

Sada Reddy: Fiji's economic situation

Talk by Mr Sada Reddy, Governor of the Reserve Bank of Fiji, to the Ministry of Information, Communications and Archives, Suva, 22 April 2009.

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I'm very humbled that I had been appointed the Governor of the RBF. I have taken this responsibility at a time when the whole world is going through very difficult times. And, of course, as you know we have our own economic problems here.

There are a lot of challenges ahead of us but I am very confident that with my appointment I'll be able to make a big difference in the recovery of the Fiji economy. I realize the big challenges lying ahead. But given my long experience in this organization running RB is not going to be difficult for me. I've worked in the RBF for last 34 yrs in all the important policy areas and have been the Deputy Governor for the last 14 years so.

It's the policy choices that I have to make would be the challenge. I need the cooperation of the Government, of the financial system, in particular, the banks, and the business community to make our policies successful. In the next few months I'll be actively engaging all the key players and explain our policies and what we need to do so that we are able to somehow buffer ourselves from what's happening around the world. I think we underestimated the impact of the global crisis on the Fiji economy. It is having a very major impact.

Question 1: And when it comes to taking challenges, I know you have taken the “bull by the horn” and the first step was the devaluation of the Fiji dollar. Can you explain what is devaluation and why the devaluation?

Answer: Devaluation is not a new word in Fiji. We devalued our currency, including this time around, four times so far. Twice in 1987. Pretty hefty devaluations. Again in 1998. Because of the Asian crisis, we had to devalue our currency by 20per cent. Actually, when we devalued in 1998 the situation was not as bad as now but we could see it could get worse so it was a preemptive devaluation. This time around the devaluation had other reasons.

But let me explain what devaluation means: devaluation means that the central bank, of course, with the approval of the Minister of Finance, reduces the value of the Fiji dollar by a certain percentage against foreign currencies like the NZ dollar, US dollar and the Australian dollar. So, when we devalued by 20per cent on Wednesday 15th April, 2009, the Fijian dollar was 57 cents US before devaluation and after devaluation was 45 cents US; a drop of 12 cents. By devaluing, what we do is, we make our imports more expensive while our exports earn more. It has two effects: it encourages our export sector and discourages imported items and that's why the need to devalue comes because when I'm talking about exports and imports I'm talking about our balance of payment and our foreign reserves.

Question 2: And as the purpose of the devaluation you have mentioned, there are major sectors that are affected, Can you elaborate on what major sectors and how they will be affected?

Answer: Before I do that, let me explain why we devalued when we devalued. The reason why we devalued is because we've been monitoring our currency closely for a number of years now and our balance of payments.

We've been doing a lot of work over the last 6 to 7 years putting in a number of policies. The economy was growing quite strongly 2003-2004 on the back of booming building and construction industry. Even some of our exports were doing well; tourism was also doing very well. All these were sucking in a lot of imports. That was good, foreign reserves going down due to imports, which go into productive areas is good, but our balance of payments could not sustain that because our exports were not increasing. So we thought, okay, we will not

tighten monetary policy. What we did was we borrowed US\$150 million in Sept 2006 to support our balance of payments so that the investment that was happening in the building industry and all the other areas will start to pay off in couple of year's time. But events overtook us and we lost the advantage of the offshore borrowing. In the meantime, of course, we were hit by this global crisis and the massive floods in January.

So, the situation became very critical and foreign reserves gradually started to fall and quite rapidly in recent months. Our foreign reserves were as high as 6-7 months few years ago. Gradually came down to about 4-5 months to 3 months last year and now 2 or even below 2 and the outlook is not very good. So, I had no choice but to act at this time.

The other good thing was that inflation rate had declined substantially so it provided the right time for devaluation. The inflation rate was only 0.5per cent recently, on an annual basis. With devaluation inflation rate is going to go up quite rapidly.

Inflation is low and you have balance of payment problem, so I think, devaluation is the right way to go. You also know that there was huge speculation in the market place, even people talking about certain percentages of devaluation. So, when that happens capital starts to move out of the country. We can't afford that. So, I had to act very swiftly, which I did on Wednesday 15th April to devalue the F\$ by 20 percent.

Question 3: So what are the benefits of the 20per cent devaluation of the Fiji dollar immediately?

Answer: The immediate effect is that all our exporters are going to receive 20 per cent more in Fijian dollars. Our tourism is going to benefit greatly. The global crisis is really affecting our tourism sector and it is going to have greater effect later on. We had to correct this situation. We cannot go on the way we were doing. One more thing, because our major source markets – Australia and New Zealand are in recession and their currencies had fallen against the US \$ substantially. In our case, our Fijian dollar was strengthening; Fijian dollar, for few months, was stronger than New Zealand dollar. How can you have that? So, it was becoming extremely expensive for Australians and New Zealanders to come to Fiji. Now it would be cheaper for them to come to Fiji and of course when they come they bring with them foreign currency. Our employment in the tourism sector is going to grow and our tourism industry will put more investment and I'm sure that it will have very positive effect all around for all the exporters.

Question 4: Were there any other options other than devaluation whereby you could have handled the current situation?

Answer: As I explained to you, I think we had used up all the options and the time was right to move on the currency.

Question 5: Concerns have been expressed that the devaluation would mostly affect the poor so how do you think the pinch felt by the poor will be cushioned?

Answer: No, everybody will be affected by devaluation. Not only the poor. Of course, the poor will be more affected because of the impact on food prices and so on but there may be some safety net to assist. Maybe those people who are on welfare and so on, the Government may have to look at some options to support them. But where possible I would urge our people, especially our rural people, in the villages and the islands and so on, already they are quite self-sufficient, but they should become more self-sufficient in terms of local food and fruits. People should rely less and less on imported items.

Question 6: How can we grow the economy to ensure long-term sustainability?

Answer: Investment is critical to that process. As you know our level of investment is not very high. It reached about 20-22per cent of GDP in 2004-2006 but since then has fallen to around 15 per cent of GDP. We need to raise our investment to 20 to 25per cent of our GDP. That's a big challenge and there are a lot of issues, which come into investment. We are trying our best to increase investments. Last year Government announced a number of

initiatives to promote investment. We have to provide the right environment for investment to take place. Now, there are some elements missing. In this regard, with devaluation now out of the way, it provides a very stable financial environment for people now to consider investing.

I would urge business sector to concentrate on business. Fiji goes on, we live on, we increase investment, our people have to survive, and we have to grow our economy. There is no choice. We have to invest and make the most of it. I have now provided the right kind policy environment for investment to increase.

In this regard, let me explain a little bit more; we not only devalued the currency, we also acted on interest rates. The interest rate environment is now also stabilized.

I have been very concerned about interest rates in the country.

Let me explain this particular policy because to me this is more important than devaluation. We invited the banks last year at the time of the national budget preparation, and had one on one discussion with the Chief Managers. We said, look we are going through this very difficult time. Every country is going through difficult times. All sections of the community need to get together as partners and assist in this growth process. We pleaded with the commercial banks to play a key role in this and they have great ability to do that. I'm sure they will do that. But I'm afraid I did not see much progress in this regard. We had asked them that by January this year; they should come up with some very clear policies in this regard. When I saw two of the banks increasing interest rates recently, I was dumbfounded.

After the discussions we had with the banks and for them to go ahead and increase interest rates was not acceptable. So I had to introduce some measure whereby we provide a stable interest rate environment as well. Now the currency and interest rates are both stabilized for investment to take place.

Let me explain how the interest rate policy is going to work. What I've told the banks is that the weighted average – it's a technical term but slowly people will understand, the weighted average interest rate of each of the banks, say for instance Bank A, has got a weighted average interest rate of 7per cent in December last year and today their weighted average is say 7.5. I told them, your rate should go back to the rate that was at the end of December last year. But I left it to them to decide at what rate they will lend. I have not interfered with their decision as to at what rate they wish to lend to their individual customers. They can charge any rate, maybe 14 per cent to 5per cent. It's their choice. They set the rate based on the risks of each loan but on average I want them to be at December 2008.

The other thing I did for the first time in the history of the Reserve Bank is to control the spread – ie the interest rate spread which is the difference between the lending rate and the deposit rate. Now, normally this is not done. I was very reluctant to introduce this policy. I have been instrumental in deregulating the financial system in this country. I advised the then Governor of RBF, Mr Savenaca Siwatibau, in 1987/88, that the environment was right to free up interest rates and Siwa accepted my advice and we freed up interest rates. So, I played a very key role in freeing up interest rates and I worked in developing financial instruments; I led the work which set up the Capital Market Development Authority so that the market forces worked. However, as things moved on I could see certain trends developing in banking practices which were not healthy. I had seen banks maintaining their spread even when times are bad for the country.

I'll give the example of 2007 – the economy declined by 6.6per cent and the Banks made huge profits. I have all the information with me – what each bank makes, what is their spread, for how long and how they quickly adjust their rates to maintain their profitability. So, it's the rest of the population which bears the brunt of adjustment while the banks maintain their profitability. To me that is unacceptable. I want to give a very clear signal to the banks that I'm not interested in controlling the interest rates but I want to see banks behaving responsibly in our economy. They must support the growth of our economy. They operate

here. If we all do well, we all benefit, if we go down, let's all go down together. I do not like some sections to take advantage of the situation. That is my sole reason to introduce the policy, which is very unprecedented.

Question 7: How will the devaluation affect the sugar industry and agricultural sector?

Answer: Very positive – they will get 20 per cent more revenue immediately and they'll be encouraged to grow more food, those who are exporting eggplants, chilies and all sort of things, I would encourage them to grow more food – not only for exports, but grow more food for local consumption as well. And this devaluation is going to give that nudge which was required.

Question 8: Going back to Banks – very soon Banks will be advised to open up Micro Finance units, what is the purpose of Micro-Finance and how will it affect the economic growth?

Answer: That is another area that we have been having long conversations for a number of years, as far as 20 years back. I've been personally talking to banks. Please, can you do something, change your banking practices, and don't just concentrate on big businesses. You're operating in Fiji. We are a developing country. We are spread along the islands. See how we can grow the rural sector. That's where the future of the country is. It's the rural sector we need to grow. Without the right kind of financing structure our rural sector can not grow. They have all the resources – Fiji doesn't lack resources. It's got all the resources it needs. We need somehow to get the capital to work with the resources. And the banking system can facilitate that. This is done very successfully in many countries – you go to Asia, South America, almost all the central banks have special micro-finance areas and they expect all the commercial banks to be actively involved in the rural areas.

I visited the Chairman of the Bank of Baroda, few years ago, in Mumbai and he briefed me on what they are doing in India in terms of Micro-Finance and I was very impressed.

There is no reason why banks cannot have Micro-Finance specialization in their operation. There is no reason. We just have to change their mindset – that's the key. People are too stuck with their own style of operation. We want them now to change their mindset, they are operating in Fiji; we are a developing country, we have large number of people in the rural areas and we want them to benefit from our banking industry.

That was the thinking behind making the banks to open Micro-Finance units in each of their branches from Jan next year. To assist in that process I have also announced the set up of a Micro-Finance Research and Development Unit in the Reserve Bank, headed by a Chief Manager, to drive this process. So, in the next few months we'll be having active discussions with all the key stakeholders and we really want to make a difference in a couple years of time.

Question 9: Any comments, any message to the nation?

Answer: As I've said we are going through difficult times. Unfortunately, we had to devalue our currency. The circumstances warranted it. I feel for the people, poor people, but we had to do something in terms of the economy. Prices are going to increase. I urge our people to grow more food, reduce consumption of imported items and be self-sufficient as much as possible. Do not consume too much luxury items; avoid imported items as much as possible. This is a subject, very dear to me. I'll talk a little bit more about this.

It's a question of changing mindsets. Sometime ago I went to Navua. I walked about three hours up the Navua River and got to this village. I was given cordial juice. I didn't refuse but I was sitting under a lemon tree and ripe lemons were lying on the grass. But here I was drinking imported cordial juice. So, I said to the Headman, I would have loved to have this lemon juice rather than the cordial but I found out they feel honoured to serve imported items to a visitor. I said to him, please, this is a wrong thing to do, change your mind – a visitor will love local lemonade rather than a cordial made from imported items.

I'll give you another example; half the country is covered in sugarcane. You never can buy a glass of chilled sugarcane juice anywhere in Fiji – I'm told there is one in Nadi somewhere; I haven't seen it. But you go to Asia almost every stall serves chilled sugarcane juice. But, why not in Fiji?

We tend to drink coke etc all imported stuff, we don't make local fruit juices, our fruits rot. We have the best pineapples and watermelon in the world, and everything from guava to mangoes but do you see our people preparing fresh tropical fruit juices that they can serve hygienically. No. It's all a matter of changing mindset. We have to work on these things. I'm going to propose certain policies to Government in this regard.

Another area that I have been very vocal in my public statements is the hotel industry. They are the biggest culprits in not utilizing more of our local fruits and vegetables because of the mindset. They find it too difficult and their chefs and their systems are all geared to cooking imported food. You go to Asia – almost everything is local, very little imported. I think we should learn from our Asian friends.