Sada Reddy: Fiji's economy

Presentation by Mr Sada Reddy, Deputy Governor of the Reserve Bank of Fiji, to the FIJI NZ Business Council, Suva, 3 October 2008.

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Outline

The outline of my presentation is as follows:

- Global economic conditions
- Domestic economic conditions
- Summary

Global economic conditions

Global growth is slowing. In its July 2008 forecast, IMF expected global growth to slow to 4.1 percent in 2008 and to soften further to 3.9 percent in 2009. However, in light of the severe global financial crisis, which unfolded in the last few weeks, there is a high likelihood that global growth may further decline. We therefore expect our major trading partners and visitor source markets to have a sluggish outlook for the next two years. Emerging economies, like China and India, may experience some slowdown in growth but will continue to experience relatively high growth rates and may provide some stability to global growth.

Economies	**2007**	**2008(f)**	**2009(f)**
Australia	4.2	2.6	2.6
New Zealand	3.1	0.5	1.7
US	2.0	1.8	1.4
Euro-zone	2.6	1.3	0.9
Japan	2.0	0.9	0.9
China	11.9	9.9	9.1
India	9.0	7.5	7.6
Singapore	7.7	4.2	4.6
South Korea	5.0	4.4	4.3
Source: Consensus Forecast & Asia Pacific Consensus Forecast – Sep-08			

Domestic economic conditions

- **GDP growth**: After contracting in 2007 (-6.6%), our economy is showing some recovery in 2008 (1.7%). Forecasts for 2009 and 2010 are 1.4 percent and 1.9 percent, respectively. These forecasts were released by the Macroeconomic Policy Committee in July 2008. These growth rates are too low and insufficient to generate adequate employment. However, Fiji's economy has been very resilient despite the global economic slowdown and massive increase in fuel and food prices.

- **Major drivers of economic growth**: The major positive contributors to the forecast medium-term growth are tourism (transport and wholesale & retail trade and hotels & restaurants), agriculture, manufacturing and mining sectors, which more-than-offset the negative contributions from community, social & personal services sector.
- **Visitor arrivals**: Visitor arrivals are at historical highs. A strong recovery in visitor arrivals by an annual 12 percent was seen in the first eight months of the year. Using the Fiji Islands Visitors Bureau's growth forecast of around 571,000 visitors for 2008 translates to a projected annual growth rate of around 6 percent.
- **Occupancy**: There has been a huge level of investment in the hotel industry in the last few years where we have seen new hotels, renovations/extension of existing ones and an expansion of services provided (weddings/spas/conventions). The increase in hotels and rooms have seen occupancy levels fall. 50 percent of tourism capacity in terms of room days is unutilised. The challenge for the industry and for the country is to fill these rooms.
- **Sugar production**: Cumulative to August, sugar production has declined by around 23 percent compared to the same period last year. However, the FSC has maintained its forecast of around 246,000 tonnes this year, as against 237,000 tonnes last year, which is an increase of about 4 percent.
- **Gold production**: Vatukoula Gold Mines Ltd expects gold production to reach 25,000 ounces of gold this year from negligible levels last year, after the closure of the mine in late 2006. VGM Ltd is forecasting gold production to exceed over 100,000 ounces in the next 2 years.
- **Raise investment**: Investment is generally flat but sentiments appear to be improving. Government and the Reserve Bank have committed to raising investment activity. Private sector investment is the catalyst for growth as we move forward.

Public finance

- **Government balance**: The overall focus of Government's fiscal strategy for the medium term is aimed at achieving gradual reductions in its budget deficits to attain sustainable debt levels, simultaneously ensuring adequate support for much-needed investment and economic recovery. Over the last 2 years, fiscal policy was directed towards fiscal consolidation to stabilise the economy. Now that the economy has stabilised, there is scope for an increase in capital expenditure to support growth.
- **Government underlying balance**: Latest cashflow data shows that the Government had achieved a net surplus of around $77 million, equivalent to 1.3 percent of GDP, in the first half of the year. This is a result of an increase in total operating receipts (16%), and a fall in operating payments (4%) when compared to the corresponding period last year.
- **Government revenue**: Cumulative to June, total Government revenue amounted to around $658 million, an increase of 15 percent over the year. This was led by higher direct tax receipts ($10m), VAT receipts ($37m) and other indirect taxes ($20m). Compared with the Budget, revenue collections were 9 percent higher ($53m).
- **Government operating expenditure**: The 4 percent fall in expenditure was underpinned by lower payments for supplies and consumables (-16.1%), personnel payments (-11.1%), purchase of outputs (-2.9%), and interest paid (-0.4%). Government operating payments was 19 percent lower than what was budgeted.
- **Government capital expenditure**: Cumulative to June, capital spending totalled $31 million, a 5 percent increase over the year. However, this was 70 percent lower than the budgeted amount.

Government's operating to capital expenditure ratio target is 80:20 for this year, compared to the 90:10 ratio in 2007.

- Government's expenditure restraint so far, coupled with relatively tight monetary policy settings in 2007, has ensured that Fiji's external position was safeguarded. Government now has room to provide some fiscal stimulus to encourage economic activity.

Trade

- **Exports**: Export earnings remained largely flat over the years, averaging around $1.2 billion in the last 5 years. However, cumulative to July, earnings increased by around 21 percent over the comparable period last year, with annual earnings forecast at around $1.4 billion. Exports are forecast to continue to grow strongly in the next 2 years.
- **Domestic exports**: Domestic exports (excluding re-exports) rose by around 15 percent cumulative to July this year when compared with the same period last year.

  The increase was largely attributed to higher earnings from sugar, fish, other domestic exports, mineral water, timber, sweet biscuits, flour, gold, garments and folding cartons, boxes & cases. These more than offset the lower earnings recorded for uncooked pasta, coral, molasses and fruits & vegetables.
- **Sugar exports**: Sugar receipts fell sharply in 2007 as a result of lower production levels and a cut in the EU preferential price. However, earnings are anticipated to pick up this year to around $241 million. Unfortunately, this recovery is not expected to be sustained in the years ahead, as the full EU price reduction is realised next year.
- **EU sugar price/tonne**: Out of the total raw sugar produced annually, close to 85 percent is exported – 60 percent is sold to the EU, under two trade agreements: the Sugar Protocol and the Special Preferential Sugar (SPS) Agreement. Effective from July 2006, the EU preferential price has gradually eroded – altogether, the industry will experience a 36 percent price cut, with the final price reduction coming into effect next year. The local sugar industry therefore needs to implement relevant reforms so as to quickly adapt to the world market.
- **Mineral water exports**: Earnings from mineral water have grown exponentially over the last decade. Receipts are expected to be around $136 million this year. Cumulative to July, mineral water earnings rose by 15 percent, compared to the same period last year.
- **Fish exports**: Fish exports have faired quite well in the last couple of years. Earnings are expected to exceed $110 million this year and grow steadily in the next 2 years. Cumulative to July, fish exports rose by around 19 percent over the same period last year.
- **Timber exports**: Timber earnings (includes mahogany) have been performing well, with earnings expected to improve steadily in 2009 and 2010. For the first time this year, receipts are expected to be over $50 million. Positive developments in the mahogany industry are anticipated to boost revenue into the future. Cumulative to July, earnings rose by 25 percent compared to the same period in 2007.
- **Gold exports**: In line with production gains, gold earnings are expected to rebound to $36 million this year. Next year, receipts are anticipated to soar to slightly over $100 million, a historical first. The recovery of this sector coincides well with the high prevailing gold prices, currently around US$828 per ounce (September average).

- **Imports**: In line with the economic contraction, imports fell last year. However, imports have since picked up and are expected to grow by 15 percent this year to around $3.2 billion. Cumulative to July, imports expanded by 23 percent.

  The increase in imports was underpinned by higher payments for intermediate goods (12%), consumption goods (9%), and investment goods (3%).

- **Food, beverages and tobacco imports**: Cumulative to July, imports of food, beverages and tobacco expanded by 37 percent over the year for the comparable period. Strong annual growth is forecast for the year, with a gradual pick up projected for the next 2 years. The increase in global food prices underpins a substantial part of the current strong growth.

- **Mineral fuel imports**: Domestic imports of mineral fuel (excluding re-exports) have risen considerably since 2000. Last year, imports of mineral fuels declined, given the contraction in economic activity. However, mineral fuel imports have risen strongly so far this year (30%) and are expected to be around $843 million by the end of the year. The import bill for mineral fuel is projected to near $1 billion in the next 2 years. This is mainly underpinned by current high oil prices.

- **Crude oil prices**: In the first 9 months of the year, oil prices have averaged US$112 per barrel. Since its peak of US$146 in July, oil prices have since declined, currently around $US97 per barrel. Strong demand from emerging economies like China, combined with supply disruptions, geo-political concerns, the weak US dollar and speculative demand amidst the US financial crisis have underpinned the movements in oil prices. Prices are anticipated to remain high in the months ahead.

- **Volume of fuel imports**: In volume terms, total mineral fuel imports contracted by around 16 percent cumulative to July over the comparable period in 2007. All categories of mineral fuels declined. The highest decline was noted for automotive diesel followed by motor spirit, aviation turbine fuel and industrial diesel oil.

- **Trade balance**: Except for 2007, the trade deficit has continued to widen each year. This year, the trade deficit is forecast to be around $1.9 billion and be higher in the next 2 years. The widening of the trade deficit remains an ongoing concern.

- **Personal remittances**: These fell significantly in 2007 by around 20 percent. This is likely due to the cautious stance taken by remitters following the political crisis of December 2006. Personal remittances are projected to fall further this year and be flat at around $225 million in the forthcoming years.

- **Tourism earnings**: Except for 2000 and 2007, tourism receipts have grown steadily each year. This year, tourism earnings are forecast at $745 million. Earnings are expected to near the $1 billion mark in the next few years.

- **Current account**: The trade deficit continues to place pressure on our current account position. Despite the surplus in the services, income and current transfers accounts (led by tourism and personal remittances), it is not sufficient to fully offset the current account deficit. This year, the current account deficit is forecast at around $957 million, about 18 percent of GDP and similar levels are projected for the years ahead.

- **Financing the current account**: The current account deficit is largely financed by the capital and financial account, which reflects net foreign investment, as well as the drawdown in foreign reserves, and unaccounted inflows. Unaccounted inflows reflect those items that are not adequately captured by the Fiji Islands Bureau of Statistics. This year, unaccounted inflows are forecast at around $721 million.

Money and credit developments

- **Money and credit**: Private sector credit growth (7%) has stabilised somewhat, from the slowdown over 2007. The recent pick up in private sector credit has been led by credit to the real estate and wholesale, retail, hotels and restaurant sectors.
- **Commercial bank's investment and consumption lending**: Investment lending has picked up (15%), owing in part to allowances made in the administration of the credit ceiling, as special approvals for investment-related projects are given to commercial banks to lend above their ceilings. Consumption lending has also stabilised – the recent pick up (9%) reflects base effects. It is not expected to rise to double digit growth.
- **Commercial banks' private sector lending**: Despite the credit ceiling imposed by the Reserve Bank, lending to the private sector has exceeded the credit ceiling due to special approvals given by the Reserve Bank for special investment projects.

  Special approvals have totalled $272 million. Approvals for building & construction have reached $140 million followed by transport, storage & communication ($21m), electricity, gas & water ($16m) and manufacturing ($16m). Other miscellaneous approvals totalled $79 million.
- **Interest rates**: The lending rate of commercial banks has trended down since early 2007 to around 8 percent in August.
- **Inflation**: Inflationary pressures will continue through to the end of the year. Inflation is expected to rise slightly above 9.5 percent in the coming months before settling at around 7.5 percent by year end. Higher inflation is due mainly to fuel and food commodity price increases in the international markets.
- **Foreign reserves**: In recent years, monetary policy was focussed on protecting foreign reserves. Foreign reserves levels are holding up well at around $911 million. Current levels are sufficient to cover close to 4 months of imports of goods. This is a comfortable level.
- **Exchange rates**: Over the year to September, the Fiji dollar strengthened against the NZ and Australian dollars by around 7 and 5 percent, respectively. However, the Fiji dollar fell against the Euro and US dollar by 6 and 4 percent, respectively.

Summary

- Global economic slowdown may adversely impact smaller island countries in the Pacific, including Fiji.
- Economic growth positive in the medium term but very low.
- Fiji's economy very resilient despite the global economic problems, and high oil and food prices.
- Government's fiscal consolidation over the last 2 years. Greater scope for increase in capital expenditure from 2009 onwards.
- Exports expected to pick up although imports remain strong: trade deficit remains a concern.
- Monetary conditions conducive for growth but will remain tight.
- Inflation is high – downside risks remain high.
- Foreign reserves stable but need to manage carefully.

ADDRESS KEY CHALLENGES NOW:

- Raise economic growth to around 5% plus.
- Reduce reliance on imported fuel – invest in alternative energy and introduce fuel consumption policies.
- Food imports to be reduced through more local production. Will require reforms e.g. land tenure.
- Raise investments through stable and consistent policies and create a more investor friendly environment.
- Reduce trade deficit through growing exports and increasing visitor arrivals to raise occupancy to around 80 percent.