RESERVE BANK OF FIJI

PRESENTATION AT
THE ASCO MOTORS LUNCHEON

FIJI ECONOMIC UPDATE

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Introduction

I am honoured to make a presentation on the economy at your luncheon.

The outline **(Slide 2)** of my presentation is as follows:

- The Global Economy;
- Fiji's Macroeconomic Performance & Challenges;
- Macroeconomic Indicators;
- Indicators of Land Transport Industry; &
- Summary.

I. The Global Economic Outlook

- **Slide 4: World GDP Growth**

  According to the International Monetary Fund (IMF), the global economy is expected to grow by 4.2 percent this year, following a contraction of 0.6 percent in 2009. Further growth of 4.3 percent growth is expected in 2011.

- **Slide 5: Trading Partner GDP Growth**

  Except for Australia, all our trading partner economies contracted last year as a result of the global financial crisis, affecting our exports and tourism. However, all are expected to post a modest growth this year and continue this in 2011. This is good news as the demand for our exports and tourism should increase.

- **Slide 6: World Economic Outlook**

  Overall, the global economy has performed better than expected. Among advanced countries, the US economy is doing better than Europe and Japan, while for the emerging and developing economies, Asia is driving the recovery.

- **Slide 7: Selected Emerging Asian Economies**

  China and India recorded high growth rates in 2009 and are expected to record similar growth in 2010. China's growth quickened to around 12 percent in the first quarter of this year, the fastest pace in almost three years, driven by stimulus spending and credit boom.

II. ***Slide 8: Fiji's Macroeconomic Performance & Challenges***

- **Slide 9: Fiji's GDP Growth 2006 - 2012**

  Over the past 10 years (2000 – 2009), Fiji's economy has grown, on average, by just 0.7 percent per year. Looking at the past trends, growth rates have been anything but stable during the last decade. Furthermore, economic growth has not been able to match the population growth rate, which means that per capita income growth in Fiji has been slowing over the last decades.

- **Why has Growth been so low?**

  On the one hand, we have been prone to factors out of our control which include natural disasters, adverse global developments such as the recent financial crisis, and the erosion of preferential market access. On the other hand, but within our control, our sluggish growth over the past years has been largely due to our slow progress on economic and structural reforms and declining terms of trade, which are essential to support a balanced economic growth path. As a result of this slow growth, unemployment levels have risen. In 2009, official unemployment rate was 8.7 percent. However, this is still relatively high for an economy like Fiji where unofficial unemployment rates can be much higher.

  A number of factors have contributed to this 3-year (2007 - 2009) contraction in the economy. Of course, you know the significant impact the global crisis has had on our economy. In addition to that, we had several natural disasters that we had to contend with. We also saw during this period, some of our large projects getting into financial difficulties not because of any domestic issues but because of the difficulties foreign developers had with their financiers offshore. And a number of construction projects were affected in this way which had significant negative effects on the economy.

  For the year 2009, the economy is estimated to have declined by 2.2 percent.

  However, a growth of 1.8 percent is expected this year. For this year, we are expecting all sectors to show positive growth except for agriculture & forestry and health & social work sectors, which have projected declines. The agriculture sector was badly hit by Cyclone Tomas, resulting in a downward revision of the overall growth rate for this year.

Next year, growth is also expected to be broad-based, apart from an expected decline in the building and construction sector. The tourism industry is expected to lead the growth assisted by some growth in agriculture. The forecast for 2011 and 2012 is a growth of 1.7 and 1.9 percent, respectively.

Let me now move to the performance and challenges of major sectors. I begin with sugar.

III. Performance of Key Sectors

- **Slide 10: Sugar**

Sugar has traditionally been the backbone of Fiji's economy. Apart from its direct benefits, the industry has also had significant benefits to the economy. However, the sugar industry has been plagued with on-going problems for a number of years which we were unable to solve decisively and now these problems are threatening the viability of the industry.

The cane and sugar industry's contribution to real Gross Domestic Product (GDP) has fallen over the years. This industry now contributes only around 3.0 percent to real GDP, a significant fall in contribution when compared to around 11-12 percent contribution 10-15 years ago. Following a peak of around 500,000 tonnes of sugar produced in 1994, production has steadily declined. Last year, sugarcane output was the lowest since 1961. The total sugar output last season was 168,000 tonnes. The significant fall in sugar output last year was due largely to the inefficiency of the sugar mills, which affected sugar production. The sugar industry today faces major challenges. These challenges have to be addressed urgently. Areas of reforms needed in the sugar industry are:

- **Slide 11 Garment**

The garment industry is another sector where output has fallen over the years. The garment industry in Fiji began in 1988, following the introduction of the tax free schemes in 1987. Over the past ten years, the garment industry contributed on average, 3.4 percent to Fiji's real GDP with garment production peaking in 2001 with production valued at around $188 million.

However, the expiry of trade agreements and strong competition from Asian economies has seen production dwindle. In 2004, the Government withdrew the tax free factory status given to exporters to comply with the WTO requirements (World Trade Organisation). In addition, since 2005, the industry suffered the loss of a quota system for garment exports to the United States, which saw the closure of a major garment manufacturer, which generated approximately 50% of total garment production. Moreover, the implementation of the minimum wage regulation effective from July 2009 has increased the cost of producing garments. On average, the industry contracted by 6.5 percent from 2006 to 2009. These developments have further weakened garment production. Strategies are needed to revive the garment industry as we have seen that Fiji's garment industry is able to produce high quality garments.

- **Slide 12: Forestry**

Over the last 15 years, timber production has fallen notably. In 1995, timber output reached a total of 600,000 cubic meters. To reach similar levels now, we would need to increase output by 150,000 cubic meters per year.

Support for implementing the necessary infrastructure and value-adding must be considered. There is a need to explore and develop strategic partners and work to enhance the capacity of resource owners. Improving road access to indigenous timber resources is also necessary. Certification of our timber is imperative for us to market Fiji timber for premium prices in the world market. In light of these changes, the recent move by the Government to restructure the mahogany industry is very encouraging.

With the promulgation of the Mahogany Industry Development Decree 2010, in March this year, we are hopeful that the opening of access to mahogany timber will generate much needed export earnings for Fiji in time to come. The Decree seeks to ensure that the mahogany industry is able to provide suitable and sustainable returns for the betterment of the economy and the people of Fiji and creating a distinct brand for Fijian Mahogany. It will facilitate a sustainable harvesting and reforestation program with the view to create a liberalised mahogany industry with maximum returns to Fiji.

In addition, with the encouragement from the Government, the Kadavu Provincial Council has allowed the Fiji Pine Limited (FPL) to harvest pine plantations on the island of Kadavu. Kadavu has close to 92,000 cubic metres of pine ready for harvest. The FPL has agreed to harvest, weigh and pay resource owners the value of the trees straight after harvest. The FPL mentioned that for every tree harvested, the Company would re-plant three more. This form of sustainable operations will not only boost foreign income in the short term but will provide a platform for long term gains. We need more of such initiatives in maritime areas which have the right soil and climate for pine and mahogany forests.

Sandalwood also, I believe, has great potential. There should be special efforts made to plant more of these forests.

- **Slide 13. Fishing**

Fishing industry output has fallen from potential levels of around 30,000 tonnes reached in 2005 to around 13,000 tonnes in 2009. This can be done if all the stakeholders come together to develop a well articulated plan for the fishing industry to drive growth and increase value of our exports.

- **Slide 14: Mining**

The re-start of the Emperor Gold Mine is very encouraging and the mine is gradually increasing production. We need to raise gold production from the current levels of around 35,000 ounces to our potential of 150,000 ounces per annum. We had achieved these levels in the past. We must explore the possibility of new gold mines and other metals and minerals. Recent information on the Wainivesi gold project in Tailevu shows that mining commenced in quarter three of 2009, but has not progressed well due to power and milling problems. In addition, a bauxite mining project in Nawailevu, Bua is expected to start soon and may bring in much needed foreign exchange. Moreover, copper exploration in Namosi and gold prospecting in Tuvatu are progressing well. The ongoing review of the mining legislation, expected to be completed by end of June this year, is encouraging.

- **Slide 15: Exports**

  Our export sector has performed below potential over the years. This is attributed to our narrow export base and other structural impediments hindering growth of key potential sectors as I mentioned before.

  The average growth of exports over the last 15 years was 4 percent. In 2009, exports fell by around 16.4 percent driven by re-exports, sugar, mineral water, timber garments and coconut oil. However increases in earnings were noted for molasses, sweet biscuits, gold and fish. In 2010 total exports are projected to grow by 9.5 percent. Further growth is envisaged for 2011 and 2012. Some export commodities have shown a consistent growth trend, such as mineral water which has performed exceptionally well over the past decade. This trend needs to be maintained and improved.

  Ladies and gentlemen, for us to lift our GDP growth from the current low levels to around 5 percent, we need nearly F$500 to F$600m, additional foreign exchange receipts every year. If not the bop constraint we are facing now will not be solved and our policies cannot be relaxed to allow for easier business conditions.

IV. Fiji's Major Macroeconomic Challenge

Why is it that we have this **bop constraint**? This is because our exports are not keeping pace with our imports.

- **Slides 16: Total Imports**

  On its part, the RBF has recently introduced an Import Substitution Facility to try to assist large scale commercial agricultural businesses to obtain credit at concessional rates of interest. The RBF has also offered a scholarship for Chef Training in Malaysia which should encourage the use of local foods in preparation of hotel menus. This is targeted at reducing our import bill and improving our balance of payments position, as well as encouraging local value adding.

- **Slides 17: Current Account**

  As a result of the trend of declining exports and rising imports, the country has been faced with a deteriorating trade deficit and an associated current account deficit which reached a new high recently. The current account deficit is estimated at around 9 percent of GDP in 2009. A 9 percent current account deficit is unsustainable.

Therefore, we have to do everything in our power to increase export earnings and reduce imports.

- **Slides 18: Imports of Mineral Fuels**
  RBF Target: Reduce by $300 million over the next 3 years.

  Imports have continued to escalate. Fuel imports are around one third of our total import bill, which is very high for a country of our size. Total imports grew at an average rate of over 6 percent over the past 15 years.

  In the next 3 years, we must reduce our fuel imports by $300 million and we need to put strategies in place for that to happen immediately.

- **Slides 19: Road Vehicle Imports**

  Road vehicle imports include passenger motor vehicles, Racing cars, Bicycles, Wheel barrows, Trucks, Buses, minivans, etc.

  In 2009, $86 million worth of road vehicles were imported. This was similar to 2008 level. In January 2010, road vehicle imports was $7 million, $3 million lower than 2009.

- **Slides 20-21: Number of Vehicle Imports**

  There was a 31 percent decline in the imports of road vehicles in 2007. Since then the level of imports has been stagnant. Some reasons for the huge decline in 2007 include:

    - increase in fiscal duty in 2007 from 10% to 15%
    - increase in import duty in 20098 from 27% to 32%
    - contraction in domestic economy in 2007-2009- resulting in reduced demand for vehicles.

- **Slide 22: New Vehicle Sales**

  A cumulative total of 479 new vehicles were sold in May 2010 which represents a decline of 30.5 percent over the corresponding period last year.

- **Slide 23: Import Substitution Policies** *(paper attached)*
    - Reducing mineral fuel imports (Energy conservation and renewable energy initiatives)
    - Bio fuel
    - Dairy
    - Meat
    - Vegetables
    - Agro-processing

- **Slide 24: Reduce Our Import Bill**

  Some initiatives in place include renewable energy projects as well as encouraging energy conservation practices. Government is offering attractive incentives for renewable energy producers in 2010 National Budget. These include tax-holidays, tax rebates and lower duties.

  - 5 years tax holiday for new Independent Power Producers (IPPs) that invest in power generation or undertake renewable energy projects (exploration and production of renewable energy). To qualify, the company must initially invest a minimum of $0.25 million.
  - Free fiscal and import excise duty for renewable energy goods such as plant & equipment for wind, solar, hydro, geothermal and biomass production.
  - Free fiscal/import excise duty on energy efficient lamps and fluorescent tubes and bulbs (<25 watts).
  - 32 percent fiscal duty on imports on non-efficient energy bulbs.

- **Slides 25-26: Reduce Our Import Bill: Options for Motor Industry**

  Explore introduction of:

  - Smaller & fuel efficient vehicles
  - Discourage luxury and high cc vehicles
  - Hybrid vehicles
  - Vehicles that can operate on fuel blends (Ethanol, Bio diesel etc)
  - Introduce more LPG vehicles

- **Slide 27: Summary**

  In summary, current economic conditions show a recovering global economy, although at uneven rates amongst advanced economies. Strong growth of the Asian economies will drive the global growth. Against this background, the domestic economy is expected to pick up, albeit weakly.

  While foreign reserves are stable and inflation has peaked, concerns and risks remain. On the external front, high oil prices would place downside risks to the inflation outlook and the balance of payments.

  Ensuring macroeconomic stability is vital for achieving a sustainable growth target of 5 percent. A consistent set of policies is needed to ensure that the stage is set for the economy to grow sustainably into the future. Essentially, we need supportive fiscal and monetary policies to ensure a stable macroeconomic environment, in which structural adjustment can be successful.

  As you are aware, the Reserve Bank continues to implement policy changes to ensure that there is sufficient liquidity in the banking system at all times, and that our foreign reserves and inflation targets are not threatened. This has entailed recent changes in interest rates and the implementation of a new monetary policy framework. However, considering the limited scope that monetary policy has, it is extremely critical that fiscal policy is at the forefront of meeting the challenges I have outlined.

The Government has shown great commitment towards fiscal consolidation; however, it needs to speed up the progress on structural reforms, specifically on key sectors that drive economic growth. With these measures, ladies and gentlemen, I believe we will set in place a framework that would allow the economy to grow on a sustainable basis in the future.

Motor vehicle industry should identify policies that can support balance of payments and higher growth.

Thank you.

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