# RESERVE BANK OF FIJI

## QUARTERLY REVIEW

**December 2004**

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# QUARTERLY REVIEW OF THE ECONOMY & FINANCIAL CONDITIONS

**Overview** 3

**The International Economy** 5

International Economic Conditions 5
International Financial Markets 9

**The Domestic Economy** 11

**Domestic Economic Conditions** 11

Consumer Spending 11
Production 11
Public Finance 14
Inflation 15
Labour Market 16
The External Sector 17

**Domestic Financial Conditions** 17

Money Markets 17
Capital Markets 18
Foreign Exchange Markets 18
Financial Intermediaries 19
Banking Industry Quarterly Condition Report - September 2004 20
Insurance Industry Quarterly Condition Report - June 2004 30

**For the Record**
*Monetary Policy Statement* **32**
*Further Exchange Control Relaxations Effective 1 January 2005* **33**

**Regional Economic Integration: It's Worked For Europe, Can It Work For The Pacific?** 35

**Statistical Annex** 40

# OVERVIEW

International economic and financial conditions improved in the December quarter, driven by strong growth in the United States (US), as well as in China. However, on the downside, the South Asian tsunami in late December is expected to have negative economic consequences for Indonesia, Thailand, Sri Lanka and India, the hardest hit countries.

Global inflationary pressures abated over the quarter, as oil prices receded from its peak levels in October.

Our major trading partners are expected to record positive growth this year. The Australian and New Zealand economies' robust growth is anticipated to be driven by higher exports and buoyant domestic demand. The US economy remains on track for strong growth, while the pick up in external demand is projected to improve growth prospects for the Euro-zone and Japan.

The performance of international financial markets was mixed. The US dollar generally weakened against all our major trading partner currencies, while equity markets improved. However, bond price movements varied.

Domestically, the economy is estimated to have grown by 3.8 percent in 2004, driven largely by the construction, wholesale & retail trade and restaurants & hotels, agriculture and manufacturing sectors. For 2005, a slower growth of 1.5 percent is projected.

During the final quarter, indicators continue to suggest that the economy is on track for good growth this year. The tourism industry is estimated to have performed exceptionally well as visitor arrivals reached a new historical high. The cane & sugar industries also recorded a remarkable year, posting significant production gains. Moreover, output in the clothing & footwear and mining & quarrying sectors, as well as the copra, fishing, timber and electricity industries rose over the year.

At the end of 2004, inflation was 3.3 percent. The underlying measure of inflation, the trimmed mean, was 1.6 percent. Inflation is anticipated to be around 3 percent in 2005.

Labour market conditions continued to hold up. Newly registered taxpayers, a partial indicator of employment, rose to a record level in 2004. Survey results also indicated a rise in recruitment intentions, as well as positive sentiments for employment over the next 12 months. Wage growth expectations remain moderate.

Investment also expanded, consistent with the robust performance of the building and construction sector. To date, over $100 million has been spent on capital works and some major projects, such as the transformation of the Cultural Centre in Deuba, began during quarter. Moreover, lending to private individuals for housing purposes and to the construction sector continues to grow.

In the 2005 National Budget, Government announced its intention to reign in the fiscal deficit to around 4.3 percent of gross domestic product (GDP), compared to an estimated 4.8 percent of GDP in 2004.

Including asset sales of $40 million, the net headline deficit for 2005 is projected at $167.1 million, or 3.5 percent of GDP.

According to the latest Overseas Exchange Trade (OET) data, merchandise exports fell by around 7 percent, cumulative to November, when compared to the previous corresponding period. Imports, on the other hand, rose by around 14 percent. This increase was broad-based.

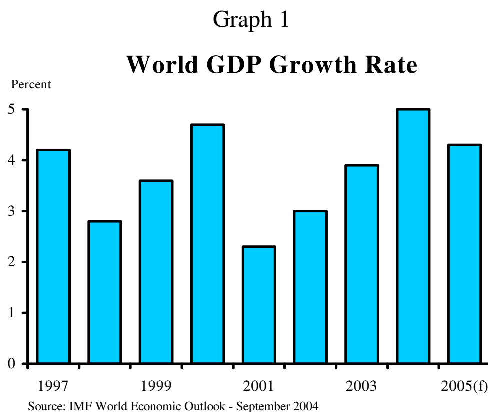
At the end of 2004, foreign reserves were around $789 million, sufficient to cover 3.5 months of import payments of goods and non-factor services or 5.3 months of imports of goods only.

# THE INTERNATIONAL ECONOMY

## International Economic Conditions

International economic and financial conditions improved in the final quarter of 2004, driven by the US economic recovery. In addition, strong economic performances of non-Japan Asia, especially China, and Latin America complemented the positive global outlook (Graph 1). The pick-up in the US economy and the robust growth in China improved prospects for most Asian economies, led by the positive outlook for their export demand.

Graph 1



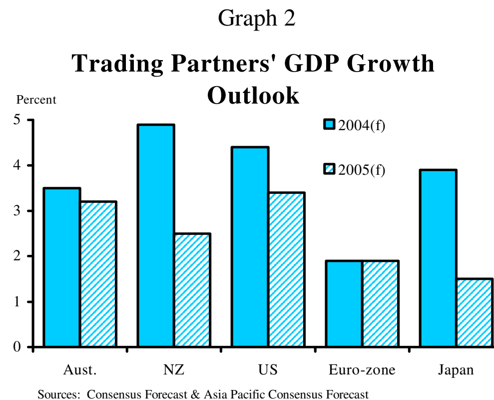

On a negative note, the South Asian earthquake and tsunami in late December severely affected coastal regions in Indonesia, Thailand, Sri Lanka and India. While the overall macroeconomic impact is still being assessed, the tourism industry has been the hardest hit.

Global inflationary pressures remained modest, largely attributed to receding crude oil prices.

Over the December quarter, the performance of global financial markets was generally mixed. Exchange rate movements saw the US dollar generally weaken against all our major trading partner currencies, while equity markets improved. However, bond price movements varied, with Japanese and Australian bond prices rising, while prices for US bonds fell.

All our major trading partners are expected to record positive growth this year (Graph 2). Australia and New Zealand are anticipated to expand strongly, fuelled by higher exports and buoyant domestic demand. On the other hand, consumer spending is expected to underpin the US economic recovery, while robust external demand is projected to improve growth prospects for the Euro-zone and Japan.

Graph 2




The **Australian** economy grew by 0.3 percent in the September quarter, its slowest pace in four years, led by declining exports. The weak growth follows a revised 0.8 percent growth in the previous quarter.

Nonetheless, latest economic indicators have generally been positive. In November, the services industry expanded and

consumer confidence rose to a 10-year high, while the unemployment rate fell to a 28-year low. In addition, manufacturing rose to more than a 2-year high in December, driven by increased consumer spending and exports.

The Reserve Bank of Australia kept its key interest rate unchanged at 5.25 percent, as inflationary pressures abated.

The economy is anticipated to record a higher growth of 3.5 percent this year, before slowing to a growth of 3.2 percent in 2005, led by the projected decline in private consumption. Consumer prices are anticipated to increase to 2.5 percent in 2005, from the expected 2.3 percent this year.

**New Zealand's** economy slowed further in the third quarter, growing by 0.6 percent, attributed to lower consumer spending. This follows a revised 0.8 percent growth recorded in the June quarter.

However, latest economic data generally indicate strong growth during the last quarter. In October, retail sales and consumer spending rose, as the unemployment rate fell to an 18-year low in the third quarter. Moreover, the trade deficit improved in the same month, while business confidence rose close to a 1-year high in December.

Consequently, to ward off inflationary pressures amid rising house prices and strong domestic consumption, the Reserve Bank of New Zealand increased its benchmark interest rate by a quarter percentage point to 6.5 percent in October.

Looking ahead, the economy is forecast to expand by a robust 4.9 percent this year, before slowing down to a 2.5 percent growth in 2005. The year-end inflation is expected to increase to 2.6 percent in 2005, from the current-year forecast of 2.4 percent.

The **US economy** grew at a higher rate of 4.0 percent in the September quarter, following a 3.3 percent growth in the June quarter, largely due to a surge in consumer spending.

Recent indicators have largely been positive. In November, consumer spending rose for the fifth straight month, resulting in an increase in retail sales and industrial production. The index of leading economic indicators, a gauge of growth for the next 6 months, also rose in November. Moreover, in December, consumer confidence rose to a 5-month high, led by the favourable outlook for labour market conditions.

In line with expectations, the Federal Reserve raised its key interest rate twice in the December quarter, by 25 basis points each in November and December, to 2.25 percent. These moves were prompted by expectations of rising inflationary pressures associated with the robust economic growth.

The US economy is expected to record a strong growth of 4.4 percent this year. However, economic growth is expected to slow to 3.4 percent in 2005. Consumer prices are projected to decline next year to 2.4 percent, compared to the 2.6 percent anticipated this year.

The **Euro-zone** economy recorded a sluggish growth of 0.3 percent in the September quarter, from a 0.5 percent growth in the previous quarter, as high crude oil prices and the strengthening Euro dampened demand for Euro-zone exports.

Economic indicators were generally weak. Euro-zone retail sales fell for the fourth

straight month in November, as job cuts and the pessimistic economic outlook discouraged consumer spending. In December, the service industries expanded at its slowest pace in more than a year, while business confidence fell.

Furthermore, Euro-zone's three largest economies, Germany, France and Italy, recorded sluggish performances. In November, German unemployment rose to a 6-year high, while business confidence fell. Moreover, French unemployment reached a 5-month high in November, while Italian business confidence fell to a 9-month low in December.

In line with the subdued economic outlook and expectations of relatively stable consumer prices, the European Central Bank kept its key interest rate unchanged at 2.0 percent during the December quarter.

The Euro-zone economy is expected to record a growth of 1.9 percent this year and growth is anticipated to be unchanged in 2005. The year-end inflation is expected to be around 2.2 percent, before falling to 1.9 percent next year.

The **Japanese** economy rebounded in the third quarter, growing by 0.1 percent, compared to a negative 0.1 percent growth in the June quarter. This was largely underpinned by the recovery in domestic demand.

However, recent data show mixed results. Industrial production rose in November, while the jobless rate fell, after a rebound in overseas demand prompted firms to increase production and step up hiring. On the external front, the trade surplus widened in November, as exports surged.

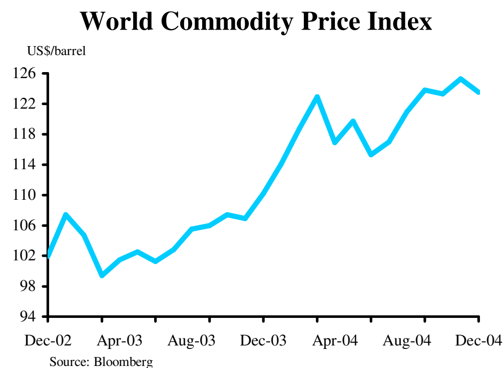
Nevertheless, retail sales fell in November, as household spending fell. Consumer prices also declined in the same month, extending a 6-year spell of deflation.

Nevertheless, the economy is expected to grow by a robust 3.9 percent this year, largely attributed to the strong performance earlier in the year. Next year, the economy is forecast to expand by 1.5 percent. Inflation this year is expected at –0.1 percent, and a similar level is anticipated for 2005.

**World commodity prices** fell by 0.2 percent over the December quarter, largely attributed to a significant fall in crude oil prices (Graph 3). However, commodity prices rose to a historical high in November, led by higher oil and gold prices.

Graph 3

**World Commodity Price Index**

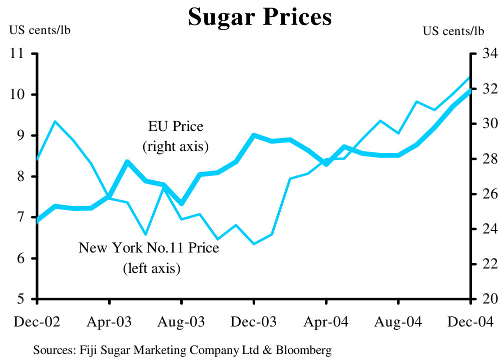



**World market sugar prices** rose by around 6 percent over the December quarter (Graph 4), reaching a 4-year high of around US10.5 cents, on expectations of lower supplies from Thailand[1] and higher demand from India[2].

[1] Sugar production in Thailand, the world's second largest exporter, is expected to fall by 25 percent in the 2004-2005 season, attributed to the current drought experienced by the country.

[2] India, the world's largest consumer of sugar, is expected to increase imports, due to lower domestic production.

Graph 4



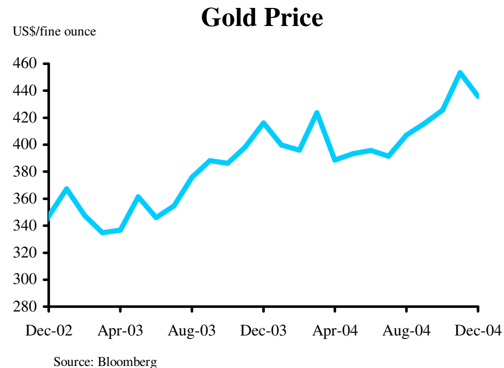

However, in the months ahead, sugar prices are anticipated to decline, in line with higher estimated supplies from Brazil.

At the end of December, the European Union (EU) sugar price was around US32 cents per pound. Over the quarter, the EU sugar price rose by around 11 percent, reflecting a stronger Euro against the US dollar.

**Gold prices** rose by around 5 percent over the quarter, reaching a 16½-year high in November (Graph 5). During the first two months of the quarter, gold prices rose as the strengthening Euro vis-à-vis the US dollar increased demand for the US-dollar-indexed metal from European buyers. The rise in prices was also attributed to higher demand for gold jewellery from Indian buyers (especially during Diwali). However, prices fell in December, as hedge fund companies sold their gold holdings, resulting in excess supply in the market[3].

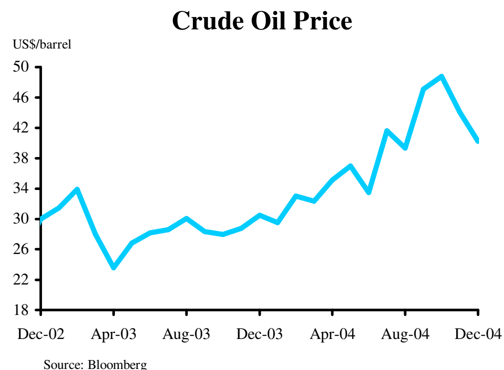
In the coming months, gold prices are expected to remain high (above US$400 per fine ounce), due to ongoing terrorism concerns.

Graph 5




At the end of December, the **Brent crude oil price** was around US$40 per barrel, 15 percent lower than the price recorded at the end of September (Graph 6).

Graph 6




In October, crude oil prices surged to a historical high of US$52 per barrel, following higher demand from China, geopolitical concerns in the Middle East and supply disruptions in Russia, Nigeria and Venezuela. Nevertheless, prices fell in the last two months of the quarter, as the Organisation of Petroleum Exporting Countries (OPEC) increased production and a rise in US inventories eased concerns of a shortage.

[3] Hedge fund companies sold their gold holdings before the year-end, to take advantage of the price increase over the year.

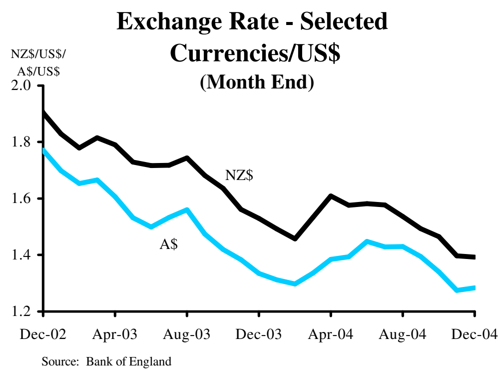
In the approaching months, crude oil prices are expected to remain high, (around US$40 per barrel), on concerns that higher demand from US and China, fuelled by their strong economic growth, will outpace the crude oil supplies to the world market.

## International Financial Markets

Over the December quarter, the US dollar generally weakened against our major trading partner currencies.

Over the quarter, the Australian and New Zealand dollars generally strengthened against the US dollar (Graph 7).

Graph 7

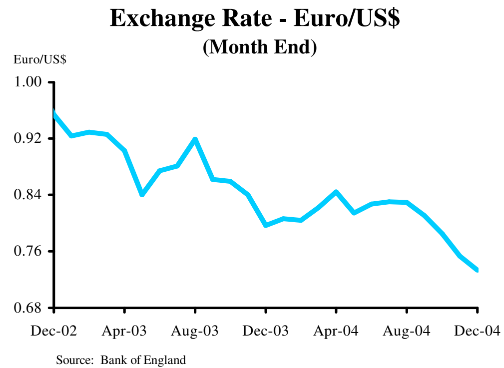



During the first two months of the quarter, the Australian dollar rose against the US dollar, led by a surge in Australia's commodity export prices[4]. However, it slightly weakened in December, as reports of poor growth performance in the third quarter reduced demand for Aussie dollar denominated assets.

The New Zealand dollar strengthened against the Greenback throughout the quarter, as the higher yield premium on the nation's assets over the US treasuries lured foreign investors to Kiwi dollar denominated assets.

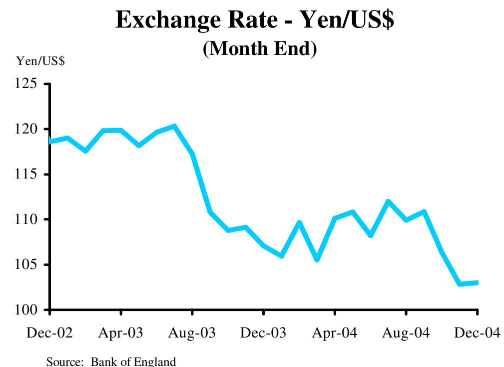
The Euro also strengthened against the Greenback during the quarter (Graph 8), on concerns the widening US budget and current account deficits would derail US growth, prompting investors to switch to Euro denominated assets.

Graph 8




Over the quarter, the Yen generally strengthened against the US dollar (Graph 9), after gains in stocks increased the demand for Yen denominated assets.

Graph 9



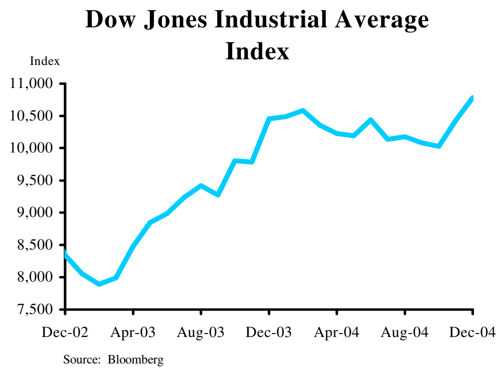

Equity prices generally rose over the December quarter.

Over the three months to December, the Dow Jones Industrial Average Index rose by around 16 percent (Graph 10). Initially, the Dow fell to an 11-month low in October, on

[4] Such as aluminium, copper and gold.

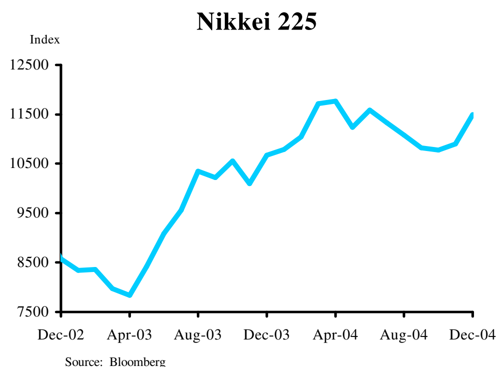
concerns that surging oil prices will hamper profit growth. However, the Dow rose in the last two months of the quarter, reaching a 3½-year high in December. The increase was led by a decline in oil prices and on reports the US economy accelerated in the third quarter. These developments fuelled optimism that US economic growth will be sustained, thus increasing the appeal of equities.

Graph 10




The Nikkei 225 Stock Average Index rose by around 6 percent over the December quarter (Graph 11). At first, in October, the Nikkei fell, as higher crude oil prices dampened the economic outlook, thus reducing demand for equities.

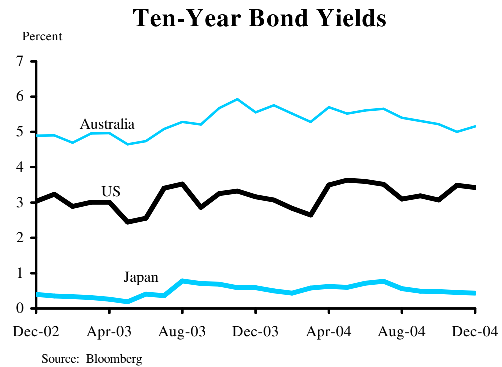
Graph 11




However, the Nikkei rose for the rest of the quarter, on the optimistic profit outlook for exporters, prompted by reports that economic growth in the US, Japan's largest export market, accelerated in the third quarter.

During the December quarter, 10-year bond yields for the US, Japan and Australia showed mixed results (Graph 12).

Graph 12




US bond yields fell in October, as growth concerns lured investors to the safety of Government debt. However, yields rose in November, as demand waned, following a weaker US dollar. Nevertheless, yields fell again in December, as inflationary concerns increased demand for the fixed return debt asset.

Japanese bond yields generally fell throughout the quarter, on expectations that a rally in the Yen against the US dollar may threaten Japan's export-led recovery, increasing demand for Government debt.

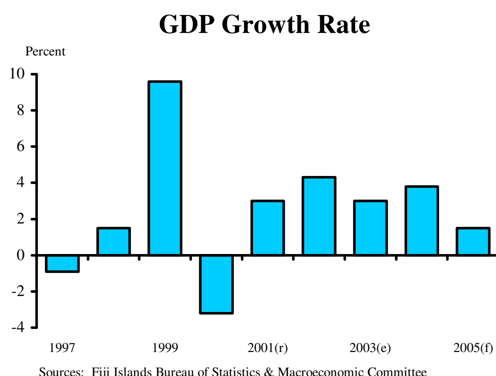
Australian bond yields fell during the first two months of the December quarter, after a strengthening Australian dollar against the Greenback, prompted investors to switch to Australian bonds. Nevertheless, yields rose in December, on expectations of sustained US economic growth, drawing foreign investors to US assets.

# THE DOMESTIC ECONOMY

## Domestic Economic Conditions

Fiji's economy is estimated to have expanded by 3.8 percent in 2004 (Graph 13). Growth was driven largely by the construction; wholesale & retail trade and restaurants & hotels; agriculture and manufacturing sectors. For 2005, a slower growth of 1.5 percent is projected, mainly stemming from lower-than-expected growth in the manufacturing; community, social & personal services and agriculture sectors.

Graph 13




## Consumer Spending

The robust performance of partial indicators suggests that **consumer spending** remained buoyant during the year.

Cumulative to December, net Value Added Tax (VAT) collections from domestic retail activities rose by around 14 percent over the 2003 collections. Moreover, currency in circulation and lending for consumption purposes also grew during the year, further supporting the strong growth in consumer demand.

In addition, favourable labour market conditions and strong growth in personal remittances from abroad continued to underpin consumption activities during the year.

## Production

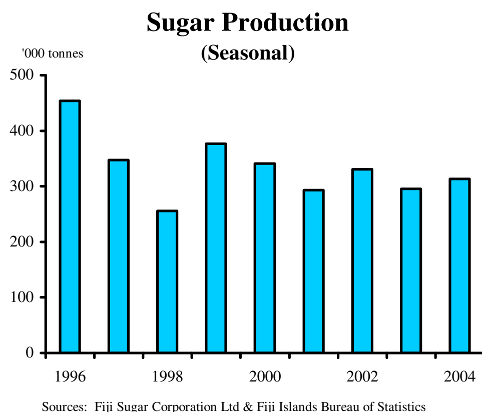
Sectoral performances have generally been positive during the review quarter.

The tourism industry performed exceptionally well during the year. It is estimated that visitor arrivals for 2004 have surpassed the revised target of 486,000 visitors. Investment also expanded, supported by the robust performance in the building and construction sector. The cane & sugar industries also recorded a better year, surpassing targeted levels of production for the 2004 season. Additionally, output in the clothing & footwear and mining & quarrying sectors, as well as the copra, fishing, timber and electricity industries rose over the year.

Compared to the poor 2003 seasonal performance, the **cane** and **sugar** industries recorded a favourable turnaround in production (Graph 14) in 2004.

At the end of the crushing season, total sugarcane produced was around 3 million tonnes, 15 percent more than the previous season. This was also 10 percent higher than targeted levels.

Graph 14




Sources: Fiji Sugar Corporation Ltd & Fiji Islands Bureau of Statistics

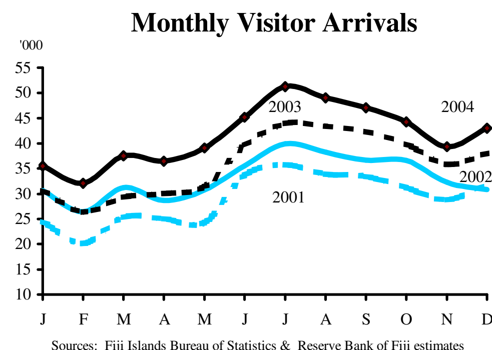
In line with the good cane output, total sugar production during the season amounted to around 313,000 tonnes, around 4 percent higher than the output during the last season. A higher tonnes of cane to sugar (TCTS) ratio recorded for the 2004 season (9.6:1) resulted in the slightly lower growth in sugar output, relative to cane output. For the 2003 season, the comparable TCTS ratio was 8.8:1.

The performance of the **clothing and footwear** industry has been stable during the first 10 months of the year. Total garment exports, cumulative to October, amounted to around $216 million, a slight increase over the corresponding period last year.

On other developments, the US garment quota system that limits garment exports into its country, expires on January 1 2005. Under this arrangement, Fiji exported garments to the US through a quota. With the expiry of this system, Fiji has to face the difficult challenge of competing with major garment producers, such as China and India, for access into the US market. Consequently, industry stakeholders are deeply concerned on the likely negative impact this will have on the domestic industry.

The **tourism** industry is estimated to have performed remarkably well in 2004, as indicated by the healthy growth in visitor arrivals (Graph 15).

Graph 15




Sources: Fiji Islands Bureau of Statistics & Reserve Bank of Fiji estimates

Although the Fiji Visitors Bureau (FVB) had revised the year-end projection upwards, to 486,000, industry liaison and other anecdotal evidence suggests that actual annual arrivals has surpassed this target. The introduction of low cost carriers and the concerted marketing effort of the FVB and the industry have been the main contributing factor towards this exceptional growth.

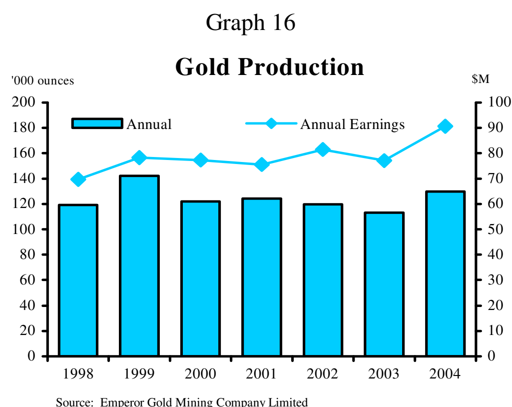
The 2005 annual projection was also revised upwards, to 521,000. Continued services by 'no-frills' airlines, as well as emergence of China, Hong Kong and India as source markets are expected to benefit Fiji tourism immensely. Nonetheless, unexpected natural disasters affecting international travel and tourism pose downside risks to the above forecast.

Output in the **mining and quarrying** sector improved significantly during the review period. In 2004, total gold production amounted to almost 130,000

ounces, 15 percent higher than the previous year's level (Graph 16).

This encouraging level of production reflects Emperor Gold Mining Company Limited's (EGM) commitment to achieving an annual production target of 180,000 ounces by the year 2006.

Graph 16



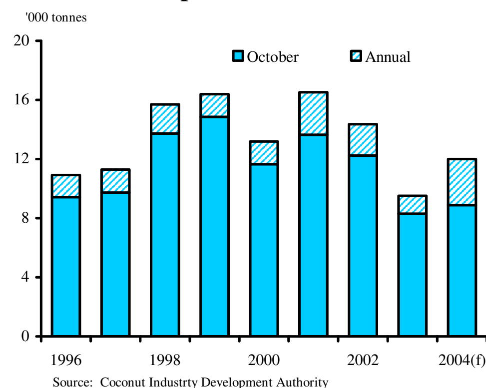

On other developments, the Company's $90 million investment program, initially scheduled for completion in 2004, encountered some delays. However, EGM will continue with its plans in 2005 and complete the remaining projects.

Consistent with the higher production and favourable international gold prices, total export earnings in 2004 increased on an annual basis by 18 percent to $91 million.

Production in the **copra** industry has improved. Latest statistics from the Coconut Industry Development Authority show that cumulative to October, copra production amounted to almost 8,900 tonnes (Graph 17), representing an increase of around 7 percent over the comparable period last year.

The minimum mill gate price of copra was maintained at $500 per tonne in October. Government's subsidy towards the mill gate price was $31.63 per tonne.

Graph 17




The **fishing** industry improved marginally during the January to October period. Trade data indicates that total fish export receipts amounted to around $71 million, representing a marginal increase over the previous corresponding period.

On the **timber** industry, cumulative to October, export receipts were around $36 million, a 21 percent increase over the corresponding period last year. Consistent with this increase, the industry is estimated to have performed well in the last quarter of 2004.

**Electricity** production continues to remain buoyant, consistent with the rise in economic activity. Cumulative to December, total electricity generated increased by 2.8 percent on an annual basis.

According to the Fiji Electricity Authority, the outlook for the electricity industry is encouraging, with a number of major new energy projects lined up for the next 5 years. Moreover, Government's rural electrification schemes were boosted

by an additional allocation of $6 million in the 2005 National Budget. In the last 3 years, these schemes have made 400 new connections and the additional funding will allow further rural communities to access electricity.

The **building and construction** sector has continued its robust performance in the third quarter this year.

According to the September Quarter Building and Construction Survey[1] Report released by the Fiji Islands Bureau of Statistics, around $114 million was spent on capital works in the first 9 months of the year, an increase of 33 percent over the previous comparable period. Cumulative to September, the value of work put-in-place by the private and public sectors rose significantly over the year, by around 36 and 27 percent, respectively.

Major projects that commenced in the December quarter include the EU-funded Information Resource Centre for the Fiji School of Medicine (FSM) and renovation works at the Cultural Centre in Deuba. The Cultural Centre will be transformed into the biggest 600-bed backpacker dormitory in the country.

This is in addition to work in progress at the Suva Central Project (Stage 2), Sofitel Island Resort and Spa, expansion work at the First Landing Resort, development work at the Maritime & Ports Authority of Fiji, continuing construction work at the Rewa Bridge, Colonial Centre, Lautoka Teacher's College and FSM campus. The Sugar City Mall and Royal Davui Island Resort were completed during the December quarter.

In line with the buoyant performance of the building and construction sector, partial indicators also suggest a steady growth in **investment** over the quarter. Lending to private individuals for housing purposes and to the construction sector has generally been trending upwards.

In an attempt to further encourage private and tourism related investment projects, Government, in its 2005 Budget, extended the Short Life Investment Package to 2008. The 40 percent investment allowance, for investments in agriculture, forestry, marine, rural manufacturing and information technology businesses, has also been extended to 2008.

**Public Finance**

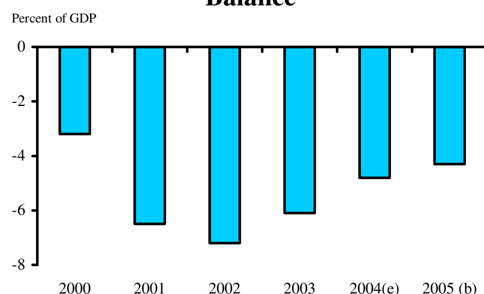
On the fiscal front (Graph 18), Government has revised its underlying deficit for 2004 to 4.8 percent of GDP ($220.5 million) from the initial target of 3.9 percent of GDP ($183.6 million). The higher deficit is a result of the two additional appropriations by Government, totalling $50.9 million, to meet costs related to the flash floods in April and additional requirements of three Government Ministries.

However, on a positive note, the provisional underlying deficit for 2004 is an improvement from the 2003 underlying deficit of 5.9 percent of GDP ($255.9 million).

[1] The Survey covers all private sector enterprises operating in the private and public sectors of the construction sector.

Graph 18

**Government Fiscal Underlying Balance**




Source: Ministry of Finance & National Planning

For 2005, Government's total expenditure is anticipated to increase by 4 percent while revenue collections (excluding asset sales) are projected to increase by 7 percent. Consequently, an underlying deficit of $207.1 million, equivalent to 4.3 percent of GDP, is expected. Including asset sales of $40 million, the net headline deficit is projected at $167.1 million, or 3.5 percent of GDP.

In terms of the Government's operating-capital expenditure mix for next year, the ratio is forecast at 82:18, not very different from the mix for 2004. The allocation for capital expenditure is expected to rise by 6 percent, driven mainly by a strong increase in capital purchases, while operating expenditure is anticipated to rise by 4 percent.

Other major highlights of the 2005 National Budget are as follows:

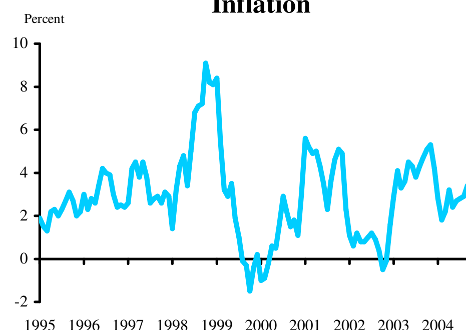
- Increase in the income tax threshold from $7,500 to $8,840;
- An extension of the Employment Taxation Scheme[2] until 2005;
- Sales of government shares, worth around $40 million, in Amalgamated Telecom Holdings Ltd, Colonial National Bank and Fiji Television Ltd; and
- Implementation of the various elements of the Financial Management Reform, which will provide better scrutiny of Government expenditure and also assist in the shift to accrual based accounting.

## Inflation

In the year to December, inflation stood at 3.3 percent, compared with 3.4 percent recorded in September (Graph 19). Over the quarter, consumer prices rose by around 1.2 percent. Prices of heating & lighting, alcoholic drinks & tobacco, transport, food, clothing & footwear and housing increased. These increases were partially offset by falls in the prices of miscellaneous items and durable household goods. The prices of services remained unchanged over the quarter.

Graph 19

**Inflation**




Source: Fiji Islands Bureau of Statistics

The underlying measure of inflation, the trimmed mean, was 1.6 percent in December, up from 1.2 percent in the previous quarter.

In the coming months, inflationary

[2] Allows 150 percent tax deductions to first time employees.

pressures from domestic factors are expected to pick up slightly due to a possible rise in prices of services. However, this is likely to be moderated by a combination of lower expected domestic growth and low trading partner inflation, which are anticipated to keep imported inflation intact. In light of this assessment, the year-end inflation for 2005 is currently projected at 3 percent. Upside risks include the possibility of higher taxi and bus fares.

## Labour Market

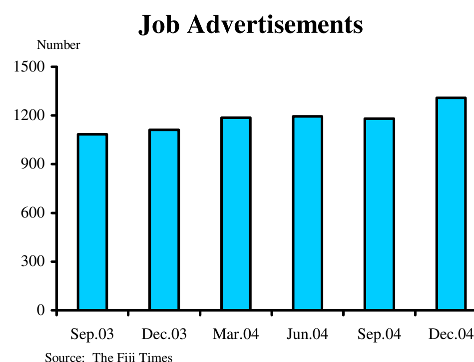
Conditions in the labour market continued to hold up well in the December quarter, as indicated by partial indicators of employment as well as survey data.

For 2004, the total number of newly registered taxpayers with the Fiji Islands Revenue and Customs Authority, a partial indicator for employment, totalled around 10,100. This represented an annual increase of 7 percent and is notably a record level in new taxpayer registrations since records were maintained. Sectors that recorded the most new taxpayers included the finance, insurance, real estate & business services; community, social &personal services and wholesale, retail trade, restaurants & hotels sectors.

Furthermore, the Reserve Bank's December Survey of Job Advertisements reported an increase in firms' recruitment intentions over the quarter (Graph 20). Over the year, the number of advertised positions rose by around 18 percent. The demand for workers was driven by the community, social & personal services; wholesale & retail trade, restaurants & hotels; finance, insurance, real estate & business services; transport, storage & communications and construction related firms.

Graph 20

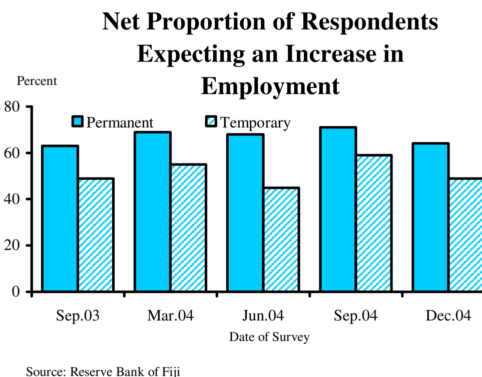
**Job Advertisements**




Looking ahead, the results of the Reserve Bank's December Survey of the Fiji Employers Federation (FEF), suggest a positive outlook for employment over the next 12 months. A net of around 64 percent and 49 percent of respondents expect an increase in permanent and temporary employment, respectively (Graph 21).

Graph 21

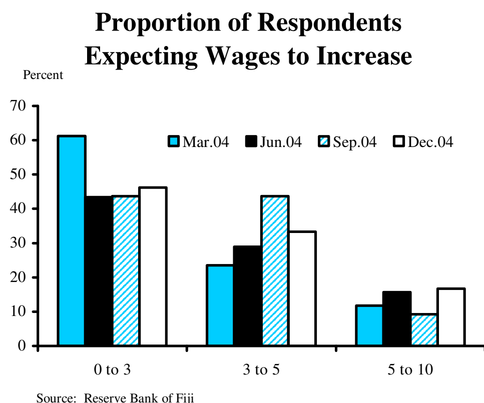
**Net Proportion of Respondents Expecting an Increase in Employment**




Expectations for wage growth are in line with trends (Graph 22). The FEF Expectations Survey revealed that around 79 percent of the respondents anticipate wages to rise between 0-5 percent, while 17 percent expect a rise between 5-10 percent.

Graph 22

**Proportion of Respondents Expecting Wages to Increase**




Source: Reserve Bank of Fiji

Cumulative to August, around 3,900 people emigrated, representing a decline of 4 percent over the corresponding period in 2003. During the review period, fewer workers under the professional & technical and clerical, sales & services categories migrated relative to last year. However, this was partially offset by an increase in the number of agriculture & production and administrative workers leaving Fiji.

## The External Sector

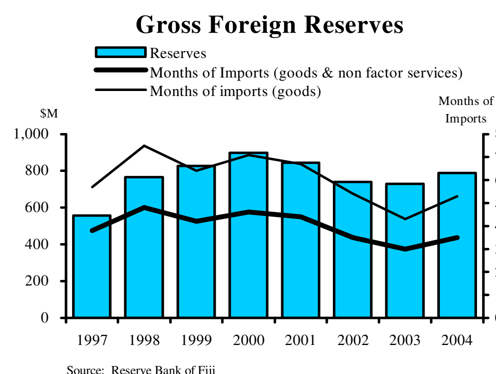
On the external front, recent Overseas Exchange Trade data showed that cumulative to November, merchandise exports fell by 7 percent, compared with a 4 percent decline in the corresponding period last year. The decline in exports was largely attributed to negative contributions from sugar, other exports and fish, which more than offset the positive contributions from gold, merchanted goods, textiles, clothing & footwear and timber.

Cumulative to November, merchandise imports rose by around 14 percent, compared with a 12 percent increase in the corresponding period last year. The increase was broad-based. Higher payments for intermediate goods was led by payments for mineral fuels, raw materials and textiles, clothing & footwear, while the machinery & transport equipment category led the increase in payments for investment goods. The positive contribution from merchanted goods, other imports, duty free goods and government imports underpinned the increase in payments for consumption goods.

Foreign reserves at the end of 2004 were around $789 million (provisional), sufficient to cover 3.5 months of import payments of goods and non-factor services or 5.3 months of imports of goods only (Graph 23).

Graph 23

**Gross Foreign Reserves**




Source: Reserve Bank of Fiji

## Domestic Financial Conditions

### Money Markets

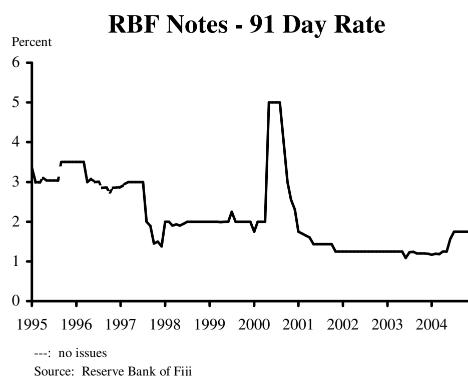
There was a pick up in inter-bank activity during the December quarter, as turnover in the market rose to $132.5 million from $54.5 million in the previous quarter. This was attributed to the lower level of liquidity in November, following net outflows of foreign reserves and a rise in RBF Notes outstanding. In line with the high turnover, the weighted average inter-bank lending rate increased to 1.00

percent during the December quarter from 0.89 percent in the previous quarter.

The Reserve Bank's monetary policy stance remained unchanged during the quarter, with the target interest rate on 91 day RBF Notes maintained at 1.75 percent (Graph 24).

Graph 24

**RBF Notes - 91 Day Rate**




As part of open market operations, around $252.1 million worth of 91-day RBF Notes was allotted in the December quarter, compared with $292.6 million issued in the previous quarter. The yield on the 91-day RBF Notes during this period averaged 1.75 percent, in line with the policy indicator rate.

During the same period, Government made 5 issues of Treasury Bills totalling $80 million, compared with 2 issues made in the previous quarter amounting to $20 million.

Of the statutory corporations, only the Fiji Development Bank (FDB) and the Public Rental Board raised funds in the market. Total promissory notes issued at the end of this quarter totalled $4.8 million.

**Capital Markets**

The Government was the principal issuer of long-term debt instruments in the market during the December quarter. It raised $160.2 million through bonds, with maturities ranging between 3 and 15 years to finance part of its fiscal deficit. During the quarter, yields on government bonds rose across all maturities, with greater increases noted in the longer-term maturities.

The FDB and the Housing Authority also raised bonds during the quarter. Yields on their bonds attracted higher rates than that of Government Bonds.

In the secondary market for bonds, there were 6 trades, amounting to $7.3 million. This compares with 42 trades, amounting to $6.2 million, during the September quarter.

Over the quarter, 500,000 shares were traded on the South Pacific Stock Exchange (SPSE), amounting to $1.2 million. This compares to 900,000 shares, valued at $1.8 million, traded in the September quarter.

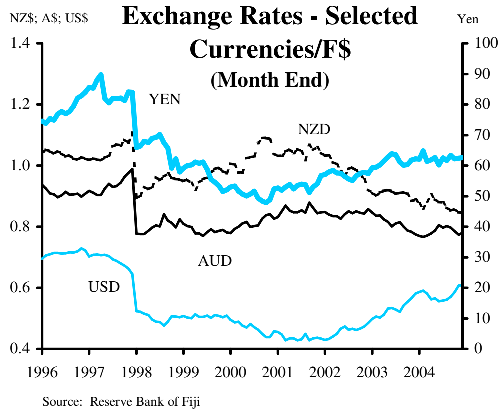
**Foreign Exchange Markets**

In December, the performance of the Fiji dollar against the major currencies was mixed (Graph 25). Compared with the end of September 2004, the Fiji dollar strengthened against the US dollar (6.5percent) but weakened against the Euro (3.7%), Australian dollars (2.1%), New Zealand dollar (0.7%) and the Japanese Yen (1.1%).

The Nominal Effective Exchange Rate Index (NEER), which reflects aggregate exchange rate movements between the Fiji dollar and currencies of major trading partners, rose marginally over the quarter, indicating an appreciation of the Fiji

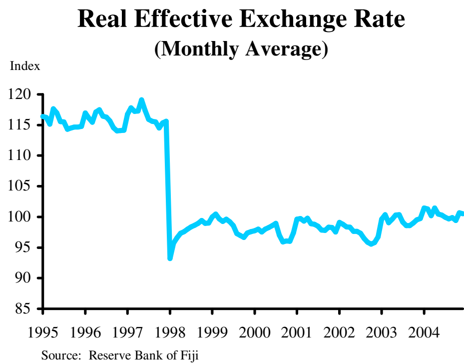
dollar against the basket of currencies.

Graph 25




During the same period the Real Effective Exchange Rate Index of the Fiji dollar, which adjusts the NEER for inflation differentials across Fiji's major trading partners, also rose (Graph 26).

Graph 26



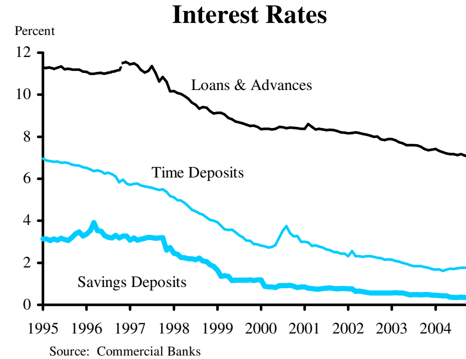

## Financial Intermediaries

Latest movements in commercial bank interest rates generally revealed a mixed trend.

The weighted average lending rate on commercial bank outstanding loans declined to 7.05 percent in November, compared with 7.11 percent at the end of the September quarter (Graph 27).

In the same period, the savings deposit rate rose by one basis point to 0.36 percent, while the time deposit rate remained unchanged at 1.77 percent.

Graph 27

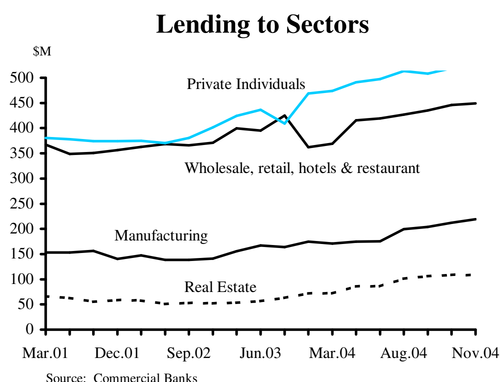



Monetary indicators strengthened in November, reflecting sustained underlying economic activity. In particular, broad money grew at an annual rate of 12.5 percent, influenced by rises in demand and savings deposit. During the same period, demand for transaction balances improved, reflecting resilient consumer spending. Narrow money, which consists of demand deposits and currency in circulation, rose at an annual rate of 20.7 percent.

Ample liquidity and prevailing low interest rates effectively supported the financing needs of the private sector during the quarter. In the year to November, private sector credit rose by 16.5 percent, following an expansion of 14.7 percent in the previous quarter. During the same period, the total amount of loans outstanding in the banking system increased by 18.2 percent with increased lending noted for the private individuals, manufacturing, real estate, public enterprises, wholesale, retail, hotels & restaurants and the building & construction sectors (Graph 28).

Graph 28

**Lending to Sectors**




Source: Commercial Banks

In contrast, commercial bank lending to the agriculture, mining & quarrying, central & local government sectors declined.

Total outstanding loans and advances by Licensed Credit Institutions (LCIs)[3], rose by 24.1 percent in the year to October, underpinned mainly by higher lending to private individuals, real estate, building & construction, transport & storage and wholesale & retail trade sectors. On the other hand, lending to the public enterprises and professional & business service sector declined during this period. Compared with the previous quarter, the weighted average lending rate on LCIs' outstanding loans fell by four basis points to 11.79 percent.

**Banking Industry Quarterly Condition Report – September 2004**

**Overview – Commercial Banks**

For the quarter ended 30 September 2004, the banks continued to perform satisfactorily. Profitability was strong, with adequate level of capital, while the quality of assets was satisfactory.

- **Total assets** for the banking industry were $2.4 billion in September, up by 3.3 percent from the previous quarter and 5.8 percent over a year ago. Increased lending ($66 million) during the quarter fuelled this expansion, the bulk going to the private business sector.

- Banks' **profitability** was strong, with net profits before taxes growing by 21.5 percent compared to the June 2004 quarter and by 9.7 percent against the same period last year. This profitability translated into a return on average equity (annualised ROE) of 41.5 percent and return on assets (annualised ROA) of 2.9 percent. The increase was attributed to the growth in net interest income of $1.7 million (6.6 percent) over the previous quarter and growth in non-interest income of $1.3 million (6.8 percent). Lower bad debt and provision expenses of $0.8 million (42.1 percent) and operating expenses of $0.6 million (2.8 percent) also contributed to the improvement.

- **Asset quality** is considered satisfactory. Total banking system classified exposures-to-total loans as at 30 September stood at 4.3 percent.

- All banks were above the minimum **capital** adequacy ratio of 8 percent.

- The **liquidity** position of the banking industry is considered satisfactory, despite a marginal decline in liquid assets in the September 2004 quarter to $662 million (September 2003: $757 million). This stood at 31.24

[3] LCI's include Merchant Finance Investment Company Limited, Credit Corporation (Fiji) Limited and Home Finance Company Limited.

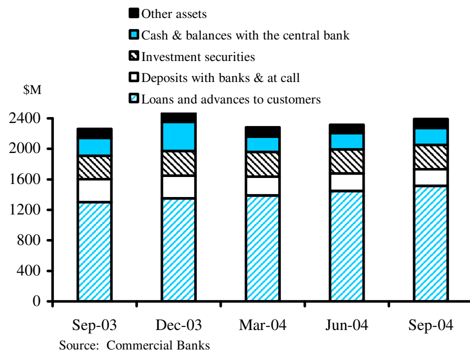
percent of total deposits as at quarter end.

## Balance Sheet

Total assets for the banking industry were $2,392 million, up by 3.3 percent over the previous quarter and 5.8 percent more than that recorded a year ago.

Graph 29

**Structural Change and Growth of Bank Assets**



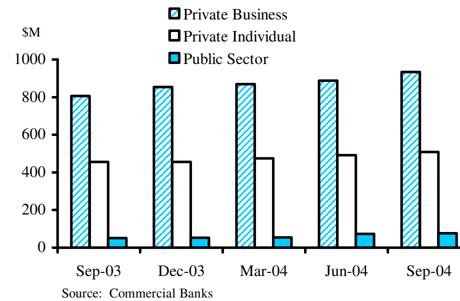
Source: Commercial Banks

The graph above (Graph 29) shows the growth in bank assets and changes in asset composition, which resulted largely from growth in lending. Total net lending growth of 16.5 percent over the previous year reflects optimism by the business sector as most of the loan growth in the review quarter originated in the private business sector. This sector grew by 5.2 percent ($45.8 million) over the quarter and 16.0 percent ($128.7 million) over the previous year.

Sectors that registered loan growth included: manufacturing, real estate, wholesale, retail, hotels and restaurant, transport & storage, professional & business services and electricity, gas and water. However the expansion in private business sector lending was constrained in the agricultural sector by the fact that lending to the sugar cane growing sub-sector, which represents 31.8 percent of agricultural loans, continued to fall (Graph 30).

Graph 30

**Loans and Advances by Sector as Percentage of Total Loans**



Source: Commercial Banks

Lending to private individuals rose by 3.5 percent ($17.4 million) to $508.5 million. This was largely driven by increases in residential mortgage lending, which dominates lending to private individuals. Public sector lending increased by 4.2 percent ($3.1 million) to $77 million.

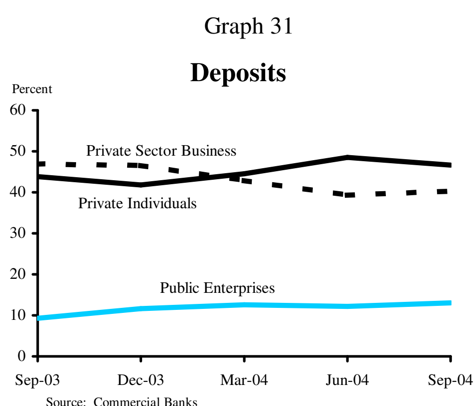
On the liabilities side, deposits remained the major source of funds for banks. The aggregate deposits of the banking industry showed an increasing trend over the quarter (3.9 percent), as well as over the year (8.2 percent). Total deposits stood at $2,120 million as at 30 September 2004.

Demand deposits comprised the bulk of the deposits (41 percent), followed by time deposits (31 percent) and savings deposits (28 percent). The graph below outlines the ownership of deposits by sector (Graph 31). It shows that, as of September 2004, 43 percent of the total deposits had been placed by private individuals, 37 percent by private sector business entities and the remaining 10

percent by the public sector. The graph indicates that no significant change has been noted in the composition of deposits over the past year.

Graph 31

**Deposits**




Source: Commercial Banks

Banks' total capital and reserves rose $5.2 million or 6.5 percent due to higher retained profits resulting from improved profitability.

## Profitability

Consolidated bank profitability in September 2004 was relatively strong, with net profits before taxes growing by 21.5 percent over the quarter and by 9.7 percent against the same period one year earlier. This profitability improvement translates into a return on average equity of 41.5 percent (annualised), up from 38.8 percent in the previous quarter and 39.9 percent in the same period last year.

Higher net interest income was the most significant contributing item, increasing by $1.7 million (6.6 percent) over the previous quarter, while non-interest income rose $1.3 million (6.8 percent). A decline in bad debts and provision expenses of $0.8 million (42.1 percent) and operating expenses of $0.6 million (2.8 percent) supported the improved profitability of banks.

**Bank Profitability**

| | Sep-03 | Jun-04 | Sep-04 | % Change | |
|---|---|---|---|---|---|
| | $M | | | Over Qtr | Over Yr |
| **Net interest income** | 24.63 | 25.54 | 27.22 | 6.6 | 10.5 |
| *Add:* **Non interest income** | 23.51 | 19.63 | 20. 96 | 6.8 | -10.9 |
| Income from OET | 8.84 | 7.27 | 7.30 | 0.4 | 17.5 |
| Commission | 2.19 | 2.61 | 2.55 | -2.3 | 16.5 |
| Fee Charges | 11.52 | 9.05 | 10.41 | 15.1 | -9.6 |
| Other income | 0.96 | 0.70 | 0.69 | -0.8 | -27.4 |
| *Equals:* | | | | | |
| **Total operating income** | 48.14 | 45.17 | 48.17 | 6.7 | 0.1 |
| *Less:* Operating expenses | 21.06 | 22.32 | 21.68 | -2.8 | 3.0 |
| *Less:* Bad Debts & provisions | 3.99 | 2.00 | 1.16 | -42.1 | -71.0 |
| *Equals:* | | | | | |
| **Profit before tax** | 23.09 | 20.85 | 25.33 | 21.5 | 9.7 |
| *Less:* Tax | 6.15 | 5.52 | 7.87 | 42.7 | 28.0 |
| *Equals:* | | | | | |
| **Net profit after tax** | 16.95 | 15.34 | 17.46 | 13.9 | 3.1 |

Source: Commercial Banks

For the quarter, banking industry profitability has also been strong in terms of return on average asset, growing by 0.2 percentage points on a before-tax basis and by 0.1 percentage points on an after-tax basis.

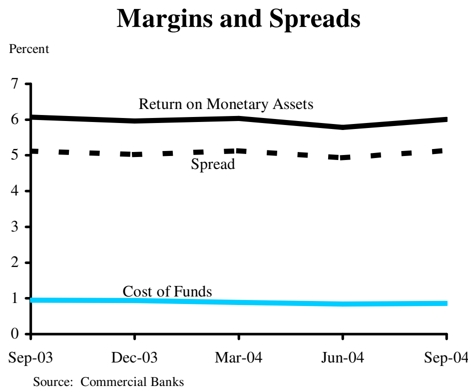
The major component contributing to the increase in net interest income was interest-received on business loans. Interest expenses rose 5.1 percent ($0.2 million) over the quarter. This rise in interest expenses can be attributed to the growth in the value of deposits. The major component that contributed to non-interest income rising over the quarter was income from fees, which rose by $1.4 million.

## Interest Margin and Spread

Both the interest margin[4] and interest spread widened in the September quarter, as the increase in yield on earning assets was greater than the increase in the cost of funding liabilities. Net interest margin was 4.1 percent for the September quarter compared to 3.7 percent in the June quarter (Graph 32).

Graph 32

**Margins and Spreads**




Source: Commercial Banks

## Asset Quality

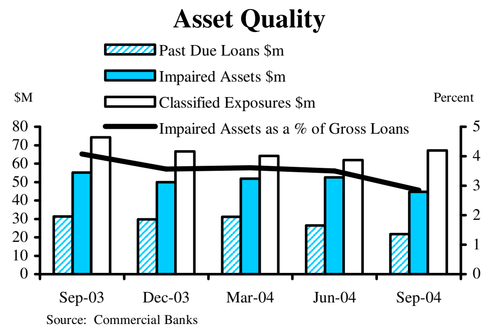
After some improvement in banks' asset quality over the last four quarters, the classified exposures[5] of the banking industry increased by 8.2 percent from $62 million in June 2004. However, compared to September 2003, classified exposures had substantially declined by 9.6 percent to $67.1 million in September 2004 (Graph 33).

Total impaired assets (non accruals) of the banking industry improved further by 14.9 percent to $44.7 million, in the review quarter (September 2003: $55.1 million). As at 30 September 2004, impaired assets were just 2.9 percent of total lending, having improved by 40 basis points compared to the June 2004 level.

Doubtful loans continued to represent the majority of impaired assets, comprising 69.2 percent of total impaired assets as at end September 2004, followed by the loss category (27.8 percent). Substandard loans made up the remaining 3 percent. The improvement noted in the substandard category of the impaired loans was due to the reclassification of non-accrual accounts to fully performing status.

Graph 33

**Asset Quality**




Source: Commercial Banks

Total past due loans (excluding 1-3 months) decreased significantly by 18.8 percent to $21.7 million in September 2004. Substantial reductions were noted for all categories including the 1-3 months category as well (Graph 34).

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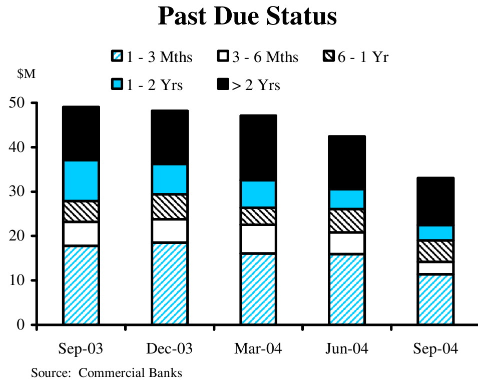
[4] Defined as net interest income divided by average interest earning assets.

[5] Credit facilities falling under Substandard, Doubtful and Loss categories of loans as defined in the Banking Supervision Policy Statement Guideline Number 3 of the Reserve Bank of Fiji.

Graph 34

**Past Due Status**

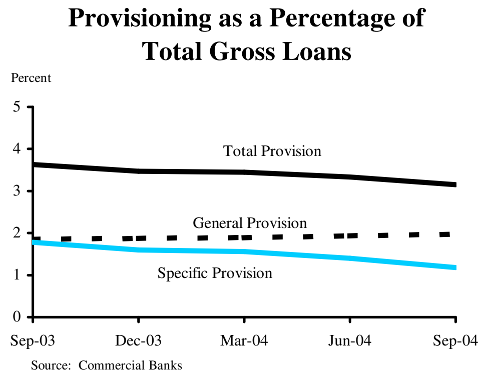



Source: Commercial Banks

In line with decreasing impaired assets, specific provisions of the banking sector declined to $18.5 million from $21.0 million in June 2004 (Graph 35).

Graph 35

**Provisioning as a Percentage of Total Gross Loans**



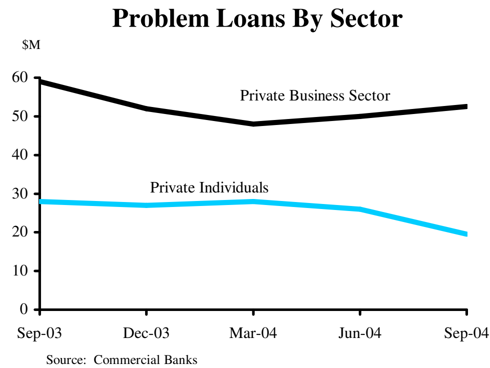

Source: Commercial Banks

While specific provisioning trended downwards, general provisions showed an opposite trend, with a 6.7 percent increase reported as at the end September 2004. As a percentage of the gross loan portfolio, general provisions rose slightly by 4 basis points to 1.9 percent. The trend in general provisions may be attributed to a conservative stance taken by banks in Fiji.

Problem loans were largely loans to the private business sector (Graph 36). Most of the problem loans to private businesses are to the wholesale/retail and hotel sector. This sector dominates the problem loans of banks, representing 48.8 percent of total problem loans, followed by private individuals (27.1 percent) and manufacturing (4.9 percent). The remainder of the problem loans were distributed to other small sectors of the economy.

Graph 36

**Problem Loans By Sector**




Source: Commercial Banks

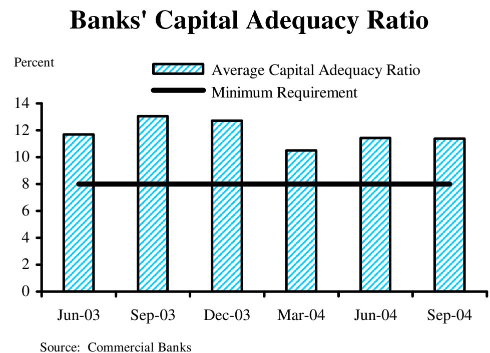
Problem loans in the wholesale, retail, hotels and restaurant in the private business sector increased from $29.3 million in June 2004 to $35.6 million in September 2004.

## Capital Adequacy

The capital adequacy ratio for banking industry at the end of September 2004 quarter was 10.5 percent (Graph 37).

Graph 37

**Banks' Capital Adequacy Ratio**



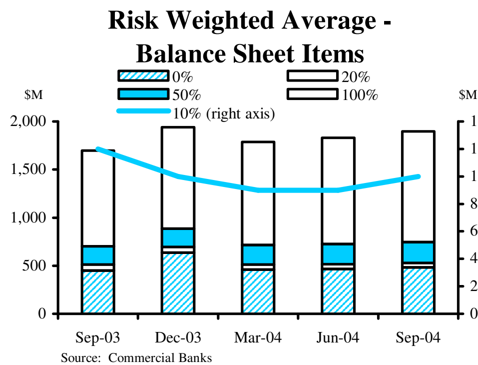

Source: Commercial Banks

Total on balance sheet risk weighted credit exposures grew by 3.8 percent during the September 2004 quarter while the off balance sheet exposure increased by 2.6 percent. In dollar terms, off balance sheet items amounts to $116.7 million or 7.6 percent of the total risk assets. Off balance sheet items are subject to a prior credit conversion factor where each type of off-balance sheet exposure is converted to an on-balance sheet credit equivalent, to take account of the likelihood that the item will result in a credit exposure.

Total risk weighted assets increased over the quarter by $56.2 million due to increases in loans to the private business sector ($37.4 million), classified under risk weight of 100 percent, loans fully secured by residential mortgages ($13.9 million), classified under risk weight of 50 percent and investments in government and government guaranteed securities with maturities over one year (Graph 38).

Graph 38

**Risk Weighted Average - Balance Sheet Items**



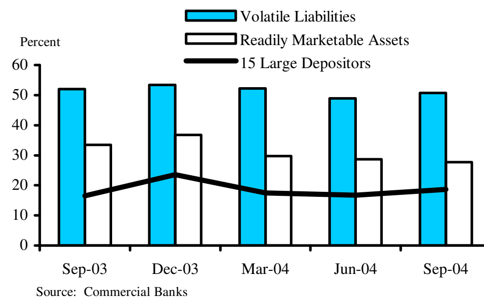

## Liquidity

During the September 2004 quarter, liquid assets declined marginally to $662.3 million (September 2003: $756.7million). Maturity mismatches of the banking industry, as a whole, reported sufficient liquidity to meet the cash outflows and any unexpected withdrawals.

Volatile liabilities increased over the quarter by 6.9 percent to $1,212 million (Graph 39). Volatile liabilities made up more than half (57.2 percent) of total liabilities, which was 8.0 percentage points above the previous quarter level.

Graph 39

**Volatile Liability Coverage**




The value of funds held by the 15 largest depositors of the banking sector increased by 14.8 percent to $445.2 million in the September 2004 quarter. As a percentage of total deposits, it stood at 21 percent compared to 19 percent in June 2004. This was mainly due to an increase in deposit balances of statutory corporations.

## Electronic Banking

The use of electronic banking technology continued to increase, while the paper-based payment transactions continued to decline.

Although the number of ATMs remained at 104 since the beginning of this year, customers have easier access to ATMs now after the arrangement between banks, which allows customers access to use

other banks' ATMs for a small fee.

The number of EFTPOS terminals has increased from 916 to 944 over the quarter. The total number of ATM transactions declined slightly to 158,000 in the September quarter while EFTPOS transactions increased to 731,000 from 656,000 in the same period.

## Overview – Credit Institutions

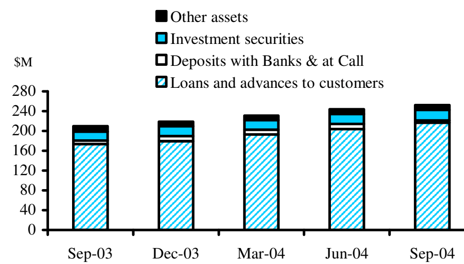
- Credit institutions' performance for the September 2004 quarter was stable. Over the quarter, the consolidated assets of credit institutions increased by 3.5 percent and by 20.4 percent over the year. The increase was largely attributed to a 6.2 percent increase in lending over the quarter. Over the year, lending grew by 21 percent.
- **Profit** before tax increased by 7.6 percent in the September 2004 quarter. The increase in profits was due to growth in net interest income and reduction in operating expense.
- **Asset quality** for credit institutions is considered marginal. At the end of September 2004, impaired assets increased to $18.0 million from $17.1 million in June 2004 and represented 7.8 percent of gross loans and advances. However, when compared to September 2003, there was a slight improvement from $18.5 million. Impaired loans as a percentage of total loans has also reduced from 9.9 percent recorded in the same period last year.
- **Capital adequacy** over the review quarter was strong and well in excess of the minimum requirement.

## Balance Sheet

Credit institutions grew by $8.1million or 3.3 percent in terms of asset size over the September quarter. Over the year the increase in consolidated assets of credit institutions was $42.6million (20.4 percent). Growth in assets is mainly attributed to the rapidly growing loan portfolios of all credit institutions while other types of assets showed minimal growth over the year (Graph 40).

Graph 40

**Structural Change and Growth of Credit Institution Assets**

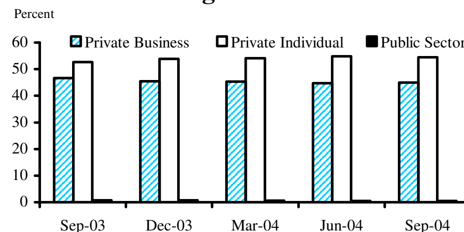



Source: Credit Institutions

Private individuals continue to dominate the customer base of credit institutions, despite a move towards commercial lending. As at September 2004, lending to private individuals was 54.5 percent while private sector business entities took up 45.0 percent of total loans (Graph 41).

Graph 41

**Loans and Advances by Sector as Percentage of Total Loans**




Source: Credit Institutions

Lending to private sector business entities is well diversified across the different sectors. However, the bulk of loans disbursed over the quarter went to the building and construction sector. For private individuals, the majority of loans were taken for housing purposes.

On the liabilities side, term deposits held by credit institutions recorded a significant decrease of $14.4 million over the quarter.

Advances from parent companies increased by $18.6 million over the quarter and $32.2 million over the year. These direct funding sources have assisted in the continuous growth in the credit institutions' loan portfolios.

**Credit Institution Profitability***

| | Sept 03 | Jun-04 | Sept 04 | % Change | |
|---|---|---|---|---|---|
| | | $M | | Over Qtr | Over Year |
| **Net interest income** | 4.5 | 5.1 | 5.3 | **2.5** | **17.7** |
| *Add:* **Non interest income** | 0.5 | 0.6 | 0.6 | **-9.0** | **16.6** |
| *Equals:* **Total operating income** | 4.9 | 5.7 | 5.8 | **1.3** | **17.6** |
| *Less:* Operating expenses | 1.7 | 2.3 | 2.2 | **-1.2** | **28.5** |
| *Less:* Bad debts & provisions | 0.8 | 0.7 | 0.6 | **-14.5** | **-16.6** |
| *Equals:* **Profit before tax & extraordinary items** | 2.5 | 2.7 | 3.0 | **7.6** | **20.38** |
| *Less:* Tax | 0.4 | 0.5 | 0.5 | **-7.6** | **44.1** |
| *Equals:* **Net profit after tax** | 2.1 | 2.3 | 2.5 | **10.9** | **16.9** |

* Figures are rounded to one decimal place.

Source: Credit Institutions

## Profitability

Credit institutions' recorded favourable profits in the September quarter. The increasing profits were mainly derived from improved net interest income and managing operating expenses efficiently.

Net interest income of credit institutions rose over the quarter by 2.5 percent mainly due to increases in interest income earned from loans.

Non-interest income remains the secondary source of income, which actually decreased by 9.0 percent compared to the previous quarter. This was due to a slight reduction in their service fees and charges.

Movement in the other administration expenses was the major cause for the decline in the overall operating expense over the quarter and increase over the year.

Increase in income led to an improvement in the efficiency ratio from 39.4 percent in June 2004 to 38.4 percent. However, in comparison with September 2003 it slightly deteriorated from 35.2 percent due to a faster rate of growth in credit institutions' operating expenses (28.5 percent) than the operating income (17.6 percent).

Return on assets (before tax-annualised) improved to 4.8 percent in September 2004 from 4.6 percent in the previous quarter. Similarly, improvement was noted in the return on equity from 25.6 percent in June 2004 to 27.7 percent.

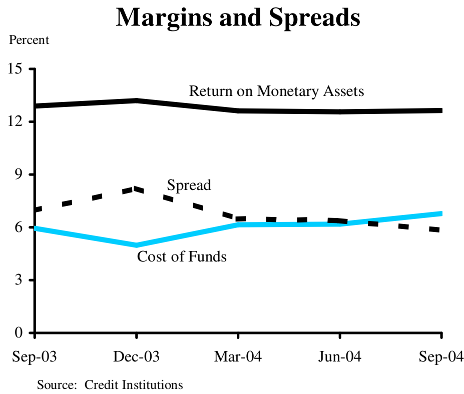
The above ratios indicate a satisfactory earnings position of credit institutions.

## Interest Margin and Spread

The return on monetary assets remained steady over the quarters while the cost of funds show an increasing trend since

December 2003. This translated to a fall in the spread over the year from 7.0 Percent to 5.3 percent. The rising cost of funds is due to the increase in total borrowings. Interest expenses increased by 26.7 percent over the quarter and 64.0 percent over the year (Graph 42).

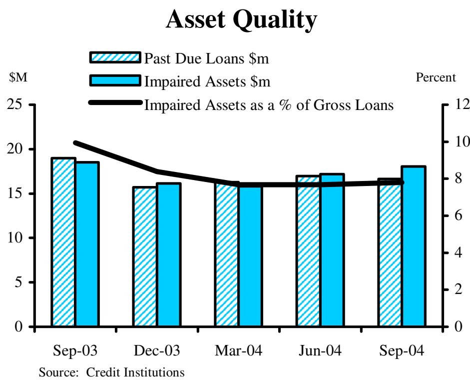
Graph 42




## Asset Quality

Over the September quarter, credit institutions' asset quality position slightly deteriorated due to a rise in the level of impaired accounts and decrease in the provision coverage of these loans (Graph 43).

Graph 43

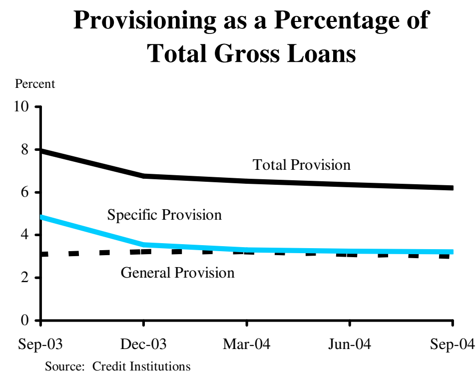



Impaired assets increased in September 2004 to $18.0 million from $17.1 million in June and represented 7.8 percent of gross loans and advances. However, when compared to September 2003, there was a slight improvement from $18.5 million. Impaired loans as a percentage of total loans have also reduced from 9.9 percent recorded in the same period last year.

General trend also depicts a similar approach as taken by banks in classifying accounts that are not past due but warrant an impaired classification due to other qualitative factors.

Specific provisions are allocated on the impaired portion of loans while general provision covers for the whole loan portfolio of credit institution's. The following graph (Graph 44) shows that since December 2003 specific provisions have reduced and now cover 37.5 percent of classified loans. This has reduced significantly from September 2003 when the coverage was 45.4 percent. This was due to the gradual reduction in the value of doubtful accounts over the year. Specific provisions allocated by individual credit institutions on their impaired assets are considered adequate.

Graph 44




General provisions cover 3 percent of the gross loan portfolio of credit institutions. The coverage has declined compared to

3.2 percent in September 2003, due to a faster rate of growth in loans than in the general provisions. However, the percentage remains high and is higher than the percentage held by banks (1.97 percent). This is a prudent approach taken by credit institutions as they are engaged in higher risk lending than banks.

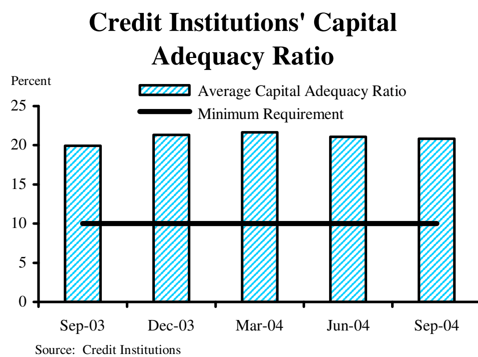
Although the volume of past due loans and classified assets is a cause for concern and warrants a poor rating, it is mitigated by the adequate allocation of provisions. The threat on earnings position and capital is also minimised. As such, the asset quality position of credit institutions is rated as marginal.

## Capital Adequacy

All credit institutions maintained their capital above their prescribed minimum requirements. Credit institutions recorded a strong capital adequacy ratio of 20.8 percent in September 2004, indicating the presence of surplus capital. With such a high capital ratio, credit institutions are expected to remain well capitalised in future periods, provided there are no unexpected major setbacks in their asset quality position. The consistent flow of earnings is also expected to further strengthen the capital position (Graph 45).

Graph 45

**Credit Institutions' Capital Adequacy Ratio**



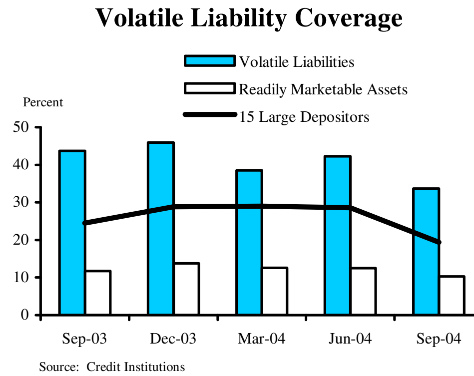

Source: Credit Institutions

## Liquidity

The graph below (Graph 46) shows a large gap in the level of volatile liabilities and readily marketable assets (liquid assets). The current position indicates that readily marketable assets would cover only 30.5 percent of volatile liabilities and 53 percent of the large depositors, which indicates high liquidity risk for credit institutions.

Graph 46

**Volatile Liability Coverage**




Source: Credit Institutions

The level of volatile liabilities is high, indicated by the fluctuating trend of these deposit liabilities. Over the quarter, there was a big reduction from 42.2 percent to 33.6 percent. As the 15 largest depositors form a major part of these volatile liabilities, a corresponding decline was also noted in the percentage of large depositors from 28.6 percent to 19.4 percent.

The level of readily marketable assets to cover for these volatile liabilities continues to be generally steady. However, over the quarter, the liquid assets-to-total-assets ratio decreased slightly to 10.3 percent from 12.5 percent in June and 11.8 percent in September 2003.

Liquid assets-to-total deposits ratio for

credit institutions was 21.0 percent in September 2004 compared to 22.5 percent in the previous quarter and 20.7 percent in the same period last year.

The above ratios indicate an inadequate liquidity position. However, the institutions minimise this risk by holding stand-by credit facility arrangements with their parents or banks.

## Insurance Industry Quarterly Condition Report – June 2004

### Overview of Industry Performance

For the quarter ended June 2004, the aggregate solvency surplus of assets for life and general insurers more than doubled to $50.4 million over the required solvency margin, compared with the corresponding quarter of 2003. The outturn was underpinned by surpluses recorded by the two life insurers. The minimum required solvency margin of the industry, also increased and this was largely influenced by general insurers.

Combined insurers assets recorded a growth of 7.0 percent to reach $650.0 million. The growth was driven by both the life and general sectors.

**Solvency Position ($M)**

| Quarter Ended 30 June | | Admissable Assets | MRSM* | Solvency Surplus |
|---|---|---|---|---|
| **2004** | General | 30.8 | 17.6 | 13.2 |
| | Life | 51.4 | 14.2 | 37.2 |
| | **Total** | **82.2** | **31.8** | **50.4** |
| **2003** | General | 16.9 | 14.3 | 2.6 |
| | Life | 29.4 | 13.7 | 15.7 |
| | **Total** | **46.3** | **28.0** | **18.3** |

* MRSM - Minimum Required Solvency Margin
Source: Insurance Companies

The industry's overall after tax surplus was recorded at $12.0 million for quarter ended June 2004, a marginal increase over the total recorded for the same period in the preceding year. The surpluses came from growth in total revenue as a result of writing more business, coupled with a fall in expenses.

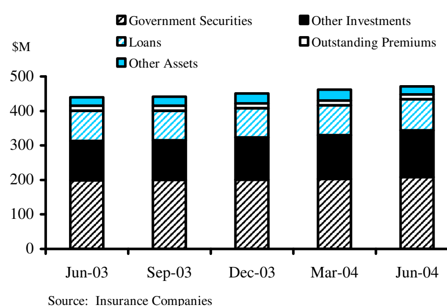
### Life Insurers

A solvency surplus of $37.2 million was recorded for quarter ended June 2004 against $15.7 million in 2003. Both licensed life insurers met the solvency requirement of the Insurance Act for the quarter under review and both recorded increases in solvency surplus over the year.

The combined life insurers assets recorded a 7.0 percent increase over the year to June 2004, standing at $471.7 million. The asset distribution for life insurers remained unchanged with government securities, property and loans remaining the dominant modes of investment (Graph 47).

Graph 47

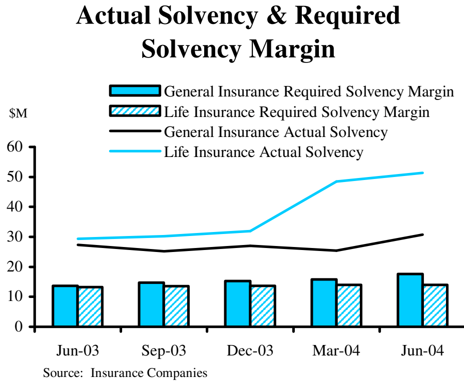
**Distribution of Assets for Life Insurance Companies**




Source: Insurance Companies

Life insurers recorded an after tax surplus of $9.2 million in the June quarter (Graph 48).

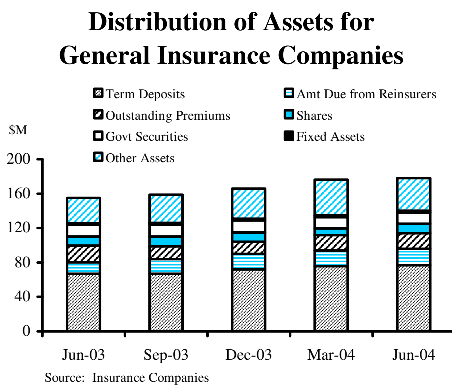
Graph 48




## General Insurers

All insurers met the solvency requirement of the Insurance Act for quarter ended March 2004. An increase of 76.0 percent in net admissible assets to $25.4 million (2003: $14.5 million) contributed to the increase in solvency surplus of general insurers to $9.6 million (2003: $1.1 million). Assets are concentrated mainly in term deposits, government securities and outstanding premiums (Graph 49).

Graph 49




An increase of 82.0 percent in net admissible assets to $30.8 million (2003: $17.0 million) contributed to the increase in solvency surplus of general insurers to $13.2 million (2003: $2.6 million). Assets are concentrated mainly in term deposits, government securities and outstanding premiums.

All insurers met the solvency requirement of the Insurance Act for quarter ended June 2004.

After tax surplus for quarter ended June was reported at $2.8 million, lower than the $4.1 million recorded in the same period in 2003. The reduced profit was a result of a number of factors including: decline in underwriting surplus; fall in investment income and increase in non-underwriting expenses.

Net premium income for 12 months ended June 2004 increased by 12 percent to $71.2 million over the comparable period in 2003.

### Insurance Brokers

Insurance brokers recorded a substantial increase in net after tax profit to $1.5 million in the June 2004 quarter when compared to $0.9 million in 2003. The growth in profit was a result of increases in brokerage earned and reductions in operational expenses.

The broking account balance stood at $3.3 million (2003: $5.0 million), with 83 percent of this balance being under 30 days hence mostly complying with Section 7 of the Insurance Act.

## For the Record

## MONETARY POLICY STATEMENT

*Statement by Governor, Mr S Narube, 29 October 2004.*

After raising its official policy indicator rate by 50 basis points in May this year, the Reserve Bank is leaving its monetary policy unchanged while it monitors further development in the economy.

The raising of the official interest rate was a clear signal that the Reserve Bank was tightening monetary policy in response to buoyant consumption demand and poor export performance. There are predominantly two reasons for holding the indicator rate unchanged since May. The first relates to the absence of any immediate threat to our two policy objectives of maintaining price stability i.e. low inflation and an adequate level of foreign reserves. The year-end inflation forecast is 3.5 percent while the reserves levels are expected to cover around 5 months of imports of goods. The second reason relates to our effort to strike the right balance between maintaining stability and promoting economic growth. Commercial lending rates remain historically low to promote investment activity and support economic growth in the country.

Most of the major sectors show signs of improving on their 2003 results. In line with the favourable labour market conditions, household income continues to rise. As a result, consumer spending remains buoyant.

The tourism industry continues to lead growth. Last year, we had record numbers of tourists coming to our shores. This year, the industry is expected to do better. The lack of tourist accommodation is however already imposing some constraints on future growth. The building and construction sector is performing strongly and there are signs that the adequacy of local skilled labour is becoming an issue.

Looking ahead, the Bank is concerned that Fiji's economic performance continues to be driven largely by buoyant consumer demand while the performance of the export sector continues to lag behind. There are signs that several growth industries are operating close to their potential. The high international oil prices may further increase our import bill, affect production costs and raise consumer prices. The Reserve Bank is monitoring these developments closely.

At this time, the Reserve Bank is keeping its monetary policy unchanged.

Future tightening of monetary policy will depend on our export performance, the speed of credit expansion, and very importantly, the stance of fiscal policy.

## For the Record

# FURTHER EXCHANGE CONTROL RELAXATIONS EFFECTIVE 1 JANUARY 2005

The Honourable Minister for Finance and National Planning in his 2005 Budget Address this morning, announced that the Reserve Bank of Fiji will further relax exchange controls effective from 1 January 2005.

The relaxations for 2005 include further increases in the delegated limits to commercial banks and foreign exchange dealers. These changes should assist investors and contribute to more efficiency in financial transactions.

The full details of exchange control relaxations for 2005 are attached.

## SUMMARY OF CHANGES OF EXCHANGE CONTROL DELEGATIONS TO AUTHORISED FOREIGN EXCHANGE DEALERS

### Section 1: Foreign Exchange Transactions (Payments/Remittances)

| | **Maximum Delegations*** | |
|---|---|---|
| ***Category*** | ***2004*** | ***2005*** |
| **1. Emigrant Transfers** | • $150,000 per family/single applicant per annum<br>• Documentary requirements apply | • $200,000 per family/single applicant per annum<br>• Documentary requirements apply |
| **2. Repatriation of Profits**<br>• Dividends and Profits | • $150,000 per business entity per annum<br>• Documentary requirements apply | • $500,000 per business entity per annum<br>• Documentary requirements apply |
| **3. Withdrawal of Investment/Capital by Non-residents** | • $150,000 per business entity per annum<br>• Documentary requirements apply | • $500,000 per business entity per annum<br>• Documentary requirements apply |

* These amounts are maximum amounts delegated to authorised foreign exchange dealers. Requests for amounts in excess of these must be referred to the Reserve Bank of Fiji.

| | | |
|---|---|---|
| **4. Foreign Currency Loan**<br>a) Repayment<br><br><br><br>b) Prepayment | • $150,000 per amount due for scheduled payments<br>• Documentary requirements apply<br><br>• $150,000 per loan balance<br>• Documentary requirements apply | • $500,000 per amount due for scheduled payments<br>• Documentary requirements apply<br><br>• $500,000 per loan balance<br>• Documentary requirements apply |

## Section 2: Other Facilities

| | **Maximum Delegations** | |
|---|---|---|
| ***Category*** | ***2004*** | ***2005*** |
| **1. Offshore Borrowing** | • $2 million per borrower<br>• Conditions apply | • F$5 million per borrower<br>• Conditions apply |
| **2. Foreign Currency Loans by local banks** | • $2 million per borrower<br>• Conditions apply | • F$5 million per borrower<br>• Conditions apply |
| **3. Investment into Fiji by Foreign Investors**<br><br>a) Foreign investment in capital markets | <br><br>• $2 million per foreign investor per annum<br>• Delegated to South Pacific Stock Exchange and its agents/brokers | <br><br>• $5 million per foreign investor per annum<br>• Delegate to South Pacific Stock Exchange and its agents/brokers |

# ECONOMICS ASSOCIATION OF FIJI FORUM
# 24 November 2004

## "REGIONAL ECONOMIC INTEGRATION: IT'S WORKED FOR EUROPE, CAN IT WORK FOR THE PACIFIC?"

The fourth Economics Association Forum was held on 24 November 2004 at the Reserve Bank of Fiji building. The guest speaker was Mrs Myfanwy van de Velde who is a trade adviser with the European Union Delegation in Suva. An abridged version of Mrs Myfanwy van de Velde's speech is provided below.

The title of my talk tonight is Regional Economic Integration: it's worked for Europe, can it work for the Pacific? And before seeking comparisons – if any comparisons are to be made – I'd like first to go back a little over Europe's history, to explain how Europe came to be integrated, and why, and to see if the European experience has any relevance in the Pacific context.

The European Union, as it's now called, emerged – as you will know – from the bitter intra-European fighting of the Second World War, which had itself been preceded by the First World War, and by centuries of intra-European nation-state wars before that.

But with the Second World War, the nations of Europe really surpassed themselves, beating the lives out of each other to the extent that Europe in 1945 was little more than a smouldering ruin. Nations had paid a heavy price to remain part of the Free World, but the toll in lives and in livelihoods had of course been immense.

In the years that followed the carnage, a number of heavyweight post-war European leaders, including Robert Schuman, Konrad Adenauer – the then German Chancellor – and Winston Churchill, began to call for another approach, a move towards a degree of interdependence that would "fix the peace" and make future conflict unthinkable. This was the start of the movement towards integration, but another very substantial incentive entered into the equation: massive sums of money were offered by the Americans for the reconstruction of Europe after the war (the so-called Marshall Aid) but on one absolute condition, only – namely that Europe worked together in the reconstruction, and in such a way as to ensure that future interdependence would prevent further wars.

The motivation for Europe coming together was therefore huge. And – to diverge a moment – the war also, incidentally, played a large part in shaping the policies of the European Community, or "Common Market" as the early European grouping was known. In particular, because people had starved to death, there was a determination to ensure that European agricultural production became self-sufficient. The Common Agricultural Policy (CAP), the famous CAP, which developed in the 1960s, was the result of a deliberate political decision to privilege agriculture above other policies. Although we now know that this policy got out of hand in later years, and overproduction led to the creation of "wine lakes and butter mountains", and aroused the fury of developing countries whose exports of competing products were stifled

by the CAP, it is worth recalling occasionally the historical origins of the policy, the rationale for which, 40 years on, is sometimes difficult to understand.

Integration began modestly in Europe in 1951, with the setting up of a common market in coal and steel between 6 European countries, including France and Germany. The choice of sector was symbolic, because it had been the rich coalfields of the German Ruhr area which had stoked Franco-German enmity, in particular, and had been an underlying factor in the outbreak of hostilities in 1939.

Joint management of a key economic sector, with a shared institution, worked well, such that in 1957 the European Economic Community was established. Its stated aim was: *"to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relations between the States belonging to it"*.

In other words, its ambitions, from the start, went beyond the level of economic integration, and clearly included establishing a greater level of solidarity among the Member States by setting up common policies and financial instruments.

None of this happened overnight, of course: it took until 1968 to establish a Common External Tariff and to completely abolish customs duties on industrial goods within the 6. And this, in many ways, was the easy part: it wasn't until 1993 that the so-called Single Market – in a European Community by then comprising 15 members – was declared complete, in other words that the movement of people, goods and services and capital became fully operational, or nearly, through the elimination of the remaining barriers to freedom of movement.

Why, one might ask, did this take 25 years? Well, partly it had to do with protectionist measures that were introduced in certain areas by certain Member States following the recession that followed the post-1973 oil crises. Partly it was the incredible complexity of attempting to harmonise taxation, or technical standards or professional qualifications. In the mid-1980s, when the process was getting bogged down, and when the so-called "cost of non-Europe" was calculated, it was realised that a different approach was needed: although intra-European trade had grown tremendously in the 1960s and 1970s, by virtue simply of the "domestic" market for goods and services having expanded so greatly, its potential for further growth was still being thwarted by many technical barriers to trade. Instead of seeking to harmonise, therefore, emphasis was put instead on equivalence: a product that was good enough for sale in Germany was to be recognised as being good enough for sale in Spain; a diploma that entitled a person to practice as an architect in Greece was to be seen as good enough to allow that person to practice in Britain. This was a smart move, and provides a good lesson for others going down the deep integration road.

The Single Market, although declared complete in 1993, is still, in fact, not yet totally achieved: there are areas, in the service sector, in particular, which are recognised as important public service areas (e.g. in the energy, transport and postal sectors), where the normal rules of competition cannot necessarily apply. The challenge now is to open up to competition these "services of general interest", but in such a way that they are not unduly disrupted or rendered unaffordable to the

public they serve.

The latest step in European integration came – partially at least – in the form of monetary union, with the introduction of the euro in 2002. Twelve of the then 15 Member States – more than 300 million citizens – began using the common currency in daily life, after a process of convergence of the European economies and a gradual limitation of fluctuations in the exchange rates between their currencies. Monetary union is not an inevitable accompaniment to economic union – indeed some countries, including Britain, have chosen not to enter into it – but where a devalued currency could give a country an unfair competitive advantage, possibly leading to distortions in trade, a single market is at risk without it.

So where does all this leave the Pacific? The exact historical parallel is obviously absent: there is, happily, no recent history of intra-Pacific conflict; there are no economic reconstruction funds on offer – except in some isolated national circumstances – and integration is not being made a conditionality of whatever funds are available for economic construction. Nevertheless, there is a kind of historical imperative at work, because this is an age of globalisation, an age when, as our former European Commissioner for Development was fond of saying – small is not always beautiful, small can sometimes be ridiculous.

Now, personally I don't like this catch-phrase too much, because – although it's obvious that a bigger grouping makes for a bigger market, and greater political clout – it also implies that the freedom to become big is always there. A free-trading, democratic country may be surrounded by protectionist dictatorships, making the option of regional integration virtually a non-starter. But where it is possible, as I believe it is here, regional integration does of course mean bigger sales markets, permitting economies of scale to be achieved, and – through exposure to more competition – leads to more efficient domestic production. Greater trade openness is generally associated with higher economic growth, and it is certainly difficult to think of countries which have rejected international trade and have nevertheless developed successfully.

There is, therefore, pressure on the Pacific for economic integration which derives from the times in which we live and from the need not to be left behind by the general movement towards the greater integration of world markets. In signing up to the Pacific Island Countries Trade Agreement (PICTA), which aims at achieving liberalisation amongst Pacific Islands by 2010 for non-less developed countries (LDC), 2012 for LDCs and small island countries and 2016 for particularly sensitive products, the Pacific region has already recognised this need. The PICTA agreement is seen as a stepping-stone to wider liberalisation and integration into world markets – whether with the European Union, if an Economic Partnership Agreement can be successfully negotiated, or with Australia and New Zealand (with which the Pacific Closer Economic Relation Agreement was signed in 2002) or with other trading partners.

As to whether there are other parallels, my guess is probably not very many: Europe is very, very different from the Pacific region both geographically (being a land mass, with little separation of nations by sea), and demographically: the population of the original 6 European Union (EU) Member States probably amounted to 160 million or so (nowadays, with 25 Member States, it is some 450 million). And this of course

means a "domestic market" of a totally different dimension from the Pacific market, and one with far, far greater potential for growth. Regional trade in the Pacific is at present only a small share of total Pacific trade (perhaps 5%), and enlargement of the market to 7 million is not, to be realistic, expected to bring major economic gains. Its main benefit will be the "stepping stone" effect, but it should also, of course, enhance Pacific solidarity in world affairs as well as – as has been the case for the EU – solidify democracy. (Though a number of EU countries were dictatorships prior to entry, no country has reverted to undemocratic rule since: the influence of peer pressure – both economically and politically is not to be underestimated. It is difficult to imagine how Nauru's economy, for example, could have become as it has become if the Pacific had been a fully economically integrated region).

The Pacific case for regional economic integration has other characteristics which give it an advantage over the European "case". In the first place, it is of course a region which is already well integrated at various levels. Pacific Island countries work together in the context of the many Pacific regional organisations, jointly agreeing on policy in fields of particular interest to the region. The University of the South Pacific and the Fiji School of Medicine are integrated Pacific institutions of a nature that Europe has not yet been able to match. Pacific Islanders already move to some extent between islands, taking up jobs where jobs are on offer. And this is made possible, in part at least, because the Pacific region has one huge advantage over European countries in the integration context: it shares a single – or virtually single, language – English – as opposed to the EU's original 4 and now incredible 19 working languages. The advantage of this – in terms of cost in money and cost in time in the integration process, quite apart from the advantage offered in doing business – cannot be over-emphasised. I would add that it is also, or could be, a great advantage if the Pacific was able to take advantage of the rapidly-growing trend in outsourcing – particularly of services. The advantage of sharing a same language as major trading partners – Australia, NZ and the US – is a considerable one.

And because other regions have preceded it in the economic integration process, the Pacific can also learn from their mistakes. From the European experience it could accept from the start, for example, that the complex process of harmonization is not a necessity, but that acceptance of equivalence can work just as well. It will also have observed that integration is, and needs to be, a gradual and well-managed process. It can also be a process with winners and losers, and it will therefore have to recognise that safety nets will need to be built into the process for those areas, or nations, which are more likely to be losers. It will take solidarity to achieve this: narrow national interests may well have to be sacrificed on occasions for the good of the whole. Interestingly, though, the EU experience has shown that some of the unlikeliest regions can benefit the most: Ireland, one of the smallest and most backward nations on accession in 1973 is now, 30 years on, one of the most prosperous of Member States. So that while it is a fairly safe bet that most countries will benefit to some degree, over time, what is not certain is which countries will benefit most.

The parallels between the European context and the Pacific context are not many: the differences of size of market and of population are of course the most striking,

as well as the difference of capacity – in human resource terms – to deal with the complexities of integration and to move the process forward. But I believe that there is, just as with Europe, a measure of external pressure on the Pacific to draw its economies closer together – just as there was in Europe, and I also believe that the Pacific will have certain natural advantages over Europe in the process. Firstly, it has already accepted the principle of regional economic integration – and partners of the Pacific, such as the European Union, Australia and New Zealand are assisting the region in moving the process along. Secondly, the Pacific is already integrated at many other levels, including at some very sophisticated levels, such as the sharing of a common University. And thirdly, the advantage of a common language is not to be underestimated. Finally, the Pacific can also benefit from the revolution in Information Technology that has taken place in the past 10-15 years, and which has enormously reduced the negative effects of physical distance. E-mail and computer-to-landline telephoning provide the possibility of instant and very low-cost intra-island communications, and this is a trend that can only grow in future.

So, to conclude, can what's worked for Europe work for the Pacific? I believe it can, though the circumstances of the two processes are, literally, a world apart and the benefits will be of a rather different nature. The European context has some natural advantages over the Pacific, but the Pacific also has some advantages over Europe. But both movements, I believe, are driven by the times in which they find themselves: for Europe, war was the catalyst, for the Pacific I believe that globalisation will be the catalyst. What has worked for Europe not only *can* work for the Pacific – I believe that it would be very much to its advantage if it did.

# STATISTICAL ANNEX

## LIST OF TABLES


**I FINANCIAL CONDITIONS** **Page No.**

1. Reserve Bank of Fiji: Assets A1
2. Reserve Bank of Fiji: Liabilities A2
3. Monetary Survey A4
4. Commercial Banks: Assets A6
5. Commercial Banks: Liabilities A8
6. Liquidity Position of Commercial Banks A10
7. Components of Commercial Banks' Deposits A12
8. Commercial Banks' Lending and Deposit Rates A13
9. Commercial Banks' Time Deposit Rates A14
10. Commercial Banks' Loans and Advances A16
11. Money and Capital Market Interest Rates and Yields A18
12. Fiji Development Bank Loans A19
13. Fiji National Provident Fund Investments A20
14. Exchange Rates A21
15. Key Disclosure Statement : ANZ A22
16. Key Disclosure Statement : WBC A23
17. Key Disclosure Statement : BOB A24
18. Key Disclosure Statement : HBL A25
19. Key Disclosure Statement : CNB A26
20. Key Disclosure Statement : MFL A27
21. Key Disclosure Statement : HFC A28
22. Key Disclosure Statement : CCFL A29

**II OUTPUT**

23. GDP by Activity at Constant Prices of 1989 (at Factor Cost) A30
24. GDP by Activity at Constant Prices of 1995 (at Factor Cost) A32
25. Gross Domestic Product A34
26. Tourist Statistics A35
27. Visitor Arrivals: By Country of Residence A36
28. Hotel Statistics A37
29. Building and Construction A38
30. Investment A39

**III GOVERNMENT**

31. Government: Expenditure A40
32. Government: Revenue A42
33. Government: Summary of Revenue and Expenditure A43
34. Government: Domestic Debt A44
35. External Debt A46
36. Government: Gross Financing A47

**IV PRICES, WAGES AND EMPLOYMENT**

37. Consumer Price Index A48
38. Wage and Salary Earnings A49
39. Total Paid Employment A50

**V EXTERNAL**

40. Exports (Merchandise) A52
41. Imports (Merchandise) A53
42. Balance of Payments (Accrual Basis) A54
43. Balance of Payments (Cash Basis) A56
44. Direction of Trade by Major Trading Partner Countries A58

**VI KEY ECONOMIC AND FINANCIAL INDICATORS** A59

**SOURCES:**

Reserve Bank of Fiji
Commercial Banks
Fiji Development Bank
Fiji National Provident Fund
Fiji Islands Bureau of Statistics
Ministry of Finance

**ABBREVIATIONS**

| | |
|---|---|
| $: | Fiji Dollars unless stated otherwise |
| m: | Million |
| bn: | Billion |
| (b) | Budget |
| (e): | Estimate |
| (f): | Forecast |
| (p): | Provisional |
| (r): | Revised |
| n.a.: | Data not available |
| n.i.: | No issues |
| n.t: | No trading |
| -: | Zero |
| RBF: | Reserve Bank of Fiji |
| IMF: | International Monetary Fund |
| CIF: | Cost of goods, including insurance and freight to Fiji |
| FOB: | Free on board (the value of goods at Fiji ports before export). |