Savenaca Narube: Fiji's economy – performances and prospects

Speech by Mr Savenaca Narube, Governor of the Reserve Bank of Fiji, address to the Fiji Australia Business Forum, Nadi, Fiji, 17 October 2005.

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Economic performance

There should be no doubt that the Fiji's economy has performed remarkably well since 2000 with an average growth of 3.5 percent. Last year, the economy grew by over 4 percent and I understand that the final figure may be even higher.

This level of growth four years in a row, I believe, is hard to match in Fiji's recent history. Our achievement is even more remarkable if we look back at the volatile and precarious situation that we started from. I don't think anyone can argue that our economic management at the macro level has not brought us the desired results. The selected mix of an expansionary fiscal stance and an accommodative monetary policy has worked well to raise domestic demand, which has driven the economy in the last four years. Perhaps, also remarkable was that this buoyant demand has been accommodated in a non-inflationary environment and comfortable balance of payments. Inflation is currently below 3 percent, interest rate is historically low, investments have started to turn north after two decades of general decline and foreign reserves are at adequate levels. I have a strong sense that confidence in the economy may be at its highest level for many years.

Economic prospects

However, the economic scenario is now turning. The economy is now slowing down. This is largely due to the sharp erosion in our market access exacerbated by poor performances in key sectors such as sugar and gold.

What can we look forward to in 2005? Late last year, we projected a growth of 1.5 percent for 2005. In April this year, this growth rate was lowered to 1.2 percent, due to the faster decline in garment production and the unanticipated reduction in gold output. More recently, we upgraded this year's growth outlook to 1.4 percent in August, close to where we started. I guarantee you that this number will change again several times before becoming final.

I am presenting this year's forecast in this way to underline the point that projections are not static and they will change. Forecasting is definitely not an exact science. Projections, of course, depend on information that comes to hand.

There appears to be a perception of inconsistency between our modest growth forecast for 2005 and the buoyant tourism and construction sectors. The only answer that I can give is that our forecast covers the entire economy. And, as I will show later, there are many sectors like sugar, gold and garments that are not doing too well. In fact, if it were not for the tourism and construction sectors, the economy would be in a very difficult situation today.

Medium term projection

For the next two years, we expect economic performance to be below 2 percent. On average, our growth rate for the next three years is less than half of the 3.5 percent achieved in the last four years. I again stress that these projections will change as new information are received.

Let me make two points here. First, to avoid past misinterpretation, let me clarify particularly to the media that may be here today that slowing down does not mean that the economy is declining. It means that the economy is still growing but our rate of growth is lower. While this might appear to be an obvious point, it does make a huge difference. Second, while growth is lower, we estimate that we will nevertheless still be growing in the next three years. This will represent an unprecedented period of 7 consecutive years of positive growth.

But I strongly believe that we should not be contented at growing at around 2 percent. This level of growth is clearly not sufficient to create enough jobs for our growing number of school leavers, will not raise our per capita incomes and very importantly, will not be enough to eradicate poverty in Fiji.

We must all aspire to grow faster towards the national target of 8 percent that the Honourable Prime Minister has set. This remains our greatest challenge. It calls for action.

Sectoral developments

Let us now look at what is beneath this outlook of the economy. We will look at it first from a sectoral perspective.

Tourism

The tourism industry continues to be the star performer. After a growth of 9 percent in the first eight months, the industry is heading for another new record this year in both arrivals and earnings. There is little doubt that tourism earnings are well on their way to reaching the billion dollar target before 2007.

The industry is already hitting its boundaries in terms of availability of high-end accommodation, adequacy of infrastructure and lack of skills. New hotels that are under way will help address the first issue but more rooms will still be needed if the industry is to continue to grow in the future. Government in partnership with the industry will need to play a proactive role in dealing with infrastructure and training.

I am often asked about the retention ratio in the tourism industry. While the retention ratio may be lower in the tourism industry than the resource based sectors and we need to continue our efforts to increase it, my view is that the industry contributes significantly to the country particularly to the lives of the rural communities in Fiji. Something is always better than nothing and in tourism that something is sizeable.

I believe that tourism will continue to drive the economy in the next decade. We therefore need to nurture and protect this star performer to ensure that we exploit its potential.

Building and construction

The boom in the construction industry that started around 2002 is continuing largely at the back of the growth in the tourism industry. This is well supported by construction of commercial and residential buildings in the major urban centres. At the same time, the public sector is contributing its share in the construction of the Rewa Bridge, the extension to the Kings Wharf and the Nadi Airport, as well as the investment by the Fiji Electricity Authority. Total value of the work put in place is growing rapidly and so far this year private sector works alone is rising by a phenomenal 106 percent.

The construction sector is also facing constraints in higher prices of inputs and the adequacy of skills. Unlike tourism, whether we will see the same level of building activity after two years is uncertain. We have therefore built some slow down in this sector in the medium term.

Garments

Garment production has been hit hard by the removal of quotas to the US market declining by 40 percent this year. Another decline of 20 percent is envisaged for next year. However, in the medium term, the garment industry is expected to stabilize at a lower level. Beyond that, some industry experts are confident that garment has the potential to grow by about 5 percent annually. I hope they are right. We will wait and see. The extension of the SPARTECA Scheme by Australia and other assistance will help stabilize the industry.

Gold Production

Despite a sizeable investment program, gold production is projected to decline dramatically this year. This is a major turn around to the bullish outlook following the 15 percent growth in gold output in 2004. Cumulative to August this year, total gold output has fallen by 28 percent. We are really not sure what is happening in Vatukoula but we are told that this reflects equipment failures, high oil prices, productivity concerns and lower quality ore. On a positive note, the mine is currently undergoing a major restructure to lift performance and reduce operational costs. In this vein, the mine anticipates a strong recovery in production in the near term. We certainly would like to see gold production back to at least its historical level by 2007.

Sugar

What about sugar? Everyone knows the problems that this industry faces. The preferential prices for our sugar will start falling from next year, for the next 4 years, leading to the drop in export receipts by close to 40 percent. Everyone also knows that we need to urgently address these critical problems to safeguard the livelihood of close to 100,000 people that are directly or indirectly supported by this industry. In purely economic argument, the opportunity costs of propping the sugar industry will be extremely high. But I share the view that given its social and economic importance, we cannot let this industry slip away. We have built into our forecast a recovery in the sugar production from 2006 onwards based on our faith in the proposed industry restructure. The industry itself is more optimistic of its medium term prospects than we have allowed in our forecast.

In particular, we are encouraged by the industry's performance so far this year. By September, both cane and sugar production has exceeded last year's levels by almost 20 percent. This is one of the best performances recorded by the industry in the last 5 years.

Emerging industries

On the emerging industries, the success of Fiji's mineral water is now well known. New businesses are starting up in this industry. Mineral water exports will fetch some $70 million in earnings this year and has moved up to be the 7th largest foreign exchange earner. With major investment at the Yaqara plant last year, we are expecting the exponential growth in mineral water exports to continue into 2008.

ICT Industry

I believe that Fiji's embryonic ICT and audio visual industry has potential. To enable us to realize this potential in an extremely competitive business, a host of factors will need to be in place. Communication charges in Fiji have already dropped and the introduction of broadband will provide businesses with faster access to the Internet. An ICT park is now in the planning stages. All of these will increase Fiji's appeal as an investment destination. But we will need to build up our manpower capacity in this ICT area to adequately support its full potential and again government's initiative will be important here.

Agriculture and resource based industry

Before I leave this sectoral commentary, let me say something on agriculture and resource-based industry like forestry and fishing. Taking into account our economic endowments, Fiji's long-term prosperity remains with agriculture and resource based industry. Up to now, we have not even reached the potential level of harvesting these resources. We have these resources ready for use. But for some reasons we are not using them. Someone said that this is like seeing a $100 bill on the ground and walking past without picking it up. I might add that not only do we not pick up the bill, we go around the corner, spread our handkerchiefs and beg for gratuity. Fulfilling our own domestic requirements on some of these agricultural products is elusive let alone exporting them. We are unable to meet the needs of our hotels on fruit, vegetables and seafood. We hear a lot about forestry but not as much is coming out of the forest.

We should seriously ask: What can we do to lift this important industry? It appears that the agriculture sector needs a complete overhaul. If we can get this sector moving, the gains are immediate and the benefits flow to many in our rural communities.

Sectoral summary

In summary, our sectoral performances are broadly unchanged from the last time we met. Tourism and construction are the drivers supported by some sectors like mineral water. The garment sector is suffering but may stabilize at a lower level. Gold production is declining but may pick up again in the medium term. Almost all the other traditional sectors are yet to realize their full potential. Our agricultural sector sorely needs to be revitalized. The somewhat optimistic outlook for the sugar sector entirely depends on its restructuring program. ICT has potential but at the same time, we need to put a host of things in place before we can see growth in this emerging industry.

I know that this summary does not sound too optimistic. But there are potential upsides in the tourism industries, sugar and agriculture that if realized will change this outlook significantly for the better.

Aggregate demand

We have looked at the sectors. Let me now talk about the economy from what we economists call the expenditure side. This approach will give some very useful insights on what we could do to raise growth.

To put it very simply, economic growth is an aggregate measurement of what we produce in Fiji. This is equivalent to what we all spend in the economy. The expansionary policies that we introduced after 2000 were aimed at inciting spending in the economy. As I said, this policy package has worked very well and the economy has been driven largely by domestic demand in the last four years. Simply put, people, government and corporations are spending more. This spending comes largely in two parts - consumption and investment. Both these are buoyant and are helping to move the economy along.

Consumption spending

Let me talk first about consumption spending. The buoyancy in consumer spending is clearly reflected in the growth in the wholesale and retail sector, buoyant VAT receipts and strong pick up in credit. While consumption helps growth in the year that it is spent, its impact does not last beyond that. In fact, for an economy like Fiji, consuming more also means more imports and over time this can lead to balance of payments problems if we cannot sell enough exports.

After four years of high consumer spending, this is exactly what we are facing now. Our imports are rising while sadly our exports are not keeping up. As I explained, sugar, gold, agriculture and garments are struggling. Exports in the last three years have declined in absolute terms. We forecast exports to increase only by 3 percent in the next three years. Meanwhile imports are rising by an average of 6 percent annually. The trade deficit is therefore widening. Something will have to close the gap very soon.

The solution is therefore obvious. We must sell more exports. A modest target of 10 percent growth in our domestic exports per year for the next five years should help. And we can easily meet this target if we accelerate the sugar reform, lift the productivity of our agricultural exports and grow the new industries.

Financing of consumption

One may ask where is the funding of this strong consumer spending coming from. Well, from four major sources. Firstly, wages and salaries, secondly, credit or borrowing, thirdly, Fiji National Provident Fund withdrawals and lastly from remittances. Withdrawals from FNPF are running at around $16 million a month.

Remittances

Let me elaborate on the remittances. Personal remittances have become a prominent source of foreign exchange for Fiji. Personal remittances have surged to $300 million in 2004, compared to a mere $50 million five years ago. Remittances are now equivalent to 7 percent of GDP and that is more than many of our traditional economic sectors. They have also displaced garments and sugar on their rise to become the second largest source of foreign exchange earnings for Fiji. Furthermore, we are only capturing remittances that flow through the financial system. There are others that are carried in person and sent through the ordinary mail. There are also those remittances in kind. One estimate puts these unrecorded remittances at over $150 million lifting total remittances above retained tourist receipts.

These remittances have come at an opportune time for us, with our exports not performing well. They have given us much-needed breathing space. Everyone should say thank you to all our peacekeepers, security personnel, nurses, sportspersons and family members abroad for helping us pay for our imports.

This level of remittances warrants immediate national attention. A study estimates that about 40 percent of households receive remittances in Fiji. From experience, remittances generally flow to lower income families and are used more for consumption.

We must understand this phenomenon better. We need to know more about the sender, the receiver and what the monies are used for. Data collection through surveys is a priority and an opportunity is to piggyback on the census due next year.

An important issue is their sustainability. I personally think that the current number of our workers abroad will be maintained or even rise in the next three years. We can therefore sustain the current levels of remittances in the medium term. So far this year, remittances are higher than last year's.

We must acknowledge this valuable source of foreign exchange. I would urge Government to examine ways in which it can maximise opportunities for labour exports, facilitate the sending of these remittances and provide infrastructure and incentives to help channel these into savings, businesses and investments. The linkage of these remittances into micro finance is an exciting possibility.

Investment

Let me turn to investment spending. We know that investment spending permanently increases capacity and lead to lasting economic growth. Over the past 5 years, investment has consistently risen in Fiji from around 12 percent of GDP in 2000 to around 17 percent now - levels that we last attained way back before 1987. Pleasingly, most of the current increase in investment is now driven by the private sector.

We expect investment to hover around this level next year. Some investors understandably may be taking a 'wait and see' approach in the run up to the election. We have set ourselves an investment target of 25 percent of GDP. We have some way to go to reach that target. I am certain that with the election successfully out of the way, we can see investment rising again towards 25 percent of GDP.

However, we should also keep in mind that we can still extract more growth from the existing level of investment. It depends on how efficient we can turn the investment dollar into growth. Unfortunately, our efficiency ratio in Fiji is quite low. It takes around $6 of investment to produce $1 of GDP. Some countries need only about half of that. If we want to improve our efficiency, we must undertake reforms to improve resource allocation, speed up our decision making processes, lower the cost of doing business and enhance productivity.

Net exports

Finally, some may ask that if investment and consumption are buoyant, why then is economic growth falling? When we look at all the three expenditure components of GDP, we see that consumption and investment spending actually accounts for more than 100 percent of the GDP. How can that be possible? The explanation is that our net exports, which is the difference between what we spend on imports from abroad and what we receive from our exports is negative. Yes, I repeat negative! This is exactly what is pushing growth down and is consistent with the sectoral trends that I had explained already. Again, the answer is obvious. Get more exports.

Oil prices

I would now like to turn to international crude oil prices. Demand is not the major cause of this price rise. The high oil prices have been blamed on supply uncertainty with the heightened geo-political uncertainties, natural disasters and the limited spare capacity among the world's oil producers. The future direction of oil prices is uncertain. Some are talking of further increases as the Northern winter sets in.

The oil prices will hit us in three ways. Immediately, our oil bill is escalating. This adds to our already increasing demand for imports, which worsens our deteriorating trade balance.

Secondly, the high oil prices will increase the input cost to businesses. In turn, they will try to pass on these costs to consumers. We are already hearing noises about rising bus fares, taxi fares, freight charges and travel surcharges. All these will lead to higher inflation.

Inflation

We have forecasted inflation to stay at around 3 percent in 2005. Fortunately for Fiji and generally true for the world, the impact of this oil crisis on inflation has been benign compared to the last oil crisis. This is due to several factors. Inflation at the beginning of this oil crisis was low. Many of our trading partners have managed to control inflation extremely well. Lower prices of domestically produced goods and services are also suppressing consumer prices. However, in the next year, inflation could rise as the effects of oil prices work its way through the entire economy. We are projecting inflation to rise to 4 percent next year. This again depends on where the oil price goes from here.

Thirdly, in the medium term the higher fuel costs will ultimately dampen spending and lead to lower economic growth.

Oil Price

The rise in crude oil prices has come at bad time for Fiji when our exports are falling; imports are rising; and economic growth declining. Our immediate concern is its impact on our external position. Clearly, we cannot do anything about the level of oil prices in the world. What we can influence is our response to it. We must avoid the cyclical impact of this inflation back to wages. We must continue the search for alternative sources of energy, we must conserve the use of fuel and also exports more to pay for the rise in oil imports.

Asset price inflation

I would like to move on to another topical subject of asset prices. In the last four years, we have seen significant movement in property values. Anecdotal evidence suggests that prices of residential properties in some centres have almost doubled since 2000. Our assessment, at this stage, is that demand in the property market is expected to remain buoyant.

We can understand some of the underlining factors behind this trend like the growth in incomes, improvement in labour market situation as well as lower interest rates and competitive loan conditions. But we are concerned about the quantum of the price increases that appear to be well in excess to the real rate of growth in incomes or even expected future incomes. It implies that speculative elements may be at work. If asset price bubble continues to be artificially inflated, they not only take the affordability of owning a house out of the reach of many of our citizens, they potentially can lead to unsustainable debt levels particularly if incomes drop with flow on effects to the quality of loans of financial institutions. The Reserve Bank is monitoring the situation closely.

Productivity

Let me briefly raise the topic of productivity. A major challenge for Fiji, in assessing labour productivity, has been the lack of consistent and timely data. Additionally, no national benchmark for productivity at corporate level exists. However, we estimate that productivity growth in the country at the aggregate level has averaged around 1 percent over the last 10 years, on the assumption that the capital to labour ratio has remained stable.

Fiji's one percent average productivity growth is less than half of that of Australia. Mauritius' is four times higher than Fiji's. It is obvious from benchmarking our performance against these countries that

Fiji seriously lags behind in productivity growth. Therefore, if we could raise productivity it would increase our economic growth without using additional capacity or resources.

Financial system

Let me say a few words on the financial system. Fiji's financial system is sound and stable. Total assets are growing well and key prudential indicators of Fiji's financial system are strong. Moreover, the Reserve Bank will modernise the country's payment system by installing a Real Time Gross Settlement (RTGS) System next year.

In terms of combating money laundering and terrorism financing, the Financial Intelligence Unit (FIU), which was previously operating from the Reserve Bank on an informal basis, will now be formally established when the Financial Transactions Reporting Act becomes effective at the beginning of next year. Additionally, a Capital Markets Group is exploring options to further develop the country's capital markets.

Policy mix

I have discussed some of the specific issues that can help us grow faster. I would now like to conclude by getting back to strategy. As I said, both fiscal and monetary policies have been pro-growth since 2000. The result has been a consistent improvement in our macroeconomic performance. But given that economic growth is now slowing, prices are rising and our balance payments needs protecting, one of the key issues facing policy makers is what policy mix can they put in place to address these issues simultaneously.

Unlike 2000, we are now faced with two additional issues. Our debt level is now over 50 percent of GDP and the balance of payments deficit is widening now exacerbated by the hike in oil prices. For these reasons, the expansionary stance of policies up to now may not be appropriate any longer. We need a new strategic mix. What could this be? Perhaps the panel can help us identify this.

The new strategy will need to sensitively balance growth and macroeconomic stability in the short term. This balancing act is a tough one under normal circumstances but becomes more complicated with the general elections around the corner.

But let me shed some thoughts on this balancing act. We have basically two pillars of policy, fiscal and monetary. One of the realities of policy making is that by its nature, fiscal policy has a more immediate and powerful impact on the economy through its annual budget than monetary policy. Therefore, the fiscal stance becomes the de facto policy thrust. One important thing that we should avoid is for the two polices pulling in opposing direction.

If I were given the policy choice, I would put more weight on safeguarding macroeconomic stability now. Why? This stability will certainly deliver us a much better growth potential in the next three years and beyond. But without stability, growth will be at best, uncertain and at worse, virtually impossible. Hence, there is really no conflict between stability and growth in the long run. I would therefore like to see government resist any further expansion in the fiscal deficit beyond what is currently projected. In fact, I expect that the consolidation of the debt position is very high on the government agenda.

Once we know that we can immediately protect our balance of payments and consolidate debt in the medium term, we should then look at the possibility of introducing growth oriented measures. The mix of government expenditure plays a pivotal role in this area. Debt creation should only be available for capital formation and not operating expenditure. We all know that this is easier said than done. The reality of the situation is that government operating expenditure is generally inflexible downwards. Perhaps I can also invite the panel to suggest ways of addressing this difficult issue. In addition, selected incentives can spurn growth in many of our industries particularly the emerging ones.

What then of monetary policy? The Reserve Bank has made our future intention clear early last year when we announced an increase in official interest rate. However, even with this tightening, interest rates are still very low by historical standards and competitive against our neighbours Australia and New Zealand. In no way can one therefore regard current interest rates as impeding investment and growth. Monetary policy remains accommodative. To date, we continue to see strong growth in domestic credit. We think that this will soften somewhat in the next two years. We are monitoring the situation carefully and monetary policy will remain on a tightening bias for the foreseeable future.

With such a mix of fiscal and monetary policy, we can protect our fundamentals and at the same time allow the private sector to lead growth. Interest rates will remain competitive. Investor confidence should continue to rise. The reforms will make our investment dollar go further and higher productivity will generate more growth. I am convinced that such a package can make Fiji to grow higher than the 2 percent that we are projecting now and closer to the 8 percent national growth target.

Concluding remarks

Ladies and gentlemen, in closing, the economy is enjoying a long period of consistent growth. This will continue into the next three years. However, the rate of growth is declining. The greatest challenge remains for us to raise this growth rate to a level high enough to at least create sufficient jobs for our people and close the poverty gap. While we have hurdles to overcome, I stress that they can indeed be overcomed. Untapped potential and possibilities are there. We know what we need to do. We can be proactive and do them now to allow us to reap the benefits as early as possible and secure a more certain future.

Such a gathering as this will help build the momentum for action.

Thank you.