is favorable, it is beset with concerns of further increases and volatility in international oil prices, which could derail the positive outlook. To some extent, this is evident in the growth projections for most of our major trading partners and selected non-Japan Asian economies.

The domestic economy, on the other hand, is expected to perform better this year on the back of strong consumer spending and continuing investment projects. Moreover, data from commercial banks revealed that loans disbursed for investment purposes surged by around 45 percent in the year to December 2005. However, the strong growth in imports continues to be a drag on aggregate demand growth.

Over the review period though, partial indicators suggest that domestic demand is still growing. In particular, indicators of consumption, net *Value Added Tax* (VAT) collections and cash collections from domestic activities, continued to rise on an annual basis. Individual incomes, a driver of consumer spending, also grew over the period as evident by growth in partial indicators, such as *Pay As You Earn* (PAYE) collections. This is also supported by the continuing backdated wage increases being awarded across the public and private sectors.

Furthermore, stronger household incomes and favorable interest rates and loan conditions are feeding into an already large demand for credit. Loans by commercial banks for consumption purposes rose in the year to December 2005 by about 18 percent.

In January, inflation was 2.3 percent, compared with 2.7 percent in December. The slight fall can be

attributed to the removal of VAT from certain basic food items, which partially offset the rise in costs of services, as well as increases in import and excise duties. The underlying measure of inflation, the trimmed mean, fell to 0.9 percent from 1.2 percent recorded in the previous month.

Money and credit aggregates continued to grow strongly in the year to December 2005. Total commercial bank deposits rose by about 16 percent at the end of last year to around \$2.4 billion. The increase mainly reflected higher placements by private sector business enterprises, public enterprises and private individuals in demand and time deposits. The demand for funds also rose during the review period, with commercial banks' lending increasing by around 23 percent to around \$2.0 billion. Higher lending to private individuals, wholesale & retail trade, real estate and building & construction sectors largely underpinned the outturn. Additionally, commercial banks' new lending rose during the review period, registering an annual growth of around 21 percent to \$104 million, influenced by higher lending to the professional and business services, private individuals, and manufacturing sectors.

Movements in commercial bank interest rates remained mixed in December 2005, with the time deposit rate rising by 16 basis points to 2.03 percent and the lending rate falling by 3 basis points to 6.63 percent. The savings deposit rate remained unchanged at 0.40 percent. Overall, the commercial banks' weighted average lending rate has been declining throughout 2005 and continues to be a supporting factor for credit expansion in the economy.

On the external front, Fiji's poor trade performance remains a concern. The general weakness in our traditional exports and the slow pick up in new

exports are unable to match our mounting import levels. Latest Overseas Exchange Trade (OET) data showed that in 2005, merchandise exports fell by around 20 percent, compared with an increase of around 12 percent in 2004. During the same period, merchandise imports rose by around 19 percent, compared to a growth of around 18 percent in 2004.

At the end of January 2006, official reserves were around \$906 million, sufficient to cover 4.3 months of imports of goods only.

SECTORAL DEVELOPMENTS

Domestically, sectoral developments were generally positive during the review period. Consumption and individual incomes remained upbeat in 2005, setting new record levels. The copra industry noted annual growth during the review period. However, output in the gold industry remained weak last year.

Consumption

After a record year in 2005, consumption continues to remain buoyant this year, evident by the growth in partial indicators of consumer spending. In the year to January, net VAT collections amounted to \$42 million, an increase of around 15 percent when compared with the same period last year.

The strong performance was underpinned by a 40 percent increase in collections from Government Departments, a 12.5 percent rise in domestic cash collections, and 4.7 percent growth in VAT collected by the Customs Services.

Furthermore, Fiji National Provident Fund (FNPF) member withdrawals are also on the rise. In the third quarter of 2005, withdrawals totalled \$60.6 million, a notable increase by 9 percent over the quarter and 16 percent over the year. Average monthly withdrawals now stand at around \$20.2 million compared to around \$18.6 million in the June 2005 quarter. The rise in average withdrawals each month continues to support consumer demand in the economy.

Income

In line with favourable labour market conditions, net income tax collections amounted to around \$26 million in the first month of this year, representing a strong annual growth of around 50 percent. Total PAYE collections, after setting a new record in 2005, amounted to around \$18 million during the review period. This represents an annual increase of around 12 percent.

Copra

Latest statistics from the Coconut Industry Development Authority (CIDA) show that annual copra production amounted to around 12,100 tonnes, representing an increase of 17 percent over the corresponding period in 2004.

In December, the minimum mill gate price of copra remained unchanged at \$500 per tonne. Government's subsidy towards the mill gate price was \$86.22 per tonne.

Gold

Gold production however remained weak. Total gold output in 2005 amounted to almost 90,000 ounces, representing a sharp decline of around 31 percent over the comparable period in 2004. Similarly, earnings declined on an annual basis by 26 percent to \$66.7 million during the review period.

Inflation

Inflation in January stood at 2.3 percent compared with 2.7 percent in December. Over the month, consumer prices fell by 0.1 percent. During January, prices of miscellaneous items, food, clothing & footwear, alcoholic drinks & tobacco, services and durable household goods rose. Conversely, costs of heating & lighting and transport fell while the price of housing remained unchanged. The underlying measure of inflation, the trimmed mean, fell to 0.9 percent from 1.2 percent recorded in the previous month.

In line with expectations, inflation eased slightly in January as a result of the removal of VAT from certain basic items, which partially offset the rise in costs of services and increases in import and excise duties. However, in the approaching months, inflationary pressures are expected to accelerate, influenced by both external and domestic factors. Externally, the further increase of international crude oil prices since December last year and a gradual appreciation of the US dollar are expected to make our imports more expensive. Domestically, prices of market items may pick up due to possible supply side constraints following the recent flash floods in the western parts of the main islands. The year-end inflation for 2006 is projected at 3.5 percent.

Labour Market

Labour market conditions remain firm despite a slowdown in some sectors. Formal sector employment is not rising as much compared to last year. In January, around 1,200 individuals were registered as taxpayers, declining by around 3 percent over the

year. Registrations in most sectors fell, except for the manufacturing sector, which increased by 3 percent. The declines were largely due to fewer registrations in the construction; mining & quarrying; transport, storage & communication; electricity & water and agriculture, forestry & fishing sectors.

On the wages front, Government paid out another 3 percent Cost of Living Adjustments (COLA) in February 2006, to around 29,800 civil servants. The total COLA payout (backdated to January 2005) is estimated to be around \$13.5 million, and this figure includes the 3 percent COLA recently paid out in December, 2005. Furthermore, Air Pacific Limited recently awarded an 11 percent increase to around 660 employees backdated to 2002. The 11 percent increase is based on 2 percent increases awarded for 2002 and 2003, a 4 percent rise for 2004 and 3 percent increments for 2005. This award is expected to be paid out in early March of this year.

These wage awards are likely to provide a further boost to demand which may lead to higher inflationary pressures. Given that the effect will filter in next year, the 2006 year-end inflation will remain unaffected.

Monetary & Credit Aggregates

Money and credit aggregates continued to grow strongly in the year to December 2005. Total commercial bank deposits rose by 15.7 percent at the end of last of year to around \$2.4 billion. The increase reflected mainly higher placements by private sector business enterprises, public enterprises and private individuals in demand and time deposits.

The demand for funds also rose during the review period, with commercial bank lending increasing by 22.8 percent to around \$2.0 billion. The outturn was underpinned by higher lending to private individuals, wholesale & retail trade, real estate, building & construction, professional & business services and transport & storage sectors. Additionally, commercial banks' new lending rose during the review period, registering an annual growth of around 21 percent to \$104 million. The increase was largely influenced by higher lending to the professional and business services, private individuals, and manufacturing sectors.

In line with buoyant consumer spending, commercial bank lending for consumption purposes rose by 17.7 percent to \$657 million. The outturn was largely underpinned by rises in the wholesale & retail, hotels and restaurants sector. The total value of loan

outstanding to the wholesale, retail, hotels and restaurant sector rose by 18.5 percent in the year to December to \$550.7 million and accounts for 27.6 percent of total loans outstanding in the banking system. Similarly, commercial bank credit channelled for investment purposes grew by around 45 percent to \$260 million. The increase was underpinned by the hotels & tourism segment of the building & construction sector.

Impetus to credit growth in Fiji is also stemming from Licensed Credit Institutions (LCIs). Lending by LCIs rose by 18.4 percent to \$280.7 million in the year to December, following a growth of 16.7 percent in November. The increase was largely due to higher lending to real estate followed by the building & construction and private individuals sectors. Furthermore, cumulative to December 2005, new loans by LCIs amounted to around \$147.9 million, which represented a 13.9 percent increase over the comparable period in 2004.

Interest Rates

Movements in commercial bank interest rates remained mixed in the last month of the year with the time deposit rate rising by 16 basis points to 2.03 percent and the lending rate falling by 3 basis points to 6.63 percent. The savings deposit rate remained unchanged at 0.40 percent. During the same period, the commercial bank new time deposit rate rose by 46 basis points to 2.23 percent while the new lending rate fell to 6.62 percent in December from 7.62 percent recorded in the previous month.

Overall, the low commercial bank weighted average lending rate prevailing throughout 2005 continued to be a supporting factor for credit expansion in the economy. While the new deposit rate generally rose in the last few months of the year, movements in the new lending rate were volatile throughout 2005.

Lending interest rates offered by LCIs are also on a downward trend, with the weighted average lending rate declining by 7 basis points to 11.28 percent in December. The new lending rate charged by LCIs also fell sharply to 10.87 percent. In terms of deposits, the weighted average time deposit rates for LCIs fell to 4.06 percent in December from 4.20 percent recorded a month earlier.

External sector

On the external front, latest OET data showed that in 2005, merchandise exports fell by around 20 percent, compared with an increase of around 12 percent in the corresponding period in 2004. The

decline in receipts was largely attributed to negative contributions from sugar, textile, clothing & footwear, fish, merchanted goods, re-exports of mineral fuels, and other re-exports, which more than offset positive contributions from gold, ginger and mineral water.

During the same period, merchandise imports rose by around 19 percent cumulative to December 2005, compared to a growth of around 18 percent in the corresponding period in 2004. The increase in import payments was due to positive contributions from all categories; intermediate goods (8.3 percent), investment goods (7.6 percent) and consumption goods (3.2 percent). The growth in intermediate goods was underpinned by the increase in payments for mineral fuels and textiles, clothing & footwear, while the rise in investment goods was largely made up of increases in imports of machinery & electrical equipment and chemicals. The higher payments for consumption goods was largely attributed to the increase in contribution from duty free goods, transport equipment, other imports and food, beverage &

tobacco.

Exchange Rates

Bilateral movements in exchange rate reveals that at the end of January, the Fiji dollar generally strengthened against the New Zealand dollar (1.1%), US dollar (1.0%) and the Yen (0.8%) but weakened against the Euro (1.0%) and the Australian dollar (1.2%).

In January, the Nominal Effective Exchange Rate (NEER)² index of the Fiji dollar fell by 0.3 percent over the year. This was accompanied by a fall in the Real Effective Exchange Rate (REER) Index³ of the domestic currency by 0.6 percent during the same period. The decline in the REER Index over the year reflects an improvement in our international competitiveness and was largely due to lower domestic inflation outcomes.

Reserves

At the end of January 2006, official reserves were around \$906 million, sufficient to cover 4.3 months of imports of goods only.

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² NEER index is the sum of the indices of each trading partner currency against the Fiji dollar, adjusted by their respective weight in the basket. Each weight reflects a trading partner's contribution to Fiji's total trade in goods and services. This index measures the overall movement of the Fiji dollar against the basket of currencies. An increase in this index indicates a slight appreciation of the Fiji dollar against the basket of currencies and vice versa.

³ The REER index is the sum of each component of the NEER index, adjusted by the relative price differential between Fiji and each of the major trading partners. This index measures the competitiveness of the Fiji dollar against the basket of currencies. A decline in the REER index indicates an improvement in Fiji's international competitiveness and vice versa.

FIJI: FINANCIAL STATISTICS

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KEY INDICATORS	Jan-06	Dec-05	Nov-05	Jan-05
1. Money and Credit (year-on-year % change)				
Narrow Money	n.a	n.a	27.28	34.07
Currency in Circulation (monthly average)	n.a	11.67	11.08	12.45
Quasi-Money (Time & Saving Deposits)	n.a	n.a	13.67	5.84
Domestic Credit	n.a	n.a	22.51	12.08
2. Consumer Prices ^{1/} (year-on-year % change)				
All Items	2.3	2.7	1.9	2.9
Food	3.7	3.1	0.6	1.7
3. Reserves (end of period)				
Gross Foreign Reserves (\$m)*	905.8	822.4	885.0	1019.3
Months of Imports (goods)	4.3	4.2	4.5	5.2
4. Liquidity (end of period)				
Liquid Assets Margin to Deposit Ratio (%)	n.a	n.a	10.0	11.6
Banks' Demand Deposits (\$m)	n.a	n.a	147.5	72.3
5. Interest Rates (% p.a.) (monthly average)				
Lending Rate (Excluding Staff)	n.a	6.63	6.66	6.92
Savings Deposit Rate	n.a	0.40	0.40	0.36
Time Deposit Rate	n.a	2.03	1.87	1.78
91-day RBF Note Rate (month end)	n.i	2.25	2.25	1.75
Minimum Lending Rate (MLR) (month end)	2.75	2.75	2.75	2.25
Overnight Inter-bank Rate	n.a	2.09	1.93	0.80
5-Year Government Bond Yield	n.i	3.07	2.88	n.i.
10-Year Government Bond Yield	n.i	5.65	5.50	n.i.
6. Exchange Rates ^{2/} (mid rates, FSI equals) (end of period)				
US dollar	0.5788	0.5731	0.5775	0.6011
Pound sterling	0.3276	0.3324	0.3336	0.3185
Australian dollar	0.7736	0.7827	0.7819	0.7770
New Zealand dollar	0.8501	0.8409	0.8245	0.8465
Swiss francs	0.7452	0.7525	0.7581	0.7136
Euro	0.4790	0.4837	0.4899	0.4611
Japanese yen	68.09	67.53	69.04	62.21
7. Commodity Prices (US\$) (monthly average)				
UK Gold Price/fine ounce ^{2/}	547.21	509.34	475.76	424.82
London Daily Sugar Price/tonne ^{3/}	384.81	356.18	306.80	261.18
Crude Oil/barrel ^{4/}	63.57	56.75	55.39	44.48

n.a. - Not available/No activity

n.i. - No issues

n.t. - No trading

* Official reserves includes foreign reserves holdings of the RBF and Non-Bank Financial Institution, as per the new definition of official reserves

Sources: ^{1/} Fiji Islands Bureau of Statistics

^{2/} Bloomberg and Reserve Bank of Fiji

^{3/} Fiji Sugar Marketing Company Limited

^{4/} Bloomberg