Savenaca Narube: Fiji's economic status and projections

Address by Mr Savenaca Narube, Governor of the Reserve Bank of Fiji, to the Australia/Fiji Business Council, Gold Coast, Australia, 18 October 2004.

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Introduction

This is my third annual update to your joint Councils on the status and projections of the Fiji economy.

I am always pleased to accept your invitation, not only because of the opportunity to visit such exotic places as the Gold Coast, but also because each time that I present to you, the Fiji economy continues to grow.

The statistics show that Fiji is now breaking out of a 20-year cycle of volatile and low economic performance.

The Fiji economy is strong. This year, we are estimating a growth of around 4.7 percent although this is currently being revised. The tourism sector is again expected to lead growth together with the building and construction sector. There are also contributions from the wholesale and retail trade and manufacturing sectors.

Our macroeconomic fundamentals are firm. Labour market conditions have improved. Investment is rising again after a long period of decline. The level of foreign reserves remains healthy. Inflation has been well contained at below 3 percent.

International commentators including the IMF and the ADB have commended our economic management. Four years of consecutive growth is a performance that was difficult to achieve in the past. Not only have we achieved growth, the growth rates have been generally higher. The average growth rate in four years is over 4 percent, compared to 3 percent average growth from 1987 to 1999. Moreover, we have achieved this performance despite the outbreak of SARS, global terrorist attacks and the Middle East war.

Immediate prospects

What about the near future?

Over the next two years, GDP is forecast to grow by 4 percent in 2005 and to slow down further in 2006. These estimates of course may change as new policy measures are introduced and as additional information comes to hand.

Let me briefly take you through the major sectors.

Building and construction

One of the major sectors driving growth in 2004 is building & construction. Like tourism, the building and construction sector is booming in Fiji. What is more interesting is that growth in this sector is being driven by the private sector. A number of major public infrastructure projects are also underway.

The building industry is doing so well that capacity constraints are being felt in the adequacy of skilled labour. This may lead to wage pressures in the industry.

Wholesale and retail trade

The wholesale and retail trade sector is also performing well reflecting the high consumer confidence. The increase in employment and the buoyant tourism industry together with higher remittances from abroad have supported this sector. A reduction in the rate of the top bracket in personal and corporate tax rate has also help raise domestic demand.

In addition, buoyant collections of Value Added Tax and rising imports of finished goods are clear indicators of this high consumption demand. Strong growth in the wholesale and retail sector is expected to continue in the future.

Manufacturing

The manufacturing sector is also growing. Processed agricultural products, production of non-food items, and in particular garments, are the main contributors here.

For garments, production is expected to rise this year following a decline last year. We are told by the industry that the larger garment companies and increased demand from abroad largely drive this year's outlook.

The future for this sector however, remains under some cloud. The imposition of WTO rules and the global move to trade liberalisation will threaten market access and pose challenges to our competitiveness. A welcomed reprieve on this front, albeit temporary, is the Australian Government's extension of the Textile, Clothing & Footwear provisions under the SPARTECA. However, the looming expiry of the US quota is a serious threat to the future growth in the industry.

Sugar

The daunting problems of the sugar sector are well known. As a result, sugar production has declined, and well below the record of 517,000 tonnes achieved in 1994. Production in 2004 is expected to remain stagnant at last year's level. The lower sugar exports have left an $80 million hole in our annual export receipts - a gap that no other commodity has been able to plug up to now.

It is obvious that the commercial reform of the sugar industry must happen sooner rather than later. We are running out of time! Preferential sugar prices are being eroded more quickly and significantly than we earlier thought. This will put additional pressure on our trade imbalance.

Tourism

The tourism industry has been the star performer in the past few years. Tourism accounts for almost 15 percent of overall output and provides employment to more than 30,000 people. Although the industry suffered several setbacks due to the US-Iraq conflict and outbreak of the SARS virus, it rebounded quickly and registered record visitor arrivals in 2003.

We expect to set a new record again this year. The performance so far in the first seven months supports this optimism with a 20 percent rise in tourist numbers over the same period in 2003. The industry has set itself a target of becoming a $1 billion industry in 2007.

But there are signs that the scarcity of hotel rooms is already imposing a glass ceiling on future growth. It is therefore encouraging to see several hotel projects under way like the Momi Bay Marriott, the Denarau Sofitel and the Hilton. I think that we will need a lot more than these to expand the immense potential of our tourism industry.

New industries

Over the years, we have seen the emergence of a number of industries, which have the potential to contribute significantly to our economy.

Mineral water is one such emerging industry. It has climbed to be the 7th gross foreign exchange earner for Fiji in a very short period of time. Its exponential growth is a result of aggressive marketing, innovation and vision in a very competitive global market. It is a classical model of what our industries can achieve globally. Recently, Natural Waters of Fiji has made additional investment to triple production to meet global demand.

In summary, while growth up to now has been broad based, there are capacity constraints are starting to emerge and there are serious threats to some sectors that need addressing.

Medium term outlook

What about the medium term outlook? In my view, this is where thediscussion becomes very interesting.

We are growing at the back of domestic demand supported by a policy environment of higher government deficits and increasing borrowing from financial institutions. This policy environment was no accident. It was a deliberate package put in place to help us recover quickly after 2000. During this time, the government increased its budget deficits to above 5 percent of GDP. We, in the Reserve Bank, kept monetary policy very relaxed and allowed interest rates to drop to historical lows. This has led to buoyant credit demand. This expansionary policy package has worked extremely well and we have seen its fruits up to now. Investment is growing, incomes are rising and employment is increasing.

This consumption driven growth is not a bad thing and many large countries do use this channel to expand their economies. But on its own, it does not last in the long run for an economy like Fiji. Fiji is a small market relying on a few commodities for exports and heavily dependent on imports. To sustain our current economic performance under such an economic set-up, we must try to pay for our local spending out of foreign earnings. That means that we must export more. Unfortunately, while tourism is booming, our exports of goods have actually declined in the last three years. We simply cannot sustain such a situation where consumption is high and exports are low or even declining.

Unfortunately, our traditional export sectors are seriously under performing. Why can't we raise the exports of our traditional agricultural products? I am told that even hotels cannot get enough local supplies of quality vegetables, fruits and seafood. We must do something to address the stagnant fish industry. On sugar, we must continue to call on all stakeholders for a quick resolution to the reforms. We also need to get cracking on the harvesting of the much-talked about mahogany.

In light of this medium term scenario, the Reserve Bank has begun to tighten monetary policy by raising our official interest rate in May this year by 50 basis points. Tightening of monetary policy was a clear signal that we are changing our policy stance. It takes time for monetary policy to work itself out through people's choices on savings and consumption.

Are we going to raise rates further? This depends on a host of reasons like the trend in exports, the speed of credit expansion and, very importantly, the stance of the government fiscal policy. Let me just say here that interest rates will always be a key policy instrument that we will always consider in the future.

The high oil prices is a big worry everywhere. It has necessitated us raising our forecast of year-end inflation to 3.5 percent from 3 percent. Continuing high oil prices will have ramifications on our cost structure and the balance of payments. It has come at a bad time for us and will complicate economic management. But this is something that we have absolutely no control over and we can only hope that supply factors that are driving oil prices upwards disappear soon. From a strategic angle, we must avoid policies and practices that ratchet upwards throughout the economy the cost effects of higher oil prices.

Overall, our medium term scenario does not appear to be as strong as our past performance. There are structural problems that we need to address in a decisive and timely manner.

Macroeconomic stability

Looking ahead, our first and utmost challenge is to maintain at all times economic stability that we have now. Without this stability, we will be extremely exposed to the many vulnerabilities that we face as a small island nation in the middle of the huge Pacific Ocean. And, like oil prices, we do not have any control of most if not all of these vulnerabilities. In my view, we must not sacrifice macroeconomic stability for short-term economic gains. As global experiences overwhelmingly show, the price that we will ultimately pay will be extremely painful.

We can grow sustainably if we let growth be export-driven. I have suggested that we embark on a national export drive. Like what the tourism industry has done, we can set targets for our traditional exports and even new exports. We can then mobilise the necessary resources and efforts to reach those targets. This cannot be the drive of government only. To be successful, it has to be a collective drive of the government, the private sector, industry organisations and even trade unions.

We in the Reserve Bank are examining several ways that we could help promote exports. First, the forward exchange cover is still available for imports associated with exports, not only of goods, but also services. Second, we are re-assessing the credit export facility that we offer through the commercial banks to see if it can be more attractive to small exporters. Third, we are studying the provisioning of export credit guarantee with the help of the ADB. Lastly, we intend to convene a conference of interested groups on exports in the new year following on from our successful inaugural symposium two months ago.

There are some emerging areas of exports that we need to harness.

Anaconda 2, shot in Fiji and released recently, is, I hope, a leading wedge of what Fiji can offer in the audio-visual industry.

I believe that there is potential for growth in the Information and Technology industry. We have seen an increase in back-office services. We are fortunate to have invested in the Southern Cross Submarine Cable, which offers more than enough capacity to cater for the growth in the IT related initiatives.

Before leaving this issue, I just want to emphasise the important role of fiscal policy in creating the enabling environment for growth and stability. Fiscal policy has a greater and faster impact on the economy, and the role of Government in promoting sustainable economic development is extremely vital. Government has reduced the fiscal deficit to 3.5 percent of GDP this year and further reduction is planned in the medium term. Such a fiscal stance will strongly support the long-term sustainability of the economy and keep debt at a moderate level.

Raising the level of growth

Maintaining macroeconomic stability does not necessarily mean that we should be contented with lower levels of growth. We can and we must raise the long-term potential growth rate of the economy while maintaining stability. The only way to raise the potential of the economy is by reforms to remove structural impediments to the effective allocation of our scarce resources, improve productivity and change our industrial culture. Government has announced initiatives in these areas in public service, public enterprises, labour and financial management. I welcome the passage of the Finance Management Bill in Parliament recently. But there is a general sense that more could still be done on these reforms now.

The Hon. Prime Minister has challenged us all to a growth of 8 percent. This does not fit in well with our slower medium term projection. But one must understand that this higher growth is a target. It is my view that we should aspire to do better and adopt this as a national target. But, and let us get this straight, it will only be achieved if we decisively succeed in the reforms that the government has embarked upon. I have heard sceptics of this 8 percent target. But I am firmly on the side that says, “Yes Prime Minister, we can achieve the target if we are prepared to do the necessary and difficult groundwork now”.

So we certainly have our job cut out for us in the medium term. But I am confident that we can raise the rate of growth higher while maintaining economic stability.

Raising investment

Let me turn to investment. Investment is the backbone of a dynamic economy. In the early 1980s, we achieved investment levels in excess of 25 percent of GDP. Since then, investment in all sectors has declined. Private investment, which was at 15 percent of GDP, is now hovering at only around 4 percent. Fiji is trailing behind the average investment level in developing countries of around 25 percent of GDP.

However, the good news is that we have turned the corner. Investment has started to grow again since 2001 from around 12 percent of GDP to the current 16 percent. We last achieved this level way back in 1986. Interestingly, investment of public enterprises is virtually back to its peak of the 1980s. More encouragingly, private investment is heading upwards firmly and is expected to expand further in the medium term.

There are many things that affect investment and these are well known to all of us here. I am pleased that government has improved the investment approvals process and it will be useful to track how the new framework is performing. But we can and should do more to dismantle other barriers to investment in Fiji to take us forward to our investment target.

Macroeconomic sustainability going forward and the reforms that I talked about earlier are very important considerations for investors.

Some have raised with me the consistency between promoting investment and raising interest rate. While we have increased our official interest rate, the lending rates remain low with ten-year bond rate at 5 percent and commercial lending rates at 7 percent. Real lending rates in Fiji, are amongst the lowest in the Asia-Pacific Region. Our average commercial banks' lending rates are very close, if not lower, than that of our major trading partners, Australia and New Zealand.

Financial developments

Let me end with a few comments on financial development.

I am glad to say that the financial system continues to be sound. Total assets continue to grow at a healthy pace. The key prudential indicators of the banking system remain acceptable. The satisfactory performance of the financial system has been characterised by high levels of capitalisation, growing profitability and adequate liquidity.

Given the increasing prominence of the Fiji National Provident Fund in the financial system, it is now under the supervision of the Reserve Bank of Fiji. There are also plans to deregulate the superannuation industry in the medium term. The Fiji Development Bank has applied to us for a commercial banking license. Credit institutions are making their presence felt in the market place.

In recent years, we have also seen a whole range of new financial products introduced in Fiji. We are no longer considered a "backwater" of the global financial system. In my view, there is a renewed sense of innovation and a concerted move to greater specialisation and financial deepening. In fact, in some areas we appear to lead. A classic example is the ANZ roll out of banking services to the rural communities. I understand that this project will place Fiji as a global benchmark in this area.

We are doing our part to prevent terrorist financing and combat money laundering. An independent review last year by the Asia Pacific Group on Anti Money Laundering concluded that generally Fiji had in place adequate systems in this area. A Financial Reporting Transactions Bill is currently making its way through Parliament. This will strengthen the exchange of information and surveillance of suspicious transactions. At the same time, a Financial Intelligence Unit, which has been operating since last year, will be formalised through this Bill.

Fiji is also doing its best to comply with international standards and codes. The IMF completed a review of the Codes of Good Practices in Fiscal Transparency last year and earlier this year completed a Report on Observance on Standards and Codes of Transparency in Monetary and Financial Policies (ROSC). The IMF has also agreed to undertake a Financial Sector Assessment Program (FSAP) in 2006. I believe that Fiji is the smallest island member country of the IMF that has volunteered to undertake such a comprehensive review.

Concluding remarks

Ladies and Gentlemen, let me summarise. I believe that the Fiji economy has come a long way since 2000. The economy is recording its fourth consecutive year of growth, the rates of growth are higher, incomes are rising and investment is picking up after two decades of decline.

In the immediate future, growth is expected to continue but at a slower pace. There are capacity constraints that we need to address.

There are however many challenges for us in the medium term and I have talked about maintaining economic stability and as the key one. Promoting exports is paramount to obtaining sustainability. Ridding ourselves of structural impediments to higher growth is necessary and essential if we are to lift our growth rates higher.

Obviously, these are not easy tasks. It requires commitment and perseverance and will.

But I firmly believe that, as a country, we can overcome these challenges.

Thank you.