RESERVE BANK OF FIJI

QUARTERLY REVIEW

December 2005

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QUARTERLY REVIEW OF THE ECONOMY & FINANCIAL CONDITIONS

OVERVIEW

Global economic and financial conditions strengthened in the final quarter of 2005, largely driven by strong economic performance in the United States (US), Japan and the Euro-zone. The improvement in the world economy was also supported by robust growth in non-Japan Asia, especially China. The International Monetary Fund's (IMF) estimate for world growth for 2005 remained intact at 4.3 percent.

The IMF expects the world economy to expand by 4.3 percent in 2006 as well. However, there are downside risks to this outlook. Firstly, the persistent high crude oil prices could easily derail the growth momentum. In addition, interest rate hikes, stemming from higher energy prices, especially in the US and Euro-zone, could disrupt the growth momentum in these economies. Furthermore, geo-political tensions in the Middle East and threats of terrorism could also undermine world growth prospects.

Globally, monetary policy remained on a tightening bias. Along with the US, the Euro-zone, New Zealand (NZ) and some Asian economies (Indonesia, Malaysia and South Korea) also raised their policy interest rates over the quarter.

The growth prospects for Fiji's major trading partners are encouraging. While Australia and the US are on course to register the strongest performances, NZ is expected to achieve a modest growth. Growth prospects for the Euro-zone and Japan remain cautiously optimistic.

During the December quarter, the performance of the global financial markets was mixed. The US dollar generally strengthened against all our major trading partner currencies. Equity markets continued to strengthen, while bond prices generally weakened.

Domestically, the economy is estimated to have grown by 1.7 percent in 2005. The economic expansion was led by the wholesale & retail trade, hotels & restaurants sector, with strong impetus from the building & construction and transport & communications sectors.

Sectoral outcomes during the review period were mixed. Anecdotal evidence suggests that the tourism industry continued to perform strongly into the final quarter of the year. Similarly, the fishing, electricity and copra industries and the building & construction sector recorded higher output on an annual basis. On the downside, output was depressed in the sugar, gold, garments and timber industries.

Inflation was 2.7 percent in December, while the underlying measure, the trimmed mean, was 1.2 percent. In 2006, price pressures are expected to arise mainly from higher import and excise duties and relatively strong oil prices. However, this will be cushioned somewhat by the removal of Value Added Tax (VAT) from certain items from January 2006. Consequently, the year-end inflation for 2006 is forecast at around 3.5 percent.

Although partial indicators suggested a slowdown in employment growth, overall conditions in the labour market remained favourable in 2005. Various surveys conducted in the review quarter also indicated improved demand for workers in the near-term.

On the fiscal front, Government's underlying deficit for 2005 is estimated at 4.3 percent of Gross Domestic Product (GDP), which is expected to rise slightly to 4.6 percent of GDP in 2006. In comparison, the 2006 headline deficit, which accounts for the $30 million worth of asset sales earmarked for next year, is budgeted at 4.0 percent of GDP.

Latest Overseas Exchange Transactions (OET) trade data shows that, cumulative to November, imports grew by 19 percent, while exports declined by 13 percent. The growth in imports was driven by an increase in all categories of imports, while lower receipts from textiles, clothing & footwear, fish, merchanted goods and other re-exports contributed to the decline in exports.

At the end of 2005, foreign reserves were around $822 million, sufficient to cover 2.9 months of import payments of goods and non-factor services, or 4.2 months of imports of goods only.

At the end of October, the Reserve Bank raised its policy indicator rate by 50 basis points to 2.25 percent. In implementing this policy change, the Bank noted that the economic environment had not changed since the interest rate hike of May 2004. Economic indicators revealed that consumption was still strong and credit (including mortgage) growth buoyant. Moreover, imports were growing strongly while exports continued to under-perform.

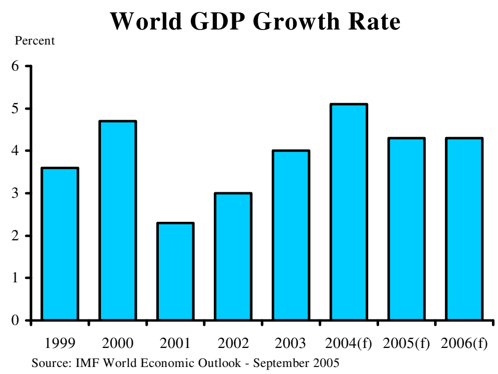
Against this backdrop, it was necessary to raise interest rates in order to dampen domestic demand. The Bank will continue to monitor developments in the coming months and align monetary policy accordingly.

THE INTERNATIONAL ECONOMY

International Economic Conditions

Global economic and financial conditions strengthened in the final quarter of 2005, supported by strong economic performance in the world's three largest economies, the US, Japan and the Euro-zone (Graph 1). Moreover, robust growth in non-Japan Asia, led by China, also added to the accelerating world economy. The IMF estimates world growth for 2005 at 4.3 percent.

Graph 1



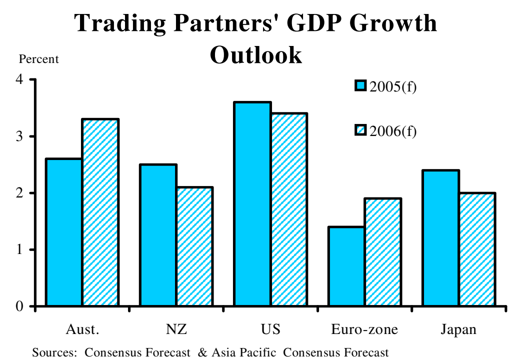
For 2006, the world economy is projected to record a similar expansion. However, there are downside risks to the outlook. Firstly, the persistent high crude oil prices could easily derail the growth momentum. More specifically, interest rate hikes, stemming from higher energy prices, especially in the US and Euro-zone, could disrupt the growth momentum in these economies. Finally, geo-political tensions in the Middle East and threats of terrorism could also weaken growth prospects.

Globally, monetary policy remained on a tightening bias during the review period. The US, Euro-zone, New Zealand and some other Asian economies (Indonesia, Malaysia and South Korea) raised their policy interest rates over the quarter.

The performance of the global financial markets was mixed in the final quarter of the year. The US dollar generally strengthened against all our major trading partner currencies. Equity markets continued to strengthen, while the movement in bond prices generally weakened.

The growth prospects for Fiji's major trading partners are encouraging (Graph 2). The outlook remains positive for Australia, while New Zealand is expected to record a respectable growth. The US economic recovery continues to strengthen, while growth prospects for Euro-zone and Japan remain cautiously optimistic.

Graph 2



The **Australian** economy grew at a slower rate of 0.2 percent in the September quarter, following a revised 1.3 percent growth during the second quarter. The slower growth was attributed to lower government spending and declining exports.

Nevertheless, latest indicators have generally been positive. The services industry expanded in November, as demand for communications and finance services rose. During the same month, the unemployment rate fell from a 7-month high of 5.2 percent to 5.1 percent, while consumer confidence rose from a 2½-year low. Moreover, the trade deficit narrowed in October, led by an increase in exports and a decline in imports.

The Reserve Bank of Australia (RBA) kept its overnight cash target rate unchanged at 5.5 percent during the quarter, on expectations of subdued inflationary pressures.

The economy is estimated to expand by 2.6 percent in 2005, before recording a higher growth of 3.3 percent next year. Consumer prices are expected to increase by 2.7 percent in 2005 and 2.9 percent in 2006, within the RBA's target band of 2-3 percent.

The **New Zealand** (NZ) economy expanded at a slower pace of 0.5 percent in the third quarter, after a revised 2.4 percent growth in the June quarter. The slowdown resulted from reduced exports, which was affected by the rising NZ dollar.

Economic indicators were generally weak in the final quarter. Business confidence fell to a 5-year low in December and retail sales declined for the second consecutive month in October. Furthermore, the current account deficit widened to a record in the year to September, as surging oil prices and consumer spending increased imports.

In line with expectations, the Reserve Bank of New Zealand (RBNZ) raised its official cash rate twice in the December quarter, by 25 basis points each in October and December, to 7.25 percent. These moves were prompted by expectations of rising inflationary pressures, associated with robust household spending.

The economy is estimated to expand by 2.5 percent in 2005, before slowing down to a 2.1 percent growth in 2006. Year-end inflation is expected to increase to 3.2 percent in 2006, from 3.1 percent estimated for 2005.

The **US** economy grew at a higher rate of 1.0 percent in the September quarter, following a 0.8 percent expansion in the second quarter. The improved performance in the third quarter emanated from a surge in consumer spending.

Latest indicators for the US have been encouraging. In November, industrial production, retail sales and consumer confidence rose, attributed to the easing gasoline prices. In addition, an index of leading economic indicators for the US economy rose in October, as labour market conditions improved and companies in the Southern States rebounded after the hurricanes.

However, the US trade deficit widened to a record in September, as oil imports surged and exports dropped by its highest magnitude in the last 4 years.

The Federal Reserve raised its Federal Fund rate by 25 basis points in December to 4.25 percent, prompted by expected inflationary pressures stemming from higher energy prices.

The economy is estimated to grow by 3.6 percent in 2005, compared with a projection of 3.4 percent next year. In 2005, inflation is anticipated to be around 3.4 percent, while it is expected to decline to 3.0 percent next year.

The **Euro-zone** economy expanded at a faster pace of 0.6 percent during the third quarter, after a revised 0.4 percent growth in the June quarter. The improvement was underpinned by higher exports and consumer spending. Furthermore, Germany and France, two of Euro-zone's major economies, reported higher growth over the third quarter, of 0.6 percent and 0.7 percent, respectively.

Economic indicators over the quarter were favourable. Retail sales rose for the second consecutive month in November, while manufacturing expanded at its fastest pace in the last 13 months in October.

However, European business confidence fell from a 5-year high in November, while annual inflation remained unchanged at 2.3 percent in October.

The European Central Bank (ECB) increased its refinancing rate by 25 basis points to 2.25 percent in the December quarter, based on higher medium-term underlying inflationary pressures.

The Euro-zone economy is estimated to expand by 1.4 percent in 2005, before recording a higher growth of 1.9 percent next year. Year-end inflation for 2005 and 2006 is forecast at 2.2 percent and 2.0 percent, respectively.

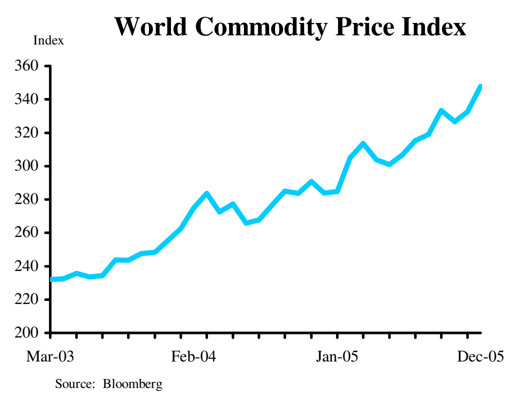
The **Japanese** economy grew at a slower rate of 0.2 percent in the third quarter, after a revised 1.2 percent growth in the June quarter, as companies reduced inventories and government spending fell.

Latest economic indicators showed mixed signals. Japanese business confidence rose in the December quarter, to its highest in the year. However, the trade surplus narrowed in October, as imports outperformed exports growth. Moreover, the service industries contracted in September, led by lower spending from consumers and companies.

In 2005, the Japanese economy is estimated to grow by 2.4 percent, compared with 2.0 percent projected for next year. Inflation is forecast at -0.2 percent and 0.2 percent for 2005 and 2006, respectively.

World commodity prices rose by around 4.4 percent over the December quarter, mainly underpinned by the surge in sugar and gold prices (Graph 3).

Graph 3



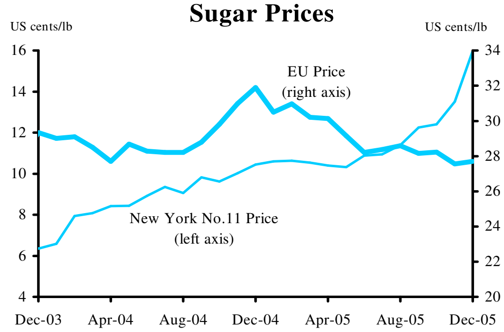
Over the December quarter, **world market sugar prices** rose by around 30 percent, reaching a historical high of US16.03 cents per pound in late December (Graph 4). The increase in sugar prices was on concern that exports from the two largest producers, the European Union (EU) and Brazil, will decline[1].

[1] Brazil is diverting more sugarcane to make ethanol, a crop-based fuel, after a surge in gasoline prices led to an increase in alternative-fuel cars. In addition, the EU will limit exports in an effort to comply with a World Trade Organisation ruling.

In the coming months, sugar prices are anticipated to remain above US12 cents per pound, in line with lower anticipated supplies from Brazil and the EU.

Graph 4

Sugar Prices



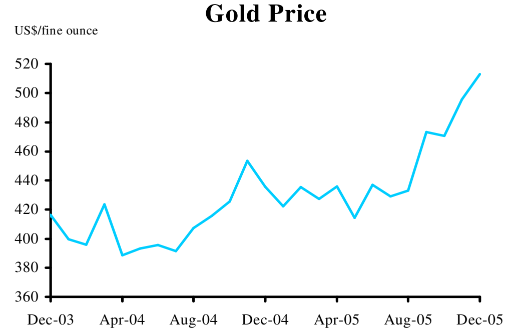
Sources: Fiji Sugar Marketing Company Ltd & Bloomberg

At the end of December, the EU sugar price was around US28 cents per pound, having fallen slightly over the quarter due to a weaker Euro against the US dollar.

Gold prices rose by around 8 percent over the December quarter, reaching a historical high of US$537 per fine ounce in mid December (Graph 5). Gold prices fell during the first month of the quarter, after a decline in crude oil prices eased concerns of accelerating consumer prices. This lowered the metal's appeal as a hedge against inflation. However, the price of gold rose strongly in the last two months, amid increased demand from investors, central banks[2] and jewellers[3].

Graph 5

Gold Price



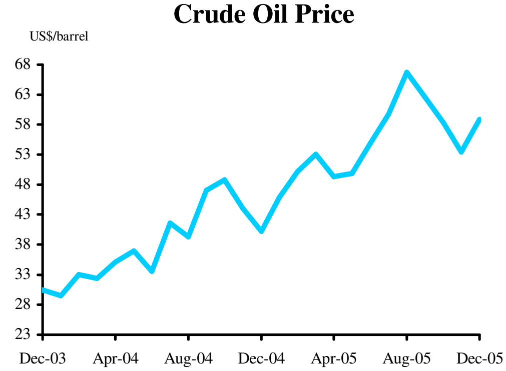
Source: Bloomberg

In the coming months, gold prices are expected to remain high (above US$450 per fine ounce). This is based on the expectation of inflationary pressures from high crude oil prices, which is anticipated to maintain the attractiveness of gold as a safe haven investment.

At the end of December, the **Brent crude oil price** was around US$59 per barrel, 6 percent lower than the price recorded at the end of September (Graph 6).

Graph 6

Crude Oil Price



Source: Bloomberg

Crude oil prices fell during the first two months of the quarter, as warmer-than-normal weather conditions in the US caused oil stockpiles to grow, thus driving prices down. Nonetheless, prices rose later in the

[2] According to the World Gold Council, central banks are demanding more of the metal as a backing for foreign reserves. At the same time, investors are seeking gold as an alternative to stocks and bonds, and as a hedge against inflation.

[3] India is the world's biggest consumer of gold jewellery, and demand typically rises in the wedding season, which runs from September to December.

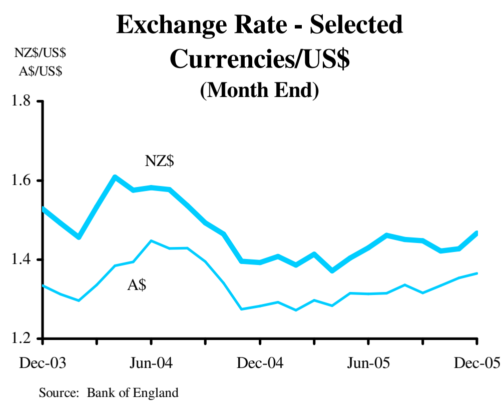
quarter, as forecasts for colder weather conditions through Christmas in the US exacerbated concerns about winter-fuel supplies.

In the months ahead, crude oil prices are anticipated to remain high (above US$50 per barrel), on expectation that higher energy demand from the US and China, will outpace crude oil supplies to the world market.

International Financial Markets

During the review period, the US dollar strengthened against all of Fiji's major trading partner currencies.

Graph 7

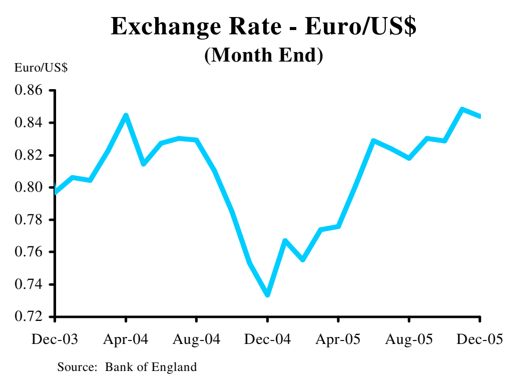


The Australian dollar weakened against the Greenback throughout the quarter (Graph 7), after the yield advantage for US Treasuries widened over Australian debt assets. This lured investors away from Australian dollar denominated assets, thus reducing demand for the currency.

The NZ dollar appreciated in October (Graph 7), after the RBNZ raised its benchmark interest rate, increasing the appeal of NZ dollar denominated assets. However, it weakened in the remaining period of the quarter, amid speculation that RBNZ will not raise interest rates any further, thus luring investors away from NZ securities and its currency.

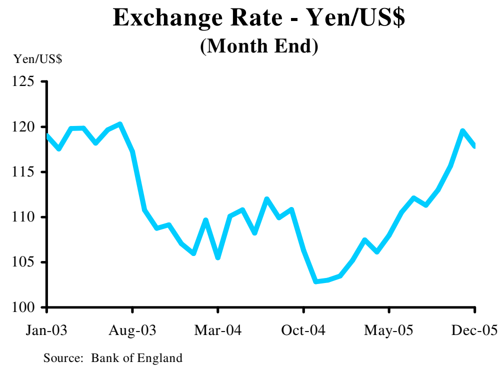
The Euro generally weakened against the Greenback over the fourth quarter (Graph 8). It strengthened during the first month of the quarter, on speculation that the ECB will raise interest rates to curb inflation, boosting the appeal of Euro denominated assets and the currency. However, the Euro depreciated in November, after expectations that the yield advantage for US Treasuries over European government securities will remain, reducing the appeal of Euro denominated assets. Nevertheless, the Euro strengthened again in December, after a gain in business confidence in Germany, the Euro zone's largest economy, prompted investors to switch from US dollar denominated assets to Euro denominated assets.

Graph 8



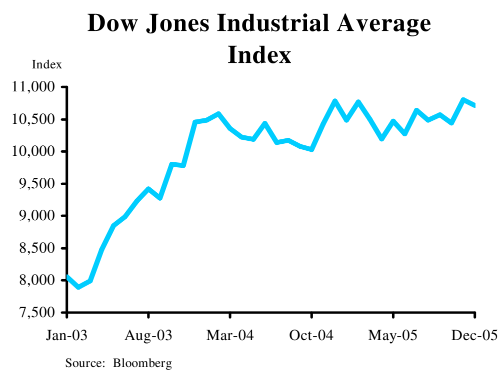
During the first two months of the quarter, the Yen generally weakened against the US dollar (Graph 9). This followed speculation that further interest rate tightening by the US Federal Reserve will widen the yield advantage for US securities over that of Japan's, prompting investors to move away from Yen denominated assets. However, the Yen strengthened in December, on speculation of an end to the Federal Reserve's campaign of interest rate hikes, which boosted the appeal of Yen denominated assets.

Graph 9



Equity prices generally rose over the December quarter.

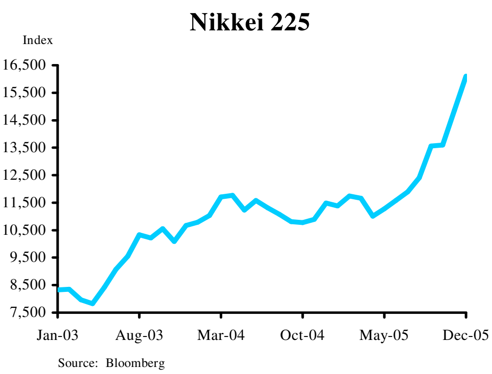
Graph 10



Over the three months to December, the Dow Jones Industrial Average Index rose by around 1 percent (Graph 10). Initially, the Dow fell in October after reports that growth in service industries, the biggest part of the economy, was slowing. However, stocks rose in November, as growing consumer confidence raised investors' profit expectations, especially for the holiday shopping season. Nonetheless, the Dow fell again in December, after an increase in crude oil prices renewed concerns that higher fuel costs may curtail consumer spending and corporate profits, thus reducing the demand for US equities.

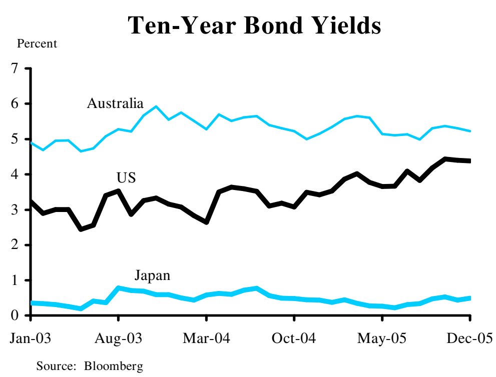
The Nikkei 225 Stock Average Index increased by around 19 percent (Graph 11) over the quarter, after a stronger US dollar against the Yen boosted the outlook and profit expectations for Japanese exporters, thus increasing the appeal of Japanese equities.

Graph 11



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

Graph 12



US bond yields rose in October, after

speculation of accelerating inflation reduced the appeal of the inflation-sensitive[4] debt asset. However, yields fell in the last two months of the quarter, as investors grew confident that the Federal Reserve was committed to restraining inflation. This boosted the appeal of fixed-return government securities.

Japanese bond yields picked up in October, after inflationary expectations reduced demand for fixed-return debt instruments. However, bond yields declined in November, on anticipation of a short-lived economic expansion, which boosted the appeal of relatively safer government debt. Nonetheless, yields rose in December, as demand waned, following a rise in stocks.

Australian bond yields rose in October, after a weaker Australian dollar prompted investors to move away from Australian bonds. However, yields fell for the remaining part of the quarter, as subdued inflationary pressures boosted the appeal of inflation-sensitive debt assets.

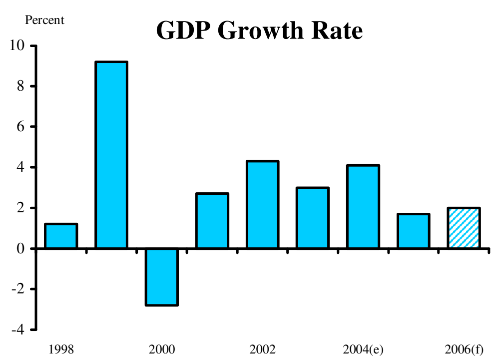
[4] Inflation erodes the real return on fixed income securities such as bonds.

THE DOMESTIC ECONOMY

Domestic Economic Conditions

Fiji's economy is estimated to have expanded by 1.7 percent in 2005 (Graph 13), driven by good performances in the wholesale & retail trade, hotels & restaurants; building & construction and transport & communications sectors. The favourable outcomes in these sectors more than offset the weaker output in the sugar, gold and garments industries. For 2006, economic growth is projected to improve to 2.0 percent, led by an expected turnaround in the performance of the agriculture sector.

Graph 13



Sources: Fiji Islands Bureau of Statistics & Macroeconomic Committee

Consumer Spending

Consumer spending remained strong into the final months of the year, as suggested by partial indicators.

For the year to November, VAT collections from domestic activities[5] grew by 12 percent on an annual basis. In line with this, lending for consumption purposes grew strongly by 19 percent in the year to November, while imports of consumption items rose by 8 percent.

Production

Sectoral performances remained mixed during the review period.

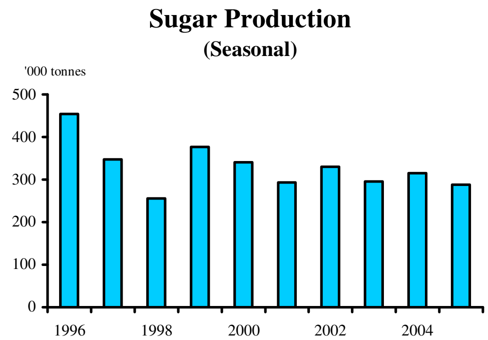
The tourism, copra, electricity, fishing and building & construction industries recorded higher output during the quarter, while production in the clothing & footwear, timber and sugar industries was lower. Gold output also fell sharply on an annual basis.

Output in the **cane and sugar** industry was weak during the review period. Data from the Fiji Sugar Corporation (FSC) indicates that total cane produced during the 2005 season amounted to almost 2.8 million tonnes (Graph 14), around 7 percent lower than the previous season. Consistent with the lower cane output, sugar production totalled around 289,000 tonnes, representing an annual decline of 8 percent.

The lower cane and sugar output in the season largely resulted from the relatively shorter crushing season this year. In addition, plant related problems, poor supply of cane to the mills, persistent cane burning and unfavourable climatic conditions hindered production during the year.

[5] There are 3 broad categories of VAT collections – (i) import VAT; (ii) cash collections; and (iii) VAT paid by Government.

Graph 14

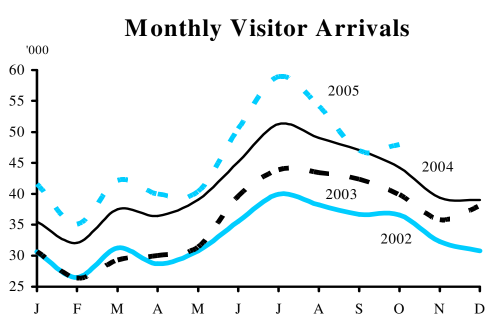


Sources: Fiji Sugar Corporation Ltd, Fiji Islands Bureau of Statistics & Macroeconomic Committee.

The industry is expected to register an improved performance in the 2006 season due mainly to the steady implementation of the Sugar Industry Restructure.

The **tourism** industry continued to perform strongly into the final quarter of the year. Industry liaison and anecdotal evidence indicates that visitor arrivals in the ten months to October totalled 442,000, representing a 6.0 percent growth, on an annual basis (Graph 15).

Graph 15



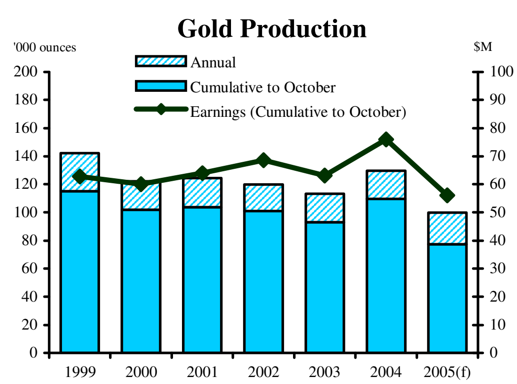
Sources: Fiji Islands Bureau of Statistics & Reserve Bank of Fiji estimates.

Moreover, the industry is estimated to have performed well in the final 2 months of the year, as major hotels have been reporting good occupancy rates, especially during the festive season.

The **textiles, clothing and footwear** industry recorded poor output during the review period. Cumulative to October, textiles, clothing and footwear export earnings contracted sharply, on an annual basis, by around 47 percent to $112 million. The second quarter Industrial Production Index for garments also declined by 60 percent over the year. The contraction in the industry's output reflects the closure of the largest garment factory in Fiji in April 2005, as well as stiff competition posed by the industry's Asian counterparts.

Output in the **mining and quarrying** sector also remained weak during the review period. Cumulative to October, total gold output amounted to around 77,000 ounces, 29 percent lower than the corresponding period in 2004 (Graph 16). The gold industry continued to face a number of challenges during the year. According to Emperor Gold Mining Company Limited, staff absenteeism, lower quality ore extraction and high fuel costs hindered production at the mine.

Graph 16



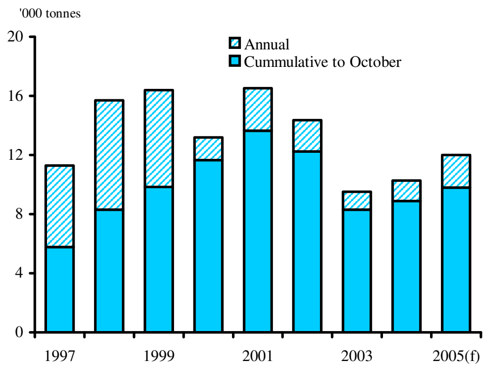
Source: Emperor Gold Mining Company Limited

In line with weak production, gold export earnings were also lower by 26 percent on an annual basis during the review period.

Copra production continued to show good growth. For the first ten months of the year, copra output amounted to around 9,800 tonnes (Graph 17), an increase of 10 percent over the corresponding period in 2004.

Graph 17

Copra Production



Source: Coconut Industry Development Authority

The minimum mill gate price of copra remained unchanged at $500 per tonne in October. Government's subsidy towards the mill gate price was $124.84 per tonne.

Electricity generation continued to hold up well. Cumulative to November, total electricity generated was around 621 million kilowatt hours. This represented an increase of around 6 percent on an annual basis.

The medium term outlook for the electricity industry is encouraging. Apart from major investments expected to be undertaken by the Fiji Electricity Authority over the next 5 years, the Government has allocated a sum of $6 million in the 2006 National Budget for the rural electrification programme. In the last four years, this programme has made 400 new connections and with the new allocation, it is expected to cover more rural communities in 2006.

The **fishing** industry continued its good performance into the final quarter of 2005. Recent trade data indicates that total exports of fish during January to October totalled around $70 million, an annual growth of around 5 percent. Projections indicate that the industry will register a modest growth this year as well.

The performance of the **timber** industry was subdued during the review period. Cumulative to October, timber export receipts totalled $33.3 million, 6 percent lower than the earnings in the corresponding period in 2004. Nonetheless, the outlook for the timber industry is promising, underpinned by good prospects for mahogany and pine production. In particular, the completion of the Wairiki-Bua port in 2006 will be an added impetus to the growth of the timber industry over the medium term.

The **building and construction** sector performed robustly in the third quarter. Latest data from the Fiji Islands Bureau of Statistics revealed that the value of work put-in-place in the year to September grew by 64 percent on an annual basis to around $186 million.

By categories, the value of work put-in-place by the private sector rose sharply by 101 percent ($72 million), while the public sector registered a marginal growth ($0.6 million) during the same period.

Notable projects which were completed during the quarter include the Suva Central project, Sofitel Fiji Resort & Spa and the extension of the Lautoka Teachers College.

In addition, construction continued at the Momi Bay Marriott Resort, First Landing Resort, Great Council of Chiefs complex, Mid-City Plaza, Rewa Bridge, Na Hina Apartments and Fiji Islands Revenue & Customs Authority Headquarters. Refurbishment works at the Sheraton Fiji Resort, Sheraton Royal Resort, the Warwick International Resort, Shangri-La Fijian Resort, Naviti Island Resort and the runway upgrade at the Nadi International Airport also progressed steadily during the final quarter.

In line with the buoyant activity in the building and construction sector, **investment** in the country is steadily rising. A strong growth in lending to private individuals for housing purposes, as well as to the construction sector during the quarter further augmented the level of investment in the country.

Apart from construction activity, a reasonable level of investment has also been undertaken in the form of capital acquisition. OET trade data indicates that the import of investment goods (including machinery and electrical equipment) rose over the year by around 36 percent in November. Consequently, investment is estimated at 17 percent of GDP this year.

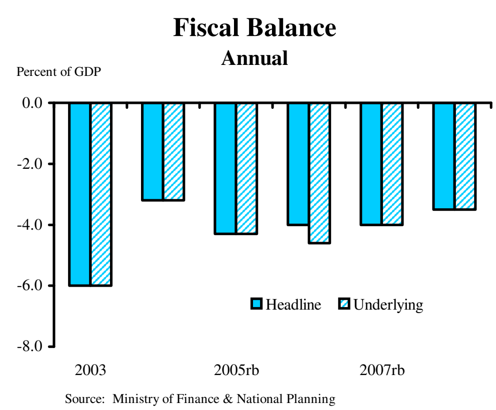
While Fiji's investment level is expected to remain at around 2005 levels, Government has announced several incentives in the 2006 National Budget to boost investment in the country. For instance, Government has now extended the Short Life Investment Package to include retirement and hospital resort investors[6].

On a similar note, the Short Term Investment Package has also been extended for another 12 months to exempt duty on raw materials for manufacturing businesses. Tax incentives have also been provided to Information, Communication and Technology companies, Small and Micro Enterprises and fisheries and agriculture industries. If the incentives provided by the Government are utilised well, investment could exceed 17 percent of GDP in 2006.

Public Finance

In the 2006 National Budget, Government has estimated the fiscal deficit for 2005 at $203.5 million, or 4.3 percent of GDP (Graph 18).[7.]

Graph 18



Government's net expenditure (excluding loan repayments) for 2005 is estimated at $1,434.5 million, an increase of around 8.5 percent over the previous year's level. With certain revenue components, particularly investing receipts being revised downwards, total Government revenue is estimated to fall by 4.7 percent to $1,231.0 million.

For 2006, Government will maintain an

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[6] Previously, this was only available to hoteliers and villa developers.

[7] With no asset sales in 2005, the headline and underlying deficits are the same.

expansionary fiscal stance, with the headline deficit budgeted at $202 million, or 4.0 percent of GDP. Excluding the $30 million sale of Government equities[8] expected in 2006, the underlying deficit is placed at 4.6 percent of GDP.

Total expenditure in 2006 is anticipated to increase by 8.0 percent to $1,548.7 million, of which total loan repayments are expected to be $192.4 million. On the other hand, total revenue is forecast at $1,346.6 million (an increase of 9.4 percent). In comparison, underlying revenue (excluding asset sales worth $30 million) is projected at $1,316.6 million for 2006 (growth of 7.0 percent).

As a ratio of GDP, total revenue collections are projected to grow from 26.0 percent in 2005 to 26.8 percent in 2006. This growth stems from higher receipts expected from fees, fines, charges & penalties; grant in aid; other revenue & surpluses; and the sale of Government assets.

For 2005, Government's capital/operating expenditure mix is estimated at 18:82. For 2006 however, this is anticipated to improve to 20:80, as Government is expected to direct more funds towards capital investments.

Government's outstanding debt in 2005 is estimated at $2,487 million (52.6 percent of GDP). For 2006, Government debt is expected at around $2,689 million (53.4 percent of GDP).

[8] The Government expects to sell around $30 million worth of its shares in Fiji TV, Colonial National Bank and Amalgamated Telecom Holdings, in 2006.

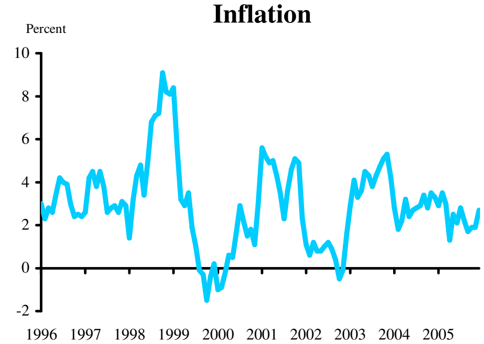
Inflation

In December, inflation was 2.7 percent, compared with 1.7 percent recorded in September (Graph 19). Over the quarter, consumer prices rose by around 2.2 percent, mainly due to higher prices of heating & lighting, food, transport, alcoholic drinks & tobacco, clothing & footwear and durable household goods.

These rises are mainly attributable to the increase in import and excise duties which came into effect in November last year, coupled with higher energy prices and relatively stronger demand during the festive season. On the other hand, prices of miscellaneous items fell, while costs of housing and services remained unchanged during the quarter.

Graph 19

Inflation



Source: Fiji Islands Bureau of Statistics

The underlying measure of inflation, the trimmed mean, was 1.2 percent in December, down from 1.3 percent in the previous quarter.

In 2006, inflationary pressures are expected to arise from the higher import and excise duties, as well as relatively high oil prices. However, this will be cushioned somewhat by the removal of VAT from certain items, beginning January 2006. Consequently, year-end inflation for 2006 is forecast at around 3.5 percent.

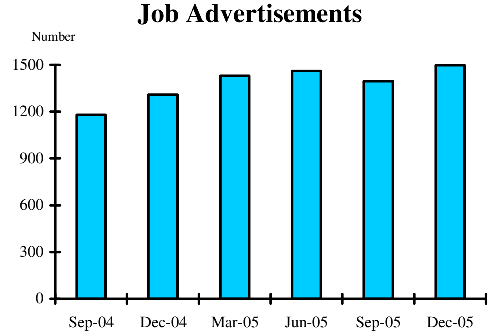
Labour Market

Although partial indicators suggest a slowdown in employment growth, labour market conditions remained favourable during the review period. In 2005, around 6,000 individuals were registered with the Fiji Islands Revenue and Customs Authority (FIRCA), a decline of around 17 percent over the year. The community, social & personal services sector recorded the most new taxpayers, followed by the finance, insurance, real estate & business services; wholesale, retail trade, restaurants & hotels; manufacturing; construction; transport, storage & communication; agriculture, forestry & fishing; mining & quarrying; and electricity & water sectors.

However, in the months ahead, the employment condition is likely to recover. The Reserve Bank's December Survey of Job Advertisements reported an annual increase of 14 percent in recruitment intentions (Graph 20).

Graph 20

Job Advertisements



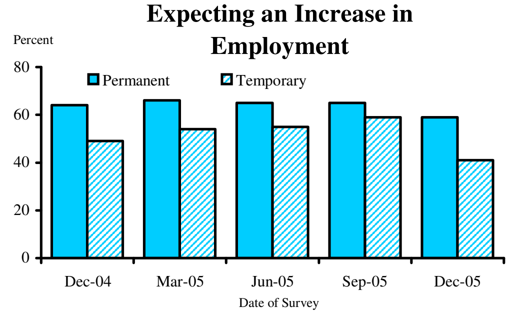
Source: The Fiji Times

The community, social & personal services sector continues to record the most number of advertised positions. This was followed by the wholesale & retail trade, restaurants & hotels; finance, insurance, real estate & business services; transport storage & communication and construction sectors.

Additionally, prospects for employment growth over the next 12 months are encouraging, as confirmed by the Fiji Employers Federation (FEF) Expectations Survey results. The December survey conducted by the Reserve Bank of Fiji (RBF), recorded a net of around 59 percent and 41 percent of respondents expecting an increase in permanent and temporary employment, respectively (Graph 21).

Graph 21

Net Proportion of Respondents Expecting an Increase in Employment

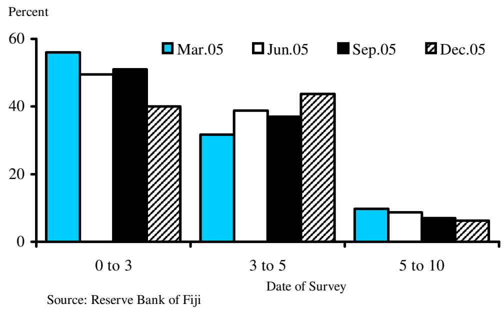


Source: Reserve Bank of Fiji

Wages growth is expected to be modest in the medium term (Graph 22). The FEF Expectations Survey revealed that around 84 percent of respondents anticipate wages to rise between 0-5 percent, while the remaining 6 percent expect a rise of between 5-10 percent.

Graph 22

Proportion of Respondents Expecting Wages to Increase



The External Sector

On the external front, latest OET data showed that cumulative to November, merchandise exports fell by around 13 percent, compared with an increase of around 3 percent in the corresponding period last year. The decline in receipts was largely attributed to negative contributions from textiles, clothing & footwear, other re-exports, fish and merchanted goods, which more than offset positive contributions from sugar, ginger, gold, mineral water and copra.

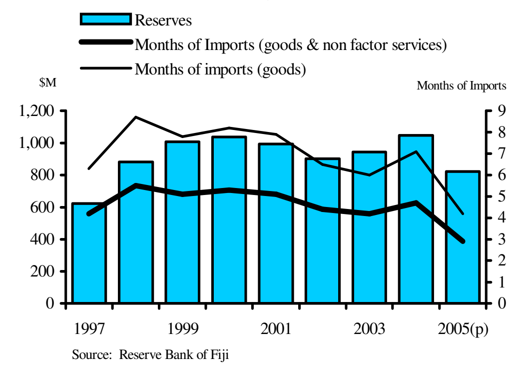
During the same period, merchandise imports rose by around 19 percent, compared with a growth of around 14 percent in the corresponding period in 2004. The increase in import payments was due to positive contributions from all categories; intermediate goods (9.1 percent), investment goods (7.3 percent), and consumption goods (3.0 percent).

The rise in intermediate goods was largely made up of increases in imports of mineral fuels and textiles, clothing & footwear, while the growth in imports of investment goods was underpinned by the increase in payments for machinery & electrical equipment and chemicals. The higher payment for consumption goods was largely attributed to the increase in contribution from other imports, duty free goods, food, beverages & tobacco, transport equipment and government imports.

Foreign reserves at the end of 2005 were provisionally estimated at around $822 million, sufficient to cover 2.9 months of import payments of goods and non-factor services or 4.2 months of imports of goods only (Graph 23).

Graph 23

Gross Foreign Reserves



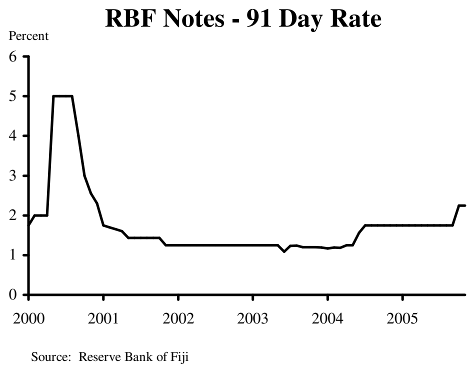
Domestic Financial Conditions

Money Markets

The demand for inter-bank funds rose during the December quarter. Total inter-bank turnover was $373.3 million during the review quarter, compared with $60.4 million in the previous quarter. The weighted average inter-bank rate at the end of the December quarter was 2.02 percent.

The Reserve Bank tightened its monetary policy at the end of October. Since the last rate hike in May 2004, the Bank had noted that consumption continued to remain strong, while credit (including mortgage lending) rose buoyantly. At the same time, imports were growing strongly while exports continued to under-perform. Such a situation warranted a policy response to dampen domestic demand. Consequently, the Bank raised the policy indicator rate by 50 basis points, from 1.75 percent to 2.25 percent at the end of October 2005 (Graph 24).

Graph 24



As part of open market operations, $86.1 million worth of RBF Notes were allotted during the October to December period, compared with $167.3 million issued in the September quarter. The yield on the RBF Notes during the review period averaged 2.18 percent.

Government also issued Treasury Bills worth $135.5 million in the same period. There were 5 issues of promissory notes during the quarter, worth $12.8 million.

Capital Markets

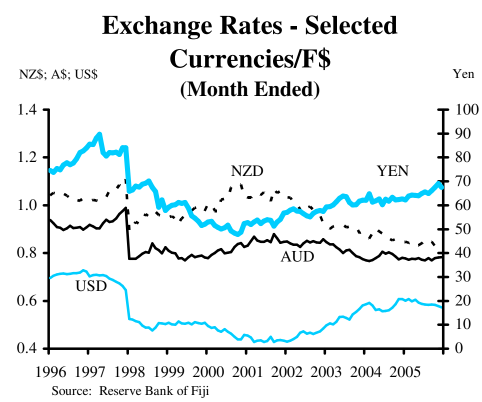
Government also issued bonds worth $105.6 million during the October to December period, compared with $107.1 million issued in the September quarter. The maturities offered ranged between 3 and 15 years, with weighted average yields spread from 2.42 percent to 6.49 percent.

In the secondary market for bonds, there were 57 trades totalling $35.5 million during the December quarter. This compares with 24 trades amounting to $6.4 million in the previous quarter.

Foreign Exchange Markets

During the December quarter, the Fiji dollar weakened against the US (2.0%) and NZ (0.7%) dollars as well as the Euro (0.4%). However, it strengthened against the Japanese Yen (2.1%) and Australian (1.7%) dollar during the same period (Graph 25).

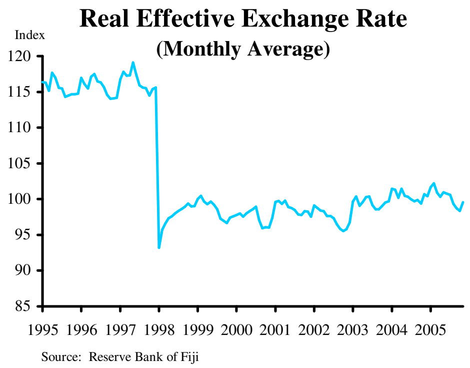
Graph 25



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

During the same period, the Real Effective Exchange Rate (REER) Index of the Fiji dollar, which adjusts the NEER for inflation differentials across Fiji's major trading partners, also increased, implying a deterioration in our external competitiveness (Graph 26).

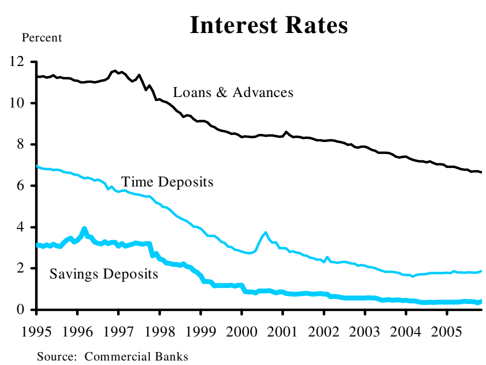
Graph 26



Financial Intermediaries

Latest movements in commercial bank interest rates generally revealed a mixed trend during the quarter. The weighted average lending rate on commercial bank outstanding loans declined to 6.66 percent in November, from 6.70 percent at the end of the September quarter (Graph 27).

Graph 27



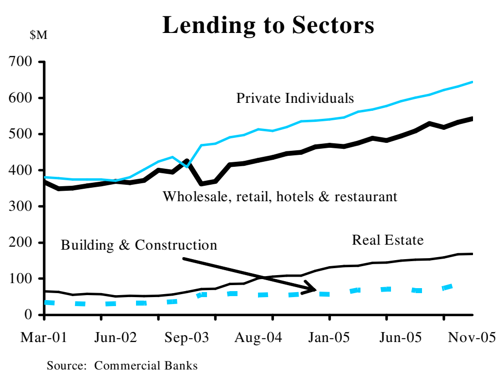
During the same period, the savings and time deposit rates rose by 1 basis point and 8 basis points to 0.40 percent and 1.87 percent, respectively.

Compared with the end of the previous quarter, the weighted average lending rate offered by Licensed Credit Institutions (LCIs)[9] remained unchanged at 11.35 percent, while the interest rate on outstanding time deposits increased from 4.06 percent to 4.20 percent at the end of November.

Monetary and credit aggregates continued its growth momentum in the year to November. During the period, broad money grew at an annual rate of 19.9 percent. The outturn was largely attributed to increases in narrow and quasi money, which in turn was influenced by rises in demand, savings and time deposits.

In the year to November, the value of loans outstanding in the banking system rose by around 22 percent. This was driven largely by higher lending to the private individuals; wholesale & retail and hotels & restaurants; real estate and the building & construction sectors (Graph 28).

Graph 28



Commercial bank lending to the manufacturing sector, as well as to central & local governments declined during the same period.

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

Total outstanding loans and advances by LCIs rose by 16.7 percent in the year to November, underpinned mainly by higher lending to private individuals and the real estate sector.

Banking Industry Quarterly Condition Report – September 2005

Overview - Commercial Banks

The overall performance of the banking industry remained satisfactory during the September quarter.

The **combined balance sheet** of the industry grew from $2.6 billion at the end of June, to $2.8 billion at the end of the third quarter. A large part of this growth was underpinned by an increase in loans, which amounted to $1.9 billion at the end of the quarter. On the supply side, deposits grew by 6.4 percent ($148.8 million), with the three main contributors being non-bank financial institutions, private sector business entities and private individuals.

The **capital adequacy** of banks remained strong during the review period, as individual banks kept their capital adequacy ratios at around 11.4 percent, well above the minimum requirement of 8 percent.

In the September quarter, banks' **asset quality** was satisfactory. Collectively, the banks recorded an improved impaired assets to total loans ratio of 1.9 percent and an $8.2 million reduction in the level of impaired assets to $36.5 million. The total provisions to total loans ratio stood at 2.0 percent.

In view of the satisfactory performance in other CAMEL[10] components, banks' **management performance** was satisfactory in the third quarter. Minor deficiencies in reporting to the Reserve Bank were noted during the quarter, which would need to be rectified immediately by the individual banks.

Banks' **earnings** for the quarter were satisfactory, with a 2.4 percent growth in pre-tax profits to $27.2 million, the highest quarterly earnings performance in the last 5 years. Interest spreads continued to increase, led by growth in returns from earning assets. The efficiency ratio deteriorated however, by 3.7 percentage points to 48.5 percent.

The **liquidity** position of banks was also satisfactory, as total liquid assets increased to $678.0 million. Liquidity risk is partially mitigated by the cash flow management systems implemented by banks and their respective contingency plans.

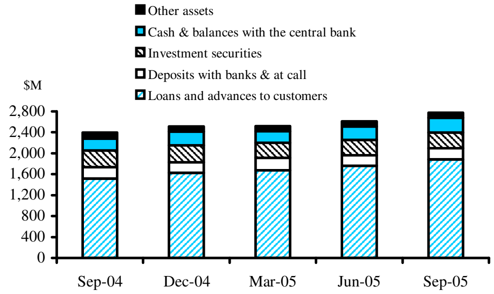
Balance Sheet

The banks' combined balance sheet grew by 6.1 percent over the quarter and by 15.8 percent over the year to $2.8 billion (Graph 29).

[10] CAMEL refers to Capital Adequacy, Asset Quality, Management, Earnings and Liquidity.

Graph 29

Structural Change and Growth of Bank Assets



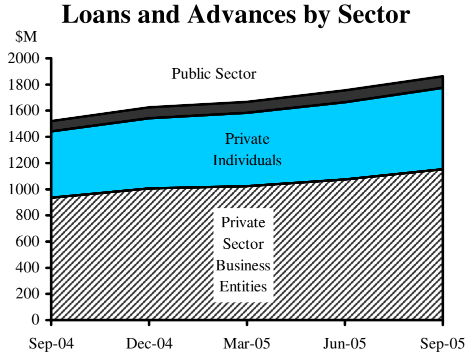
Source: Commercial Banks

The growth in assets was driven primarily by an increase in loans to private individuals ($31.8 million), as well as to the wholesale & retail ($23.6 million), manufacturing ($12.7 million) and the real estate sectors ($8.3 million). Most other sectors also showed growth in their loan portfolios, albeit of a smaller magnitude. The overall gross loans disbursed at the end of the September quarter amounted to $1.9 billion, an increase of 22.9 percent over the year.

Lending to private individuals was mainly for housing, while manufacturing sector loans were generally directed to the food, beverages and tobacco, woodwork and furniture making industries (Graph 30).

Graph 30

Loans and Advances by Sector



Source: Commercial Banks

Deposits with the commercial banks grew by $148.8 million (6.4 percent) during the quarter. The increase in deposits was led by growth in demand deposits held by non-bank financial institutions ($53.3 million), time deposits held by private sector business entities ($37.0 million) and private individuals' savings deposits ($17.5 million).

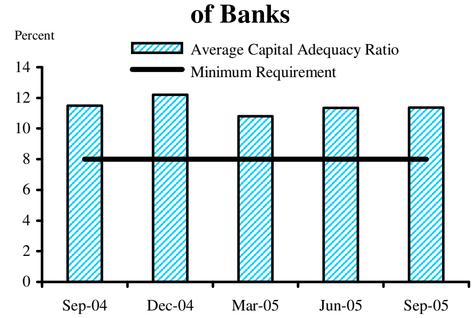
Capital Adequacy

The capital position of banks remained strong in the third quarter with a capital adequacy ratio of 11.4 percent (Graph 31). This was an improvement of 2 basis points over the quarter and was well above the 8 percent requirement for commercial banks. Risk assets grew by 6.1 percent, while capital rose by 6.3 percent.

On an annual basis however, the capital adequacy ratio declined by 15 basis points in September 2005. During the same period, risk assets increased by 17.8 percent, while capital grew by 16.2 percent.

Graph 31

Capital Adequacy Ratio of Banks



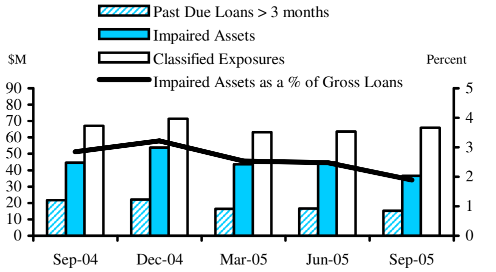
Source: Commercial Banks

Asset Quality

Banks' asset quality remained satisfactory over the quarter. While there was an increase in classified exposures, the level of impaired assets and past due loans (above 3 months) registered declines (Graph 32).

Graph 32

Asset Quality



Source: Commercial Banks

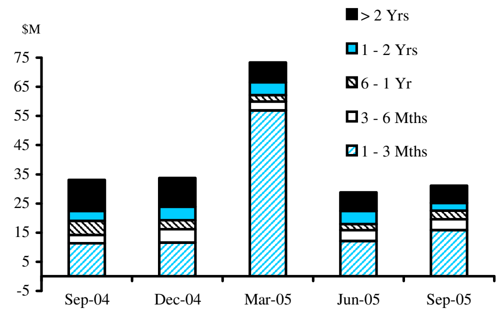
At the end of the third quarter, impaired assets totalled $36.5 million and classified exposures amounted to $65.9 million. This represented 1.9 percent and 3.4 percent of gross loans and advances, respectively. Compared with the second quarter, impaired assets decreased by $8.2 million while classified exposures increased by $2.4 million.

By sector, problem loans continued to be concentrated in the wholesale & retail sector (34.3 percent), mining and quarrying sector (26.8 percent) and amongst private individuals (19.4 percent).

Past due loans increased over the quarter by 12.9 percent. This was due mainly to a $3.7 million increase in past due loans in the 1-3 months time band (Graph 33). Past due loans represent 1.6 percent of total loans and advances.

Graph 33

Past Due Status



Source: Commercial Banks

At the end of the quarter, provisions declined by 13.5 percent to $38.9 million and represented 2.0 percent of total loans and advances. General provisions increased by $2.0 million to $23.3 million while specific provisions decreased by $8.1 million to $15.6 million.

Recent variances in asset quality have been the result of changes in classification of large accounts as 'impaired', with resulting changes in specific provisions. General provisions are expected to continue growing in the approaching quarters.

Earnings

Banks' earnings were satisfactory during the review quarter, with a 2.4 percent growth in pre-tax profits to $27.2 million. This is the record level of profits earned by the banks in any particular quarter in the last five years. The growth in profits was due to an increase in net interest and non-interest income, which more than offset higher operating and interest expenses.

Interest income growth was led by an increase in other interest income (operating lease rental income) and interest from business loans (mainly term loan growth). Interest received from housing loans also grew during the period.

The annualised returns on assets was recorded at 4.0 percent, 8 basis points lower than the June quarter results.

Aggregate Bank's Income Statement

	Sep-04	Jun-05	Sep-05	% Change Over Qtr	% Change Over Sep-04
		$M			
Interest Income	31.21	34.96	39.97	14.33	28.07
Interest Expense	4.56	5.09	5.48	7.66	20.18
Net Interest Income	26.65	29.87	34.49	15.47	29.42
Add: **Non Interest Income**	24.77	22.23	22.92	3.10	(7.47)
Income From Overseas Exchange Transactions	9.30	7.93	9.44	19.04	1.51
Commission	3.33	1.99	2.69	35.18	(19.22)
Fee Charges	11.42	10.96	11.00	0.36	(3.68)
Other Income	0.72	1.35	(0.22)	(116.30)	(130.56)
Equals					
Total Operating Income	51.42	52.10	57.41	10.19	11.65
Less: Operating Expenses	25.19	23.31	27.81	19.31	10.40
Less: Bad Debts & Provisions	0.89	2.24	2.42	8.04	171.91
Equals:					
Profit Before Tax	25.34	26.55	27.18	2.37	7.26
Less: Tax	7.73	6.85	8.72	27.30	12.81
Add Extra Ordinary Items	-	-	-	-	-
Equals:					
Net Profit After Tax	17.61	19.70	18.46	(6.29)	4.83

Source: Commercial Banks

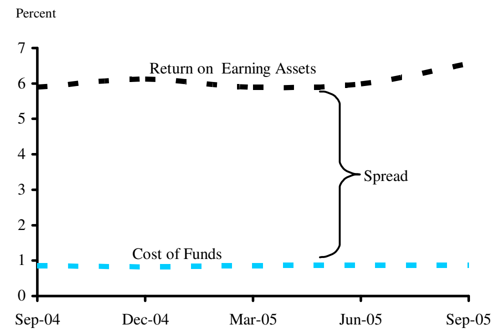
Interest Margin and Spread

The return on earning assets maintained its upward trend, growing by around 60 basis points during the year (Graph 34). This was against the continued competition between banks and a small decline in the weighted average lending rate.

The cost of funds remained at 0.9 percent. However, this is expected to increase in the medium term, in line with the October 2005 interest rate hike.

Graph 34

Margins and Spreads



Source: Commercial Banks

Efficiency

After recording an improvement in June, banks' efficiency ratio (operating costs to operating income) fell by 3.7 percentage points to 48.5 percent in the third quarter. However, the overall efficiency ratio is expected to improve in the December quarter of 2005.

Liquidity and Funding

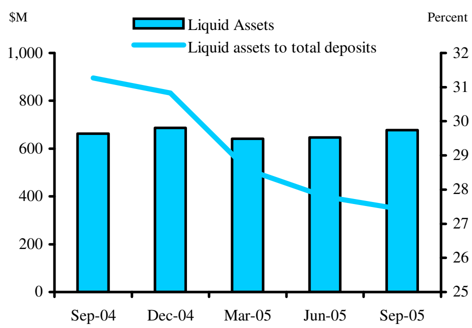
For the September quarter, the combined banks' liquidity position was satisfactory. Liquid asset levels continued to improve, with $678.0 million recorded during the review quarter, compared with $646.0 million at the end of June 2005 (and $663.0 million at the end of September 2004) (Graph 35).

Despite the growth in liquid asset levels, coverage over short term liabilities[11] declined. The ratio of liquid assets to short term liabilities was 52.2 percent for the September 2005 quarter, a decline of 4.72 percentage points over the quarter and 14.4 percentage points over the same period in 2004.

Short term loans and advances represent 31.8 percent of the total loan portfolio and will help ease any strains on liquidity levels in the short term. However, with the current trend, liquidity may tighten over a longer time period.

Graph 35

Liquid Assets to Total Deposits



Source: Commercial Banks

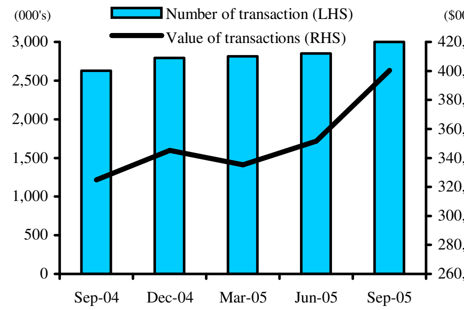
Electronic Banking

The volume and value of electronic banking transactions grew over the quarter and year (Graph 36).

The number of transactions conducted through Automatic Teller Machines (ATMs) and Electronic Funds Transfer at Point of Sale (EFTPOS) mediums rose from 2.9 million in the June quarter to 3.0 million in the September quarter. By value, the transactions increased from $351.6 million to $400.3 million in the same period. This trend is anticipated to continue as the banks introduce more electronic sites and customers become more familiar with these forms of transactions.

Graph 36

ATM & EFTPOS Transactions



Source: Commercial Banks

Overview - Credit Institutions

Overall, credit institutions maintained their satisfactory performance during the September quarter. Aggregated assets of credit institutions increased by 2.8 percent, driven by the growth in loans.

The **capital adequacy** position of credit institutions remained strong in the review period. Credit institutions' capital adequacy ratio was 22.5 percent as at quarter end, well above the minimum requirement of 10.0 percent.

Credit institutions' **asset quality** rating remained marginal during the review quarter. Total impaired assets increased slightly to $17.3 million and represented 6.7 percent of total loans, much higher than the combined 1.9 percent recorded by banks.

Earnings by credit institutions were satisfactory in the September quarter and after-tax profits increased almost four-fold. This was mainly due to a reduction

[11] The combined value of demand deposits and term deposits maturing within 12 months.

in operating expenses, which were particularly high in the June quarter as a result of audit adjustments. When compared with the same period in the previous year, after-tax profits registered a growth of 3.7 percent.

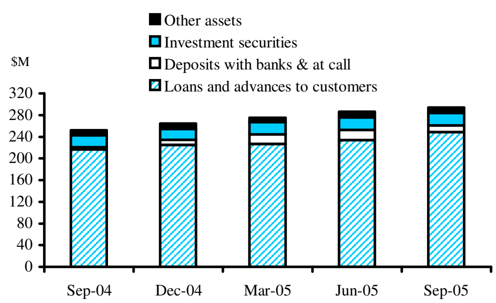
Although liquid funds held by credit institutions declined over the quarter, the **liquidity** position of credit institutions was satisfactory. This outcome was supported by the stable sources of funds and standby funding arrangements credit institutions had in place.

Balance Sheet

The combined balance sheet of credit institutions grew over the quarter by 2.8 percent to $294 million, mainly due to the continuing growth in loans and advances to customers (Graph 37).

Graph 37

Structural Change and Growth in Credit Institutions' Assets



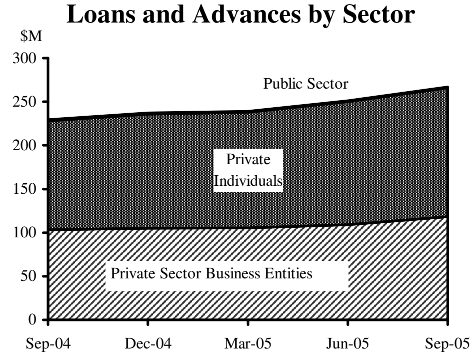
Source: Credit Institutions

The growth in the combined balance sheet during the review period was underpinned by an increase in term deposits by one particular institution. Over the previous quarter, borrowings from parent companies registered a decline of 5.8 percent to $85.8 million.

In line with the growth in credit institutions' funding, loans and advances grew by 6.3 percent to $248.3 million. New loans approved increased over the quarter by 10.5 percent to $42.2 million, with most of them largely disbursed to private individuals, the transport and storage and real estate sectors (Graph 38).

Graph 38

Loans and Advances by Sector



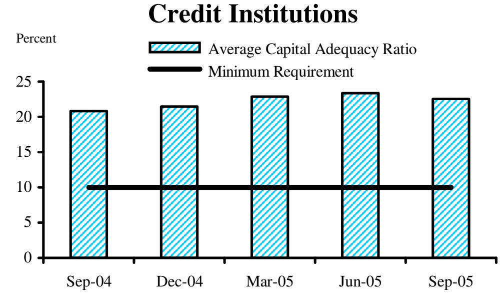
Source: Credit Institutions

Capital Adequacy

The capital adequacy for credit institutions was 22.5 percent in the September quarter, well above their 10 percent requirement (Graph 39). Nonetheless, this represents an 82 basis points decline over the quarter. Credit institutions are expected to remain well capitalised.

Graph 39

Capital Adequacy Ratio of Credit Institutions



Source: Credit Institutions

Asset Quality

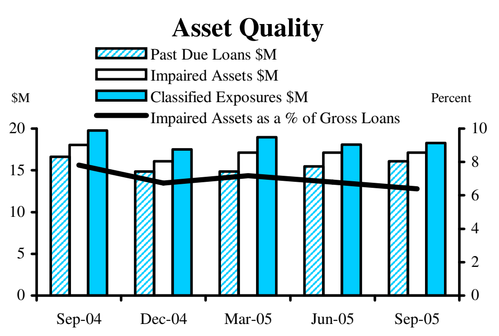
Credit institutions' asset quality deteriorated slightly over the quarter as past due levels and classified exposures rose (Graph 40).

Classified exposures increased by 1.2 percent to $18.3 million, led by the $1.0 million increase in substandard accounts over the quarter. During the same period, doubtful and loss accounts fell by $0.2 million and $0.6 million, respectively. Impaired assets increased to $17.3 million in September, from $17.1 million in the June quarter.

With the increase in classified exposures for substandard accounts, specific provisions increased by 4.4 percent to $6.5 million. General provisions continued to increase steadily for all credit institutions, with a 3.1 percent increase to $8.4 million. This resulted in a 3.7 percent growth in total provisions to $14.9 million. General coverage has been consistent during the quarter, remaining within 3.0 percent.

In light of these movements, credit institutions' asset quality rating remained unchanged from the June quarter.

Graph 40



Earnings

Credit institutions recorded a profit of $2.6 million in the September quarter, compared with $0.5 million in the second quarter and $2.5 million in the same period last year.[12]

Aggregate Credit Institutions' Income Statement

	Sep-04	Jun-05	Sep-05	% Change	
		$M		Over Qtr	Over Sep-04
Interest Income	7.54	8.11	8.47	4.44	12.33
Interest Expense	2.28	2.44	2.53	3.69	10.96
Net Interest Income	5.26	5.67	5.95	4.94	13.12
Add: **Non Interest Income**	0.55	0.69	0.90	30.43	63.63
Commission	0.06	0.07	0.08	14.28	33.33
Fee Charges	0.21	0.25	0.63	152.00	200.00
Other Income	0.28	0.37	0.19	(48.65)	(32.14)
Equals **Total Operating Income**	5.81	6.36	6.84	7.55	17.73
Less: Operating Expenses	2.23	4.23	2.95	(30.26)	32.29
Less: Bad Debts & Provisions	0.63	0.53	0.63	18.87	0.00
Equals:					
Profit Before Tax	2.95	1.60	3.26	103.75	10.51
Less: Tax	0.46	1.07	0.67	(37.38)	45.65
Add Extra Ordinary Items	Nil	Nil	Nil	Nil	Nil
Equals: **Net Profit After Tax**	2.49	0.53	2.59	388.67	4.02

Source: Credit Institutions

Interest income earned by credit institutions grew by 4.4 percent over the quarter, while interest expenses rose by 3.7 percent (Graph 41). The growth in interest income is attributed to increased lending activity, while the rise in interest expense was due to the expansion in the deposits portfolio.

[12] The low level of net profit after tax in the June quarter was a result of audit adjustments.

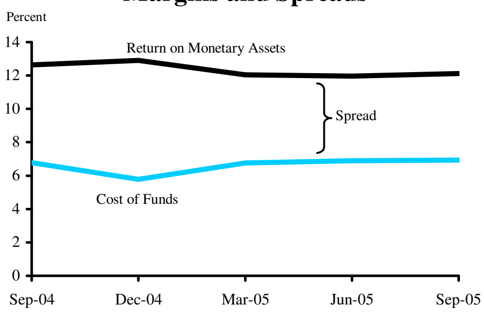
Operating expenses of credit institutions fell by 30.3 percent over the quarter, mainly caused by the reduction in depreciation charges.

Returns on equity recorded an increase of 170 basis points to 6.8 percent, while returns on assets rose by 22 basis points to 1.1 percent.

The earnings indicators improved over the quarter, indicating a satisfactory earnings position for credit institutions.

Graph 41

Margins and Spreads



Source: Credit Institutions

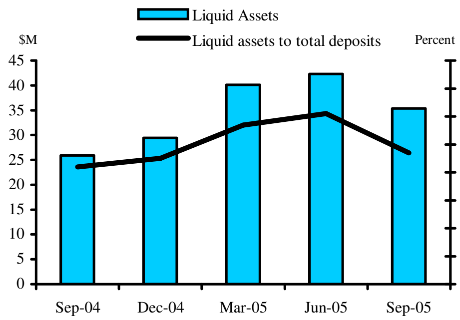
Liquidity

Credit institutions' liquid funds decreased by 16.3 percent over the quarter to $35.4 million (Graph 42). The decline is attributed to higher demand for loans, which could not be fully met by term deposits. As a percentage of funding, liquid assets decreased by 6.8 percentage points to 23.4 percent.

The total deposit holdings of the 15 largest depositors with credit institutions amounted to $64.0 million during the third quarter. This represented 180.8 percent of total liquid assets, suggesting that the current level of liquid assets is insufficient to cover volatile liabilities.

Graph 42

Liquid Assets to Total Deposits



Source: Credit Institutions

The maturity profile of credit institutions' loans and deposits reveal a mismatch of $42.8 million for the short term, half of which are due in the December 2005 quarter.

In this regard, the level of liquid assets available to cover volatile liabilities and mismatches in crisis situations is considered marginal. This liquidity risk is however mitigated by stable funding sources for existing borrowings and stand-by arrangements with banks and parent companies.

Insurance Industry Quarterly Condition Report – June 2005

Overview of Insurance Industry Performance[13]

Overall, the insurance industry performed satisfactorily during the June 2005 quarter.

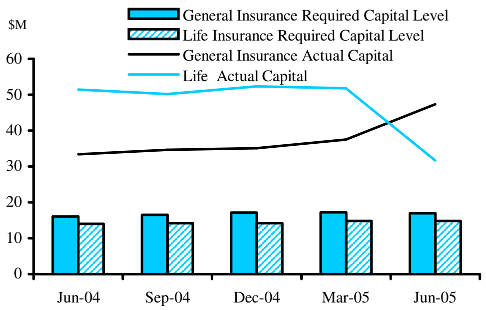
The **capital** base for the insurance industry was satisfactory. As at the end

[13] This Quarterly Condition Report introduces a new reporting insurance supervision methodology with the acronym "CARAMELS" which stands for: Capital, Assets, Reinsurance, Actuarial Liabilities, Management, Earnings, Liquidity and Subsidiaries.

of June 2005, the total solvency surplus available for the industry was $47.2 million, well above the required capital level of $31.8 million (Graph 43).

Graph 43

Insurance Industry Actual Capital & Required Capital Levels



Source: Insurance Companies

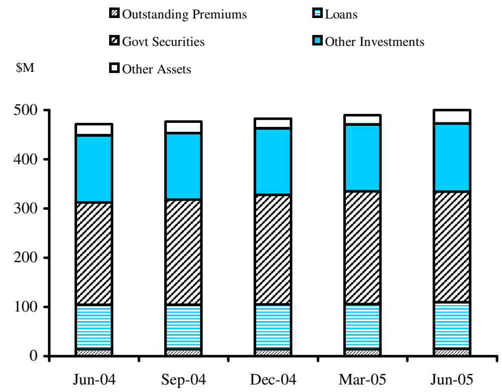
The insurance industry's total **assets** grew by 6 percent on an annual basis to reach $689.7 million, at the end of June 2005. This was driven by a growth in assets of both the life and general sectors.

By categories, the total assets of life insurers increased by 6.0 percent over the year to $500 million in June 2005 (Graph 44).

The composition of the assets remained unchanged over the past four quarters, with investments accounting for 73 percent, loans representing 19 percent and other assets making up the balance. The bulk of the life insurers' investment portfolio is made up of government securities (62 percent) and properties (land & buildings) (16.6 percent).

Graph 44

Distribution of Assets for Life Insurance Companies



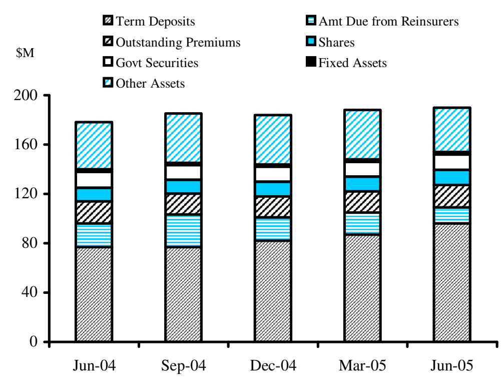
Source: Insurance Companies

At the end of June 2005, general insurers' total assets were $189.7 million. This represented an increase of 6.4 percent from the corresponding quarter in the previous year.

During the review period, investments continued to make up the bulk (67.3 percent) of the general insurers' total assets. In particular, deposits with banks represented the highest share of total assets, at 50.6 percent (Graph 45).

Graph 45

Distribution of Assets for General Insurance Companies



Source: Insurance Companies

During the review quarter, all insurers satisfactorily complied with the **reinsurance** requirements.

The total **liabilities** of the insurance industry (excluding shareholders funds) increased marginally to $576.5 million, underpinned by growth in the liabilities of the life insurance sector.

The insurance industry's **management** performance was satisfactory during the period, with adequate processes and practices in place. However, some areas for improvement have been identified from recent on-site examinations and these are currently being addressed by the respective companies.

Total **earnings** for the insurance industry grew by 18.3 percent to $52.9 million, resulting in a pre-tax profit of $19.3 million for the quarter ended June 2005. The outturn was higher than the $13.6 million recorded in the previous quarter and was mainly due to the growth in investment income of life insurers.

The **liquidity** position of the insurance industry was satisfactory, with the bulk of their assets concentrated in bank deposits and government securities.

Subsidiaries of the insurance companies also performed satisfactorily during the review quarter and did not pose any major risks to the industry.

Insurance Brokers

For the second quarter of 2005, net profit after tax for insurance brokers decreased by 28 percent to $1.1 million. The reduction was a result of an increase in operational expenses, by 11 percent, and a decline in total revenue, by 10 percent.

The Insurance Broking Account balance stood at $3.4 million for the quarter ended June 2005, compared with $3.3 million in the same quarter of 2004.

The RBF continued to process offshore applications. For the quarter ended June 2005, 84 applications totalling $5.0 million were approved in comparison with 46 applications worth $3.0 million approved in the June 2004 quarter.

For the Record

MONETARY POLICY STATEMENT

Statement by Governor, Mr S Narube, 28 October 2005.

The Board of the Reserve Bank of Fiji, in its monthly meeting on 27 October 2005, decided to raise the official interest rate from 1.75 percent to 2.25 percent.

In arriving at its decision, the Board noted that the prevailing economic conditions have not changed since the last interest rate hike in May 2004. Economic indicators reveal that consumption is still strong, credit remains buoyant, imports still rising and exports under-performing. The housing market also continues to thrive, with rapid growth in mortgage lending becoming a concern, given the possible strains on debt servicing capacity. Such a situation warrants a policy response to help dampen demand.

In choosing the policy response, the Board acknowledges the period of good economic growth since 2001 and attributes it, amongst other supporting factors, to a well-balanced set of monetary and fiscal policy mix during the period. The Reserve Bank had adopted an accommodative monetary policy, thus facilitating a low interest rate environment conducive for investment and overall growth.

On the international front, Fiji is now faced with the impact of higher international oil prices which will raise domestic inflation through increased costs of production. The hike in oil prices raises our import bill further at a time when exports are not performing well. The second-round effects, through higher wage claims also poses risks to inflation.

Inflation in the year to September was 1.7 percent. The year-end inflation is forecast at 3 percent. However, the risks to the medium term inflation outlook are now becoming increasingly evident.

At the new level of official interest rate, the Bank is of the view that conditions will continue to remain supportive of growth.

The Reserve Bank will continue to monitor developments in the coming months and align monetary policy accordingly.

ECONOMICS ASSOCIATION MEETINGS FOR 2005
FORUM COMMUNIQUÉ

The Bank held three Economics Association (EA) meetings in 2005. The meetings largely focused on Fiji's trade relationship with the rest of the world and how through regional cooperation and integration, the Pacific region as a whole could be better placed to compete in the international market.

The guest speaker for the first meeting was the American Ambassador to Fiji, *His Excellency,* Mr. David Lyons who spoke at length on the importance of reviving the Joint Commercial Commission (JCC). The theme for the second meeting was on developing public and private partnerships. The United Nations Development Programme resident representative, Mr. Richard Dictus, led the discussion on this topic. The third EA meeting for the year, focused on the European Union's (EU) role in the Pacific. Specifically, the agenda for this meeting was to discuss various economic prospects arising from regional agreements between the EU and the Pacific. Some discussion also revolved around the future of Fiji's sugar industry. The Head of the Delegation of the European Commission for the Pacific, *His Excellency* Dr Roberto Ridolfi, spoke on these issues.

Excerpts from the speakers' speeches and a summary of the main discussion points are provided below:

First Meeting: "Reinvigorating the Joint Commercial Commission", by *H.E.* Mr. David Lyon.
Date: Thursday, 9th June, 2005

The revival of the JCC represents an opportunity for Pacific Island nations to boost trade and investment between them and the United States (US). The JCC was allowed to languish almost to oblivion in the last few years, but if used effectively, it can be a powerful mechanism toward identifying and removing obstacles to trade.

The JCC was first proposed in October 1990, by the then US President, George Bush Senior, in a meeting of Pacific Island leaders in Hawaii. He envisioned the establishment of a Commission that would identify and address commercial opportunities and trade concerns of Pacific Island countries. A memorandum of understanding (MOU) was finally signed by 13 Pacific Leaders and the US in January 12, 1993, establishing the Joint Commercial Commission.

The MOU contained eight specific functions relating to trade and investment, all of which were open to discussion within the JCC context. Included among them were provisions for information exchanges, dialogue mechanisms, education programs, private-sector development, and monitoring program effectiveness. Indeed, it was an ambitious framework for economic progress for the entire Pacific region.

President Clinton confirmed his administration's commitment to the JCC shortly after he took office in early 1993. The inaugural meeting followed on October 8, 1993, in Washington where the Pacific Leaders established a Trade and Investment Working Group (TIWG). To date the TIWG is the only established working group within the JCC.

Although the Commission was designed to be a dynamic instrument to promote trade and investment, it actually seemed to function only during the yearly Leaders' Meetings in Hawaii. During those meetings good ideas were put forward and endorsed, but action was slow or not at all. More must be done to ensure that this body is not put to waste, but rather becomes an important export tool for island economies. When talking through the JCC, we are in fact drilling out some answers on trade issues and how the US Government can be used for the Pacific advantage.

Functions of JCC

A key function of the JCC is to monitor trade and investment relations, and identify and consult regarding the removal of impediments to trade and investment between signatories. New discussions on Customs and Quarantine issues that impede the flow of Pacific island goods could render almost immediate benefits to Pacific nations. The US is not going to raise these issues, but would be amenable to discussing them through the JCC.

However, my advice is that, if goods and services are placed on the JCC agenda, the list must be limited in scope, specific in focus, and regional in context. Long laundry lists and endless dialogue are hard to deal with, and can be counterproductive. What we need is a small range of goods that meets quality standards and can be produced effectively and efficiently on a regular basis. If it is clear that the product could be competitive if specific incentives are put in place, or barriers removed, then it would stand an excellent chance of acceptance.

A second function of the JCC is to commit signatories to exchange information on development projects, activities and opportunities. Here, the internet is a cost-effective tool for such information sharing, especially for small island states. The East-West Center in Hawaii, currently has an online "Business Bulletin Board" site that allows government bodies and private businesses to list trade and investment opportunities in their respective countries. The site has the potential to become a virtual market place for the Pacific, if more companies get involved and government trade officials actively encourage local businesses to post there.

The JCC also promotes education, training, technical assistance and exchanges among signatories. Much can be done by governments and the private sector under this function. For instance, based on my own experience as Ambassador to five signatory countries, several could use training toward meeting new US requirements on shipping security, developed since 9/11. Fiji's ports are in good shape, but there are concerns surrounding regulations that may require Air Pacific to place armed Air Marshals on flights to and from the US. These are exactly the kind of issues that could be discussed within the JCC framework.

The last function brings governments fully into the picture by simply stating that signatories will meet and *discuss related issues of mutual interest*. This function opens the door for discussions on all topics of trade and investment. It provides a vehicle for member States' concerns to be heard and acted upon. However, to work, the island states must drive the discussions in the JCC, and ensure that they speak in a united voice that is loud enough for Washington to hear.

In this context, I would caution that issues applying to all the Pacific signatories stand a better chance of being successfully resolved, than issues of interest to only one nation. Furthermore, it also stands to reason that a complaint about a US barrier or practice will stand a greater chance of resolution if the islands, themselves, do not have similar restrictions.

The legal environment and bureaucracy must also play a part. Internal laws must be revised and updated to improve the climate for trade and investment. For instance, remove red tape that hinders new foreign investment registration in Fiji and other Pacific islands. Enact and enforce more stringent property laws, which adequately protect both physical and intellectual property rights of individuals. Traders and investors alike are interested in these matters, and local laws and policies can and do influence commerce.

Furthermore, the political environment prevailing within the Pacific Island countries should not be left as an unnoticed parameter when considering the trade issues. We also need political and social stability in the economy for commerce and trade to flourish. For this reason, I strongly urge all of Fiji's leaders to abandon confrontation and to replace it with meaningful dialogue and negotiations aimed at truly resolving burning political and communal issues.

I again at this juncture emphasize the importance of a fully functioning Commission – the JCC as a framework for resolving disputes and encouraging trade and investment. An enormously valuable aspect of the JCC is that it very nearly approximates a TIFA, or Trade and Investment Framework Agreement. If there had been a strong, fully functioning JCC, I am reasonably sure your country would now be in a better trade position on garments.

To make the JCC work for Pacific island countries, much more effective administration is needed. My (final) advice is to have a permanent bureaucracy capable of handling evolving issues, like that of the Pacific Islands Forum Secretariat. This way its chairmanship could still rotate, but a permanent professional staff could give the organization continuity, carry on with ongoing business, and exploit long-term relationships with American trade officials. As the largest and most dynamic economy of the member states, Fiji is both well-placed to influence a reinvigorated JCC and to benefit from bilateral and regional trade with the US.

Second Meeting: "Unleashing entrepreneurship – Building Public and Private Sector Partnership", by Mr. Richard Dictus.
Date: Tuesday, 28th June, 2005

Any approach to stimulating economic growth, should be grounded in the realization that savings, investment and innovation that lead to such developments, are usually undertaken by private individuals, corporations and communities. The private sector must be allowed to take a more active role in poverty alleviation, through greater job creation and more efficient production processes that lowers the cost of goods and services.

Private sector growth and entrepreneurship works well if there is an enabling environment provided by the State. The UN Secretary-General's report to the General Assembly on 'Strengthening the role of the private sector and entrepreneurship in financing for development" has outlined 6 broad conditions and requirements for improving the overall business environment in developing countries. These relate to appropriate and enforceable regulations and laws, labour and related standards, accessibility to finance, and the availability of infrastructure and information.

<u>1. Legal and regulatory framework</u>

One of the main purposes of laws and regulations is to safeguard the public interest. At the same time, it is well known that laws and regulations can harm the business environment through imposing unnecessary costs, as well as erecting barriers to competition. Moreover, they may even fail to meet the intended social objectives. Therefore, for many Pacific islands, there does appear to be scope for reform of certain aspects of their regulatory and legal environment. Three key areas identified are:

a) The excessive and time consuming bureaucratic requirements involved in setting up a business in many Pacific Island countries. Research has shown that many countries with a more open architecture featured significant increases in economic growth. This growth tended to be aided by the greater transition of informal sector enterprises into the formal sector, which increased their access to financial, marketing and export services.
b) The second critical aspect of the legal and regulatory environment relates to property rights. In most Pacific countries, a large part of land property is not formally registered and access to scarce land for business purposes is a main inhibition to expansion. Assigning titles to property can improve land values and access to credit (through use of land as collateral), especially for small enterprises and the informal sector.
c) Thirdly, the effective enforcement of contracts and protection of creditor rights is of key importance to an enabling business environment. That, in turn, requires a well-functioning court system. The judicial procedure for resolving commercial disputes tends to be overly bureaucratic in a number of Pacific islands, in comparison with industrialized countries.

Appropriate laws and regulations need to be backed by effective enforcement, which calls for a strengthening of the administrative infrastructure and reducing corruption. Moreover, regulations should be consistent with one another, and not over-complicated, but rather be consistent and simple to understand and apply.

<u>2. Labour and Related Standards</u>

Labour standards are especially important in economies that do not have established social security systems. They are generally designed to protect workers from the arbitrary actions of employers. However, such standards may become a hindrance to employers if they involve too much unnecessary reporting and paperwork, and excessively detailed rules that do not actually add much value to employees. What are needed are more flexible employment standards, which still adequately ensure social protection for workers. Much depends upon the political will of ruling government, as well as the existing economic and social environment.

3. Access to Finance

Various surveys rate obtaining finance as a major obstacle for businesses in developing countries. Small and medium enterprises (SMEs) are affected the most owing to the higher perceived risks and transaction costs associated with lending to them. For Banks, this is largely due to the lack of information on enterprises, weak legal protection of creditors and poorly enforced or inadequate property rights.

These problems may be countered somewhat through the establishment of credit information databases. The legal environment also has a part to play in ensuring the enforcement of property rights in areas such as contracts and use of collateral. Allowing greater competition in the banking sector may also lead to greater level of financing options open to SMEs.

4. Infrastructure

Limitations in physical infrastructure-especially power, telecommunications and transport - are a major obstacle for the activities of enterprises in developing countries. Businesses are more willing to invest and grow their business if they are able to easily access adequate, cost effective and well managed infrastructure. Furthermore, dialogue between government officials and private sector must occur to resolve critical investment bottlenecks and create access to export markets on favourable terms.

Finally, private and public dialogue needs to encompass issues of public sector investment in infrastructure to ensure that it is targeted to provide social returns, balanced against economic gains. I believe public investment patterns must take into account the needs of the private sector. Identifying them at the initial stages of the development process is critical, and therefore when countries start tackling this issue, they should do so on the basis of a private-public dialogue. Here, Fiji already has the mechanisms in place with existing established structure and agenda for such dialogue. However, more effective use of such forums is needed.

Third Meeting: "Economic Prospects within the Regional Integration Framework: The European Union's role in Fiji and the Pacific", by *H.E.* Dr. Roberto Ridolfi
Date: Thursday, 21st July, 2005

The European Union's (EU) role in the Pacific has been largely concerned with the promotion of regional development through integration and trade. This trade cooperation role began its voyage back in 1975, and today, around 14 island countries in the region enjoy some sort of official cooperation agreement with the EU.

Such agreements usually include development arrangements, which underlie the main corporation instrument of the EU, the European Development Fund (EDF). The EDF works in the form of funding for national and regional program's that are in line with development priorities set out by the EU.

Since 1975, the Pacific Island- African Caribbean Pacific (ACP) economies have benefited immensely from preferential market access to the EU, with free market access for all industrial products and some agricultural products. However, in compliance with World Trade

Organisation (WTO) regulations, there is now a need to phase out some of this earlier non-symmetrical market access agreements.

The "Cotonou Agreement", signed in 2000, was therefore seen as a pathway to new trading arrangements. The Agreement basically grants a waiver to ACP countries, allowing non-symmetrical preferential access to the EU until the end of 2007. The objective is to negotiate World Trade Organisation (WTO)-compatible Economic Partnership Agreements (EPAs) with 6 ACP regions, including the Pacific, during the waiver period. However, there has been no proposal to date given to the EU in regard to this.

The aim of the Cotonou agreement with this EPA is to foster development. There are no hidden agendas, and no obligations on regions to conclude EPAs. However, the alternative to an EPA would be to go back to the General System of Preferences, which is certainly less favourable for Pacific countries.

For Fiji, a significant part of these negotiations can revolve around sugar. The current arrangement revolves around the Sugar Protocol, negotiated in 1975, which was one of the best deals ever done by the ACP Sugar Producers. The Protocol guaranteed access for over 20 years, with preferential prices that have in the main been around two to three times the world sugar market price. Fiji currently exports around 60 percent of its sugar output to the EU under this arrangement.

However, the EU is proposing a 39 percent price cut, to be phased in over 4 years. The impact of such a proposal, if passed by the EU governments, will have a severe impact on sugar revenues of the Protocol countries, including Fiji. Not only will this have serious implications for employment in the sugar and related industries, but for countries such as Fiji, their growth capacities will be seriously dampened.

Thus, there is a conscientious need for ACP countries to operate competitively in the world sugar market. This is no simple task considering that current sugar production in Thailand, Brazil and Australia are at least two times more productive than Fiji. Therefore, the Fiji government is advised to take a more adaptive strategy by looking into the whole value chain in sugar production. They must take a re-look at the processes involved in farm production, transportation to the mill, crushing and final product, as well as sales and marketing of the output. We need technical and economical efficiency at each stage to raise the productivity of the whole production process.

Fiji is by no means alone in this restructuring process, for the EU is committed to providing appropriate support with action plans focused on three key areas. The first area is to increase the competitiveness/productivity of the sugar sector, through support of the ongoing industry restructuring process. The second area, relates to support for diversification efforts into other productive sectors, such as tourism as well as other agricultural products, to ensure that exiting farmers, as well as the economy as a whole, have strong alternative sources of income. The EU is also committed to supporting programmes that mitigate the social impact arising from the restructuring process, and the unavoidable exit of some marginal farmers from the industry.

EA Speeches Summary

The first EA presentation for the year focused on strategies to revive the JCC. Reinvigorating the JCC will present an opportunity for Pacific Island nations to boost trade and investment between themselves and the US. The JCC was allowed to languish almost to oblivion in the last few years, but it can be a strong instrument toward removing obstacles and identifying business opportunities. However, Pacific Island states must take the lead in the rebuilding process through smart and well organized efforts.

In the second EA presentation, Dr Ridolfi stressed the need to have greater regional cooperation and integration so that the Pacific region was better placed to negotiate trade deals with other more developed nations and regions in the global economy. He also emphasized the EU's support for the current sugar restructure program in Fiji, as well as the necessity for progress in the Pacific Islands EPA negotiations with the EU.

For the third EA seminar for the year, Mr. Dictus emphasized the mechanisms for extending the scope of public and private partnerships in Fiji and other Pacific Islands. He stressed the need for appropriate legal and regulatory environment, flexible labour standards, and greater accessibility to finance. Well planned and appropriate infrastructure was also needed to create a climate for such partnerships. Moreover, meaningful dialogue must occur between these 2 parties to ensure that such partnerships work in the long-term.

STATISTICAL ANNEX

LIST OF TABLES

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).