Sada Reddy: National economic update and a path to sustainable tourism growth

Presentation by Mr Sada Reddy, Governor of the Reserve Bank of Fiji, to the Fiji Tourism Forum 2009, Suva, 14 August 2009.

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Introduction

Distinguished Guests

Ladies and Gentlemen

I am delighted to be here today to provide an economic update on the Fiji economy in the context of the global economic crisis and share some thoughts on how to make tourism growth in Fiji more sustainable.

Ladies and gentlemen, in light of the global economic and financial meltdown over the last 2 years, economies the world over are grappling with policy issues that will usher in economic development, progress and stability. For most of these countries, major adjustments and paradigm shifts were required. People needed to think outside of the box and move out of their comfort zone. The situation also demanded them to think creatively and in some cases implement very unpopular policies to work themselves out of the economic and financial challenges.

In the quest to be more competitive and survive in this world, which is increasingly becoming a challenge for countries like us, we need to constantly review our performance, identify the constraints to our progress and be willing to shift paradigms to realise our goals. It is logical that change will often be resisted and initially difficult to accept. But if we are determined in our efforts and have a clear vision of where we want to go and what we want to achieve, then our determination, enthusiasm and creative thinking will not be restrained.

Our country is at a juncture now when we need to direct our energy to making the economy grow. To make the economy grow and grow sustainably, we need to reform. The key word in this regard is reforms. This is a word that is sometimes viewed with scepticism. All sorts of thoughts preoccupy the mind at the mention of reform, most common of which is that people will lose their jobs. Whilst this is understandable, we need to dismiss this myth. As has been proven around the world, reforms are necessary. They allow for more efficient and effective operations.

Reforms enable a country to manage its resources well and gain mileage in their usage. It also facilitates the generation of government revenue and improved government funding position. Reforms help attract investment. The ease of doing business in Fiji in this regard therefore becomes critical. The global economy is competing for the same dollar. We have not ranked well under the World Bank's ranking of the ease of doing business. Singapore is ranked first in the world. What lessons can we learn from them? I am positive that we can address this particular structural issue and improve our world ranking. Investments will create domestic economic activities and help the country grow sustainably.

The sustained performance of the economy is important for employment generation, poverty alleviation, improving confidence and ensuring stability. Like in any other country, unemployment and poverty could become major issues if we do not grow the economy sustainably. The 2003 "Working Out of Poverty" Report by the International Labour Organisation stated that *"Poverty elimination is impossible unless the economy generates opportunities for investment, entrepreneurship, job creation and sustainable livelihoods. The principal route out of poverty is work."* We have to manage the things that are within our control whilst adjusting to those that are beyond us. Reforms in this respect are therefore vitally critical.

This is actually the new economic paradigm that we are pursuing in Fiji. We need to commit to the reform agenda that the government has developed. Our growth performance has been less than impressive over the years. We need to change the way we do things. We need to address the structural reforms necessary to unleash our economic growth potential. We have identified these structural challenges in various forums over the years. Addressing them will be part and parcel of building a better Fiji for all. We have to continue the reform momentum. Other countries are doing it in their endeavour to better their performance. To do otherwise could mean isolation for us whilst our neighbours and others progress.

We must not lose sight of this reality. We need to share this common vision that change is inevitable for us to maximise and put to good use the limited resources we have, improve productivity and efficiency, address poverty and hold our ground in this increasingly integrated global economy. We have to remain competitive. To do nothing or progress at a snail's pace would be to our disadvantage.

I cannot emphasise enough the importance of undertaking reforms now and maintaining momentum. The improved livelihood of our future generation will depend on the sacrifices we make now through economic adjustments or reforms. When we begin to reap the rewards of the reforms in future, though difficult some of them may be, we can stand back and say at that juncture that it has been worth it all.

Ladies and gentlemen, we meet at a time when the global economy continues to go through turbulent times. The numerous downward revisions of world growth by the IMF are an indication of the uncertainties that we face. The recently revised global growth projection for this year shows a contraction of 1.4 percent. However, consensus forecasts of recent months show that the global economy is beginning to emerge out of recession. This is now being popularly referred to as "green shoots". A growth of 2.5 percent is forecast for next year.

Our trading partners have been quite significantly affected as well. Most of them, namely New Zealand, the US, Euro zone and Japan are in recession this year with modest recovery expected for 2010. Basically, it means that demand for our goods and services will decline, which will be reflected in our trade performance and current account balance.

Naturally when the economies of our tourism source markets enter into recession people from these countries tend to travel less. We have been seeing the effects of this downturn on our visitor arrivals since last year.

The global economic recession has not only slowed trade and tourism, but also affected investments through tight funding conditions globally. The effects of these are still being felt by many countries, including Fiji, but the situation has improved a little as of late. Nevertheless, major adjustments by countries are still necessary to sustain these challenging times.

In my view we can now quite safely say that the worst is over in terms of the global recession while acknowledging that the recovery will be prolonged. We are looking at maybe 2 to 3 years before the benefits of global economy begin to pass through the Fiji economy.

You may ask how Fiji fared in these very difficult times.

Well, Fiji's economy was affected on many fronts. The demand for a number of our exports was quite adversely affected. Remittances, which used to form a substantial part of foreign exchange earnings, virtually collapsed. Of course, as I mentioned before, tourism arrivals were significantly affected as well. We also saw that with the massive shifts in global financial flows in the last 12 months the currencies of our major trading partner countries depreciated significantly against the US dollar. This actually led to the Fiji dollar **appreciating** against the currencies of important tourism source markets like Australia and New Zealand. For a brief period early this year the F$ was even stronger then the NZ$. This made Fiji very uncompetitive in terms of tourism.

These impacts on the Fiji economy, of course, had major macroeconomic implications. One of the most significant was the impact on our balance of payments which saw Fiji's foreign exchange reserves plummeting very rapidly. This led to extremely tight liquidity in the banking system resulting in very tight credit conditions early in the year.

This situation led to our decision to devalue the Fiji dollar by 20 per cent on 15th April this year.

At this juncture, let me say that unlike in many other countries, we have not seen any financial distress during this period of global turmoil. No financial institution has gone out of business nor needed financial support or backing. Neither have we seen people losing their homes and collapse in the real estate industry to the scale that have been seen in many other countries. We have managed well so far in light of the prevailing global conditions given our limited resources and stage of economic development. We cannot be complacent though. We need to continue to be vigilant, innovative and undertake reforms or changes that will drive our growth performance.

In terms of GDP, the adverse effects of the global crisis plus the floods in the early part of this year significantly affected the economic growth of Fiji this year. We initially expected a positive growth of over 2 percent for this year but this has now been revised down to minus 0.3 percent. All in all we should take comfort in the fact that the Fiji economy did not get that badly affected as many other countries.

At this point in time we expect our economy to start recovering and register a positive growth of around 2 percent next year.

The pace and extent of our economic recovery will, of course, depend on how quickly the world economy picks up.

Much would depend on the tourism sector that you all are a part of. It is absolutely critical for Fiji that the tourism industry recovers and recovers quickly.

At present, tourism is the major sector in our economy. Obviously, our economy will only be as resilient as the tourism sector, which comprises about **24 percent of our GDP**.

The tourism industry will be the key driver for economic recovery in the next two years. Therefore, all the tourism stakeholders and the Government need to work together to ensure that we increase the visitor arrivals from the current levels. Tourism has the greatest potential at present, compared to the other industries in Fiji, to be the engine to lift the country out of the current difficulties. Owing to significant investment in the industry in the last few years, room inventory has grown substantially – with the existing capacity on the ground, tourism is ready to drive Fiji's growth again, as it has done in the past.

At this stage let me highlight some of the major sectoral developments in the Fiji economy.

Sugar industry

The sugar industry started slowly this season due mainly to the teething problems associated with the mill up-grades. Of course, the flood damage to cane crops and cane farm infrastructure did not help. But once these up-grades are completed, I am sure, we will see the benefits of a much higher level of efficiency and production in the coming years. But we must continue with great urgency in bringing about all other necessary reforms in the industry to make sure that we have a viable and enduring industry. I believe, the Government and the key stakeholders in the sugar industry are working hard to resolve some of the long standing structural and other issues the sugar industry has been faced with for a number of years.

I do not wish to overstress this point but for the Fiji economy to be put on a sustainable footing it is vitally important that the sugar industry once again takes it proper place in the economy given its high local value added and a very high economic multiplier compared to many other industries.

The inevitable reduction in our preferential prices from the EU market remains the major challenge to the industry. The EU sugar prices are expected to decline by 25 percent in October this year. Fiji enjoyed preference sugar prices which were 3 times the world market prices. With the reductions this will now be about 1.5 times the world market price. We therefore have to adapt and adjust very quickly to overcome this major reduction in sugar prices.

In line with expectations, sugar earnings is now forecast to decline by 29 percent this year, compared to a growth of around 34 percent in 2008. The large decline in 2009 is to some extent accentuated because of the higher exports in 2008 due to some 2007 stock exported in 2008.

Mineral water

The global economic recession has had a major impact on the demand for our mineral water exports. Latest figures cumulative to May this year show a 55 percent decline in mineral water export earnings. However, mineral water exports are expected to recover next year with the expected recovery in demand in the major export markets.

Gold

Gold production has seen a significant improvement from last year, as the mine slowly gains momentum led by buoyant world gold prices. Gold exports are anticipated to be just over $60 million this year, compared to $27 million last year. Exploration of gold and other minerals such as copper and bauxite are continuing and there are some encouraging developments in this regard.

Fishing

Fish export earnings have fared quite well over the last couple of years. Fish export earnings was close to $135 million in 2008. In the first five months of this year, fish export receipts were around 22 percent higher than last year.

Again, this industry holds great promise and very clear policies and strategies need to be put in place for sustained growth.

It is very unfortunate that due to our failure to address quality and standard issues we ran into difficulties in exporting fish to the EU market. However, these issues are now being addressed and hopefully our exports to EU will pick up in due course.

Forestry

The forestry sector has been adversely affected by the global economic slowdown. Both exports of woodchips and mahogany have declined. Last year, timber exports fetched $60 million. However, with the sluggish demand, earnings from timber are forecast to decline by 15 percent.

The mahogany industry also holds great future for us as the global economy picks up in the next couple of years. Hopefully we would have put in place strategies to take advantage of the huge mahogany reserves that Fiji has.

Other economic sectors

In 2010, all sectors are projected to grow with the exception of the Community Social and Personal Services Sector.

Balance of payments

Fiji has substantial current account deficit. As a percent of GDP, Fiji's current account deficit is just over 20 percent. This is relatively large for an economy of our size.

One of the main reasons for this persistent and large current account deficit has been the lack lustre performance of our major exports. Exports have been relatively flat over the last four to five years at around $1.3 billion.

On the other hand imports have been growing steadily. Fuel and food make up the bulk of our total imports. In 2008, Fiji's total domestic fuel bill was $810 million while food imports accounted for $520 million. In total fuel and food make up 51 percent of our total domestic imports.

Therefore, to bring about a sustainable balance of payments, we have to do certain things. Either we increase our exports substantially to make up for the increasing imports or we reduce our import bill. We just can't sit back and expect that the balance of payments will take care of itself.

It is for this reason that you will find that the Reserve Bank's policies are geared very much towards correcting the perennial current account deficit that Fiji is facing. If we don't, then our economy, and your industry in particular, cannot grow in a sustainable manner.

I will go into the policy details shortly but before that I wish to share with you a few more economic indicators so you have a better appreciation of the state of the Fiji economy.

Government finances

During the first five months of this year Government revenue surpassed budget by 6.7 percent while expenditure was below forecast by almost 26 percent.

Overall, given the economic situation, this is a very positive outcome for Government finances. One of the concerns of a central bank is that if the economy contracts and the government is unable to maintain budget discipline, it leads to the central bank ending up financing the government budget. This is normally referred to as printing of money. Many countries have resorted to central bank financing in these difficult times. Normally, this is a recipe for disaster. But I am very pleased that this has never been a problem in Fiji.

The Government has been very proactive in containing non-essential expenditure and has embarked on major reforms of the civil service and the public sector. These measures should ensure that the budget deficit is kept in check. It is vitally important that more and more Government expenditure is directed towards capital expenditure. Unfortunately, so far this year capital expenditure has not kept pace with the budget but hopefully things will turn around in the next 4 months.

The Government has been able to fund most of its cashflow requirements through flotation of treasury bills and bonds in the domestic market. The increase in the liquidity in the banking system has meant that all of the government's issues are fully subscribed mainly by institutional investors.

It is pleasing to see that the Government is now able to release a greater amount of VAT refunds than in the past. This must be a big relief to the business sector, which has been raising this as a major issue for a number of years.

Inflation rate

In line with the devaluation of the Fiji dollar, inflation has risen and is forecast to keep rising in the coming months. Consumer prices rose 2.2 percent on an annual basis in July 2009. Prices are expected to rise in the coming months as the effects of the devaluation feed through the economy. There are also risks in terms of increases in fuel prices as the global economy picks up.

Inflation has been forecast at 9.5 percent for this year and next year we expect to see it falling gradually to 2.0 percent.

Foreign reserves

Foreign reserves are now around $760 million. It is a little difficult at this stage to be precise in this measure as we do not have sufficient time series data on imports. As you can understand, with the devaluation, imports have started to decelerate and it will take us a few months to know exactly what the impact of devaluation is on total imports.

Foreign reserves had fallen to critically low levels in the first three months of this year.

This is what triggered the 20 percent devaluation.

I expect foreign reserves to continue to increase in the coming months.

Commercial bank liquidity and interest rates

In line with the fall in foreign reserves in the first 3 months of this year, bank liquidity, that is, the amount of free cash balances that the banks have on a daily basis, fell to a low of around $12 million.

However, with the various policy measures put in place by the Reserve Bank the liquidity has reached levels of over $250 million now. This level of liquidity, hopefully, will engender further downward pressure on interest rates in the coming months.

Government support to the tourism industry

The Government has taken numerous initiatives to position the tourism industry in Fiji to be competitive in light of the global crisis and the growing influence of other tourist destinations in the region. Some of the initiatives include:

- Increased budget allocation to the Fiji Islands Visitors' Bureau (FIVB) to facilitate marketing and promotional efforts;
- Consolidation of the Fiji Islands Visitors' Bureau (FIVB);
- Re-branding of the FIVB to Tourism Fiji; and
- Increased presence of Department of Tourism staff in Nadi.

In recognition of the importance of the tourism industry to Fiji's development and growth, and the challenging global market, the Government designed incentive package for the industry. The incentives, which you all maybe well aware of, include:

- 10 year tax holiday for SLIP investments capital investments not less than $7 million;
- Import duty exemption on all capital goods not available in Fiji, that is used for carrying out the investment; and
- 55 percent investment allowance on total capital expenditure provided there is no shift of revenue offshore.

These incentives were in addition to the existing tourism related duty concessions. The existing customs incentives are:

- 10 percent fiscal duty, free import exercise and 12.5 percent VAT levied on:
  - Building material, furnishing and fittings; and
  - Specialised boat and vessels
- 5 percent fiscal duty, free import exercise and 12.5 percent VAT levied on heavy plant and machinery for project development work.

RBF policies

The RBF announced a number of proactive policies in response to the threat to our balance of payment position owing to the large trade deficit that was compounded by the impact of the global recession and natural disasters that we suffered. I had mentioned the devaluation above. The others included:

- Exchange Controls that were tightened, similar to December 2006.
- Interest Rates were capped to December 2008 levels and interest rate spread (between the lending rate and deposit rate) was fixed at 4 percent.
- Lending Policies – priority sector lending will continue and special approval above the ceiling will still be considered by the RBF.
- Taking proactive "hands on" approach in the development of the key areas of the economy (which are normally beyond the scope of a traditional central bank's role) through the establishment of the new Financial System Development and Compliance Group to look at issues like microfinance & SME development, sustaining remittances flows, financial literacy, rural banking, local value adding and policies to discourage the importation of high value luxury goods.

Let me correct some mis-reporting especially in the overseas media with respect to exchange controls and foreign reserves.

Yes, the RBF did tighten exchange controls in April this year. These measures are absolutely essential to prevent capital flight when there are huge speculations and expectations of currency adjustments. However, let me state here that there are no restrictions on any trade transactions whatsoever. All payments in and out of Fiji are as normal as can be expected. However, we do control Fiji residents' investments abroad. Policies in this regard are either tightened or relaxed depending on how our foreign reserves perform.

On foreign reserves, I did mention earlier that our reserve levels had started to fall rapidly since last year with the onset of the global crisis. Most countries went through similar situation. We all had to take various actions to reverse the trend. This does not mean that we are not capable of meeting our overseas commitments.

Fiji has never failed to meet any of its foreign obligations. Our reserve levels are now reaching comfortable levels and I am sure this should give more comfort to our trading partners.

RBF policies towards a sustainable tourism growth

One of the key policies that the RBF has announced this year is the Local Valued Added Content Requirement for the tourism industry. The Local Value Adding policy announcement by the Reserve Bank requires that any domestic borrowing by the hotel industry from banks for extension or development purposes should have a local value content included. This is to encourage the use of local goods and services. It would help reduce dependence on imports.

Why did we have to introduce this policy? I am sure there is lot of interest in this audience on this subject.

As I mentioned previously, there is no doubt that tourism plays an important role in Fiji. Tourism industry is multi-sectoral by nature; therefore, it supports a number of local industries, like wholesale & retail, transport sector, etc. Furthermore, tourism remains our largest gross foreign exchange earner and also has the most significant growth potential.

You may recall that during my presentation to this Forum last year, I highlighted that the retention rate of tourism in Fiji is around 44 percent, compared to 60 percent in developing countries and between 80-90 percent in advanced economies.

There are a number of reasons for the relatively low retention of our tourism dollar. Earlier I alluded to the persistent current account deficit that Fiji is facing. Tourism industry is one of the highest importers of food and other tourism inputs given that every year we look after more than half the population of Fiji in terms of number of visitors.

Therefore, it is in the long term interest of the tourism industry that every effort is made to increase the local value added. We can take incremental steps now to reverse this retention scenario and move towards the levels achieved in other developing and advanced countries. This is why the RBF has taken steps in this direction.

In our view, the industry can contribute more to the economy and the people of Fiji, through:

- Buying and encouraging local products – e.g. fruits, vegetables, furniture and using local timber for furnishing needs. Of course, we have to improve consistency of supply and quality standards to fulfill this requirement. I believe that relevant government agencies are also taking steps in this regard, particularly the Ministry of Agriculture. As mentioned in the National Budget, improving the links between domestic agriculture and tourism is a priority of the Ministry of Agriculture. Imported agricultural produce for tourist consumption represents a loss of scarce foreign revenue and represents opportunity cost of potential employment and income that could be generated domestically. As such, methods to increase backward economic linkages, including utilising local food products, must be found and developed, ultimately leading to an industry that consistently provides a sufficient quantity of high quality produce.
- Harnessing the use of natural resources – e.g. solar energy, energy efficient buildings. Just ask yourself how many hotels in Fiji use alternative sources of energy? Very few indeed!! How many hotels have solar panels fitted to use the abundant sunlight? Very few. While we market the sun, sand and sea, we don't seem to use these here in our building designs!!

  Our architects and engineers have to adopt more greener and energy efficient designs. We hope that the Town and Country Planning will put in policies which will ensure that future large projects have designs that will conserve energy and are environmentally friendly.
- Contribute more to Environmental Protection – especially coastal areas & eco-tourism sites

In our continuous effort to encourage use of local resources in hotels, the Reserve Bank will look to sponsor from this year the most promising graduate from the Catering and Hospitality Schools to train in one of the Asian countries to study the use of local resources in food preparation. I hope that the tourism industry will do likewise.

Similarly, the RBF will be sponsoring the Prime Minister's Award to the most innovative hotel in utilising local products & environment protection.

We whole heartedly acknowledge and support the ongoing inclusive approach taken by the industry and relevant government ministries to link tourism with agriculture. This is another economic paradigm shift. In this regard, I am aware that the Ministry of Agriculture, with the support of the FITHA will be working on the pilot Farmers Import Substitution Project (FISP) in Sigatoka.

I was very pleased to read in the papers a couple of days ago that the Cabinet has approved the FISP programme as a pilot project in Sigatoka.

This is a step in the right direction and I wish the project every success. Such projects can become catalytic for future related projects in the industry that will help reduce food imports.

I am also aware that some of the large hotels have their own farms. Some, I believe, meet 40-60 percent of their food needs. I commend such initiatives and hope these import saving schemes provide the impetus for other hotels/resorts in the industry to follow.

Conclusion

Fiji, like most other countries, is feeling the impact of the global financial crisis. The domestic economy will contract marginally this year but we expect a positive growth next year.

The challenges for small and open economies like us are multiplied due to our limited resources and vulnerability to these forces, including natural disasters. To sustain ourselves during this period, we need the concerted efforts of government, the RBF, the industry players in the various sectors of the economy and the community at large. We all want to see the economy develop and grow.

The tourism industry has the greatest potential to be the engine of growth in the next two years when the other sectors of the economy may not be doing that well.

It is my hope that the players in the tourism industry will continue to be innovative. In this regard, I look forward to seeing the industry build appropriate response mechanisms to mitigate the effects of the economic crisis. Similarly, that the industry would continue to improve resilience through collaboration, market research & forward looking policies to weather the effects of any threats. For a sustainable tourism in Fiji we wish to see the industry working towards a “Green Tourism Industry” – to lead the way on the transformation to carbon-clean operations, environment management and energy efficient building.

We need to continue to work together for a better Fiji.

I wish the Forum well in its deliberations.

Thank you.