

Sada Reddy: Economic indicators and implications – where to from here?

Address by Mr Sada Reddy, Governor of the Reserve Bank of Fiji, at the Fiji Institute of Bankers' Convention, Suva, 23 October 2010.

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Introduction

His Excellency the President of the Republic of the Fiji Islands, Ratu Epeli Nailatikau,
The Attorney-General & Minister for Justice, Anti-Corruption, Public Enterprise, Industry,
Tourism & Trade and Communications, Mr. Aiyaz Sayed-Khaiyum,
The President of the Fiji Institute of Bankers, Mr. Norman Wilson,
Distinguished Guests,
Ladies & Gentlemen

Good morning and thank you for inviting me to speak to you on this occasion of the inaugural convention of the Fiji Institute of Bankers (FIB). The FIB, which will turn 20 years soon, plays a very important role in the training and development of bank professionals in Fiji.

I must congratulate the FIB for this excellent initiative in bringing together professionals and partners from the financial sector as well as stakeholders from the public and private sectors towards a common interest, that is, to establish a vision and strategic direction for the banking sector towards 2015 – the theme of today's convention.

I have great pleasure this morning to speak on the topic "***Economic Indicators and Implications – Where to From Here?***"

First I will provide an overview of the current state of the economy and its future outlook, before I move on to outlining the future policy direction for our economy.

As bankers, we can attest to the prominent role played by financial institutions in the development of any economy. In Fiji, the contribution of the financial sector to total real growth or total value added product of the economy is around 9 percent. As a measure of its size, total assets of the financial sector in Fiji is around 180 percent of the country's overall gross domestic product (GDP). This ratio has increased from about 150 percent five years ago and shows the increasing importance of the financial sector in our economy.

In addition, the financial sector employs around 8,800 people which accounts for around 7 percent of paid employment in Fiji. An efficient and sound financial sector is essential for economic growth. The intermediation process which facilitates the transfer of funds from savers to borrowers, contributes significantly to raising investment, generating income, creating employment opportunities and supporting our economy. As someone said, credit is the oxygen on which businesses grow and survive. Therefore, as would be true in other developing economies, our financial institutions play a very key role in the socioeconomic development of Fiji.

Central to this process is the role of the Reserve Bank in not only ensuring that monetary policy is appropriate but that the financial system is stable and sound. This has become more critical in light of the impact of the recent global financial crisis. The enormous costs borne from the negative impact of the crisis, is a lesson which has forced central banks to rethink their monetary policy strategies and strengthen macro-prudential supervision and regulation, in aiming to avert the adverse impact of possible future crises.

Having said this, it is noteworthy that Fiji's financial system was largely insulated from the direct impact of the global crisis which began 3 years ago. However, the devastating economic fallout and implications of that event on both developed and developing countries has provided valuable lessons for small developing nations like ours. Bankers and regulators have come under increasing pressure to implement reforms, improve supervision, curb

excessive compensation and limit their appetite for risks so that the stability of the financial system is preserved. Nevertheless, the indirect impact of the crisis through reduced global demand for our exports and tourism services, together with the adverse effects of the floods and cyclones on major domestic industries, hugely impacted our balance of payments, which deteriorated significantly early last year, prompting the Reserve Bank to put in place specific policies as a response to the In favourable economic situation. As we saw, the economic situation turned around and the country is now on a path to recovery.

The current economic conditions and outlook for Fiji's economy is stable. However, there are some risks to be borne in mind, which can have possible adverse impact on the economy should they occur. Let me share a little on recent economic developments. As a background to domestic developments, the global economy continues to recover at a better than expected rate. The pace of this growth, while largely driven by Asia, varies significantly across the major regions of the world. In line with the improved outlook for the world economy, the growth of our major trading partner economies from this year onwards are all expected to be positive. This positive outturn augurs well for us in terms of expected increases in visitor arrivals and higher demand for exports.

The latest economic projections for this year show that the economy is expected to grow marginally, following a notable contraction of 3.0 percent last year. This year's marginal growth however, reflects a broad-based recovery, with the exception of the sugar sector. The turnaround in output is expected in the major sectors for wholesale and retail, construction, mining and quarrying, hotels and restaurants, manufacturing, education, fishing and finance, all of which declined last year.

Not with standing the weak turnaround in overall output forecast for this year, performances in some of our major sectors so far have been encouraging. Tourism has recovered very strongly. Visitor arrivals are higher by around 20 percent compared to the last two years. The tourism industry is clearly on track to achieve its targeted 600,000 record arrivals for the year.

Activity in the mining and export sectors is also encouraging. Exports, particularly of gold, fish, mineral water and timber, continue to gain momentum, supported by favourable commodity prices. The outlook for this sector is very promising and bodes well for our balance of trade. In contrast, output in the sugar sector has been very disappointing. Sugar production has been declining over a number of years.

The deterioration in both cane and sugar production has been attributed to frequent mill problems which have restrained cane harvests and affected mill efficiency. Unfortunately, the mill upgrade over the past three years has not been able to produce the desired results and has only added to the debt burden of the Government.

However, the outlook for this critical industry is positive pending the implementation of a range of reforms to bring the industry back to its glory days. It is encouraging to note the Prime Minister's recent pledge to fix the industry and safeguard the livelihood of nearly 200,000 people who rely on the sugar sector. Consumer spending has picked up slightly from levels recorded last year, as indicated by recent partial indicators. Higher Net Value Added Tax (VAT) collections and Pay As You Earn collections indicate growth in private consumption.

This has also been supported by strong visitor arrivals and increases in inward remittances. Inward remittances which has fallen significantly over the last 3 to 4 years is recovering very strongly.

Against this macroeconomic background, the Reserve Bank continues to focus monetary policy on ensuring that the interest rate environment is appropriate and liquidity is adequate at all times to allow credit to grow. Inflation has significantly trended downwards in recent months as the effect of the devaluation has fully worked through the economy.

From a peak of 10.5 percent in April, inflation has fallen to 1.1 percent in September, and is forecast to be around 4.0 percent or less by the end of the year. Foreign reserves, I am pleased to say, have held up very well this year, helped by the strong growth in domestic exports and higher tourism receipts as well as lower import demand. Reserves are currently around F\$1.3 billion, equivalent to 4.0 months of import cover. Not too long ago, foreign reserves had reached critical levels of below 2 month of imports. While inflation and reserves are stable, domestic economic recovery this year has not been as firm as earlier expected, thus posing some concerns to our objectives and the economy's future growth. As such, it is critical that national policies are aimed at facilitating sustainable economic growth which will create long term macroeconomic stability.

To reiterate the views I shared at the private sector consultative forum on the 2010 national budget as well as at the Fiji Institute of Accountants Congress in June this year – the challenge before us is to raise growth – that is to raise investment and exports, improve business conditions, accelerate reforms, raise productivity and diversify the economy.

For its part, the Government remains committed to providing the needed impetus to the economy through collaboration with and providing incentives to the private sector, reduction of operational costs, facilitating competition in the economy, caring for the poor and the marginalised and pursuing plans to modernise and reform the economy.

The Government continues to make progress on implementing structural reforms in all facets of the public service through various reforms including the downsizing of the civil service and the implementation of a more accountable public financial management system. The restructure of public enterprises is to make them more efficient and business friendly.

Investments in infrastructure also remain a key priority given the Government's push for more investment activity. Land reforms now being implemented will greatly boost investment. In particular this will give the farmers in the agriculture sector the opportunity to sub-lease or lease land from the State for investment with certainty of tenure, while improving the rental return to landowners and the State.

This may also provide opportunities for greater commercial agriculture. In partnership with Government, the Reserve Bank continues to do its best to contribute in this national effort. Faced with huge challenges in financial stability early last year, the Bank implemented various policy measures which returned stability to the country's balance of payments position. Since then, the Reserve Bank has implemented various other policy changes to support the Government's efforts to facilitate growth in the economy.

In this regard, the Reserve Bank has taken a number of initiatives to encourage local value added and to reduce imports of goods than can easily be produced locally. In relation to this, the Bank offered sponsorship for training of a local chef in Malaysia. More recently, the Reserve Bank rationalised its \$40 million Import Substitution and Export Finance Facility to make it easier for eligible businesses to access. Exporters and agricultural entities that engage in businesses which will bring down our imports can tap this facility at concessional rates of interest.

Importantly, we continue to partner with financial institutions to ensure that they provide an efficient and effective facilitative role in the development of the economy. I note the enormous progress made towards the development of microfinance in Fiji. It is encouraging to see the active participation from banks and stakeholders from the private and public sectors as well as nongovernment organizations in the various microfinance expositions held so far. These expos are an opportunity for the public to learn about self employment and rural financial services available through microfinance.

The training sessions offered by banks during the Expo events have greatly facilitated this learning curve. The RBF firmly believes that the extension of microfinance and the promotion of greater financial inclusion can contribute to greater economic activities in rural areas and

address poverty alleviation. I urge all stakeholders to continue their efforts towards supporting the development of microfinance in Fiji.

The National Financial Inclusion Taskforce (NFIT), which was established in November last year and is tasked with guiding and monitoring the development towards greater financial inclusion in Fiji, is making good progress. The three working groups under the taskforce are continuing diligently to develop and implement national strategies to improve financial literacy and statistics, and develop microfinance. Some recent work by the taskforce have included following up on a review by the Ministry of Education on how best to incorporate financial education into both primary and secondary school curriculum.

The taskforce has also endorsed a consultancy review on a household financial competency baseline study in Fiji. I am very pleased that the commercial banks and other financial institutions are playing a very active role in the NFIT and its various working groups. Looking ahead, the NFIT will continue to work with the Government and donor agencies to innovate and encourage the use of new technologies, such as telecommunications and mobile money to expand the reach of financial services. In this respect, the Reserve Bank, in partnership with the two mobile companies in Fiji recently launched its E-Money Fiji Project, the first of its kind in the Pacific region, as a new way of providing financial services using mobile phone technology and network. It is very pleasing to note the positive uptake so far of mobile money services by the mobile customer market.

As at September 2010, over 220,000 active users have registered with mobile money while total e-money in circulation totalled over \$670,000. With the active pace of marketing by the mobile companies, we can expect more activity generated by the mobile phone market in the future. More pleasing to note, is the recent new development on potential inward remittances through the mobile phone network, which will have huge positive impact on domestic economic activity.

The establishment of Local Advisory Boards (LABs) for foreign banks in Fiji is another critical step to assisting banks to better understand and align their strategies to the local regulatory and supervisory environment as well as national development objectives. Members of the LABs themselves must have sufficient knowledge and understanding of Fiji's business and socio-economic environment and banking industry and be aware of long term growth strategies of Government.

To date, all LABs are in place with members having met the Reserve Bank's fit and proper requirements. The Reserve Bank provides special induction of all LAB members so that they can fully appreciate and understand their important role in the economy. Another key development implemented last year was the setup of Customer Complaints Processes in place of a Financial Services Commission and Banking Ombudsman. As outlined in the Complaints Management Guideline of the Reserve Bank, this process ensures that customer complaints received by financial institutions are addressed efficiently and effectively, bringing confidence to the customer.

I urge institutions to ensure that a proper policy framework for complaints management is put in place, to guide staff on proper handling of customer complaints. Staff training and public awareness exercises are very critical to provide clear direction to all on each institution's processes. More recently in May this year, the Reserve Bank implemented a new Monetary Policy Framework, aimed at improving the effectiveness of monetary policy implementation by the Bank. The implementation of the new framework marked the return to a market based mechanism for monetary operations following the removal of interest rate controls and lending policies by the Bank.

The modernisation of the framework is expected to improve the transmission of monetary policy. To complement the changes under the new monetary policy framework, the Bank issued a disclosure policy which requires banks to publicly disclose in a press statement, any increase in interest spread above 4 percent.

Additionally, the banks will be required to publicly disclose a base lending rate, which will serve as a reference rate for customers. The Reserve Bank will be issuing a statement on the latter once consultations with banks are completed. Both these changes are expected to benefit consumers and enhance competition in the market. This framework was very well received by the banks and we look forward to their continuing support towards improving the efficient and effective transmission of interest rates in the market.

Reducing the costs of bank intermediation is another important area that the Reserve Bank is pursuing and I am pleased to say that work by a recently established joint ABIF/RBF committee to drive the ATM/EFTPOS Interchange Project, is progressing well and work on this is expected to be completed by the end of this year.

Ladies and Gentlemen, we have weathered the storm of the global financial crisis coupled with several natural disasters over the last 3 years and are expected to recover from this year onwards. Partnership between all stakeholders to ensuring practical solutions are carried out to build our economy and nation is critical.

While much has been done in recent times, a huge part of our growth potential is still at stake should we become complacent. As you know, the Reserve Bank has clearly ventured outside the domain of central banking, in support of Government reforms and policies to move the economy forward.

We hope that, as partners with the Government and the Reserve Bank, you will continue the momentum with which you have worked, to help take Fiji forward towards economic and financial prosperity.

Thank you.