RESERVE BANK OF FIJI

Fiji Economy: It is time to Build Confidence
Biman Chand Prasad

A Response to the above Paper by Prof. Biman Prasad presented at the Fiji Economy Update 2010 by Mr. Barry Whiteside, Deputy Governor, Reserve Bank of Fiji

Ladies and gentlemen, it is my task this morning to provide a brief response to Prof. Prasad's presentation which is titled in the programme - "Fiji Economy: It is Time to Build Confidence". The presentation is taken from a recent paper he wrote and on which I have based my comments.

Let me first thank Prof. Prasad for highlighting some critical issues and concerns of the Fiji economy. You will agree that these are not new to us, but we continue to discuss them, and as the old saying goes, put a number of economists in the same room and we will all have differing views!

As I indicated, I have had the benefit of receiving an early copy of Prof. Prasad's paper, which has just been published in the latest edition of the Australian National University's Pacific Economic Bulletin (Volume 25 Number 2, 2010).

The paper is entitled **Global Crisis, Domestic Crisis, or Crisis of Confidence: which is the way forward for Fiji?** I am thankful the title was tweaked a little for this session as I would be hard pressed to suggest a particular crisis as a way forward. Instead, as per the new title, building confidence is what we all need to be doing! We need to be hearing good stories of how we can move forward and take this country of ours to the next level.

Given that I only have 10 minutes I have the benefit of being fairly selective in my responses.

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Assessment of the economic policies and achievements of the last three years: the macro-economy

1. *Pg 1 Prof. Prasad comments that instead of adopting an expansionary fiscal policy, the Government's 2007 and 2008 budgets went for lower deficits and this led to further contractions of the economy. He states the budgetary stance taken by the Government in 2007 and 2008 ran counter to the approaches taken worldwide by both developed and developing economies.*

   Prof. Prasad suggests that government should have adopted an expansionary fiscal policy, instead of its efforts to consolidate its fiscal position. While the suggestion may have its merits in certain situations, given the persistent current account deficits we have been experiencing over the years (upwards of 20% of GDP and now just under 10%), and the worsening of the BOP situation after the financial crisis, it was necessary for government to cut back on its deficit levels to protect Fiji's external position.

   While this may have been contrary to how other countries responded to the crisis, as argued by Prof. Prasad, one of the main reasons for that was that most of those countries have a strong external positions (their reserves are strong) and they also have flexible exchange rate arrangements that are responsive to external shocks, unlike Fiji.

   I note that there is some contradiction to these initial statements later in the paper when Prof. Prasad states…. "The fiscal objectives set by the government – to gradually reduce the levels of deficits and debt make sense – particularly given that the public debt levels are so high". Pg 6

   Investment

2. *Pg 4 Prof. Prasad states that Investment is the key to Fiji's economic recovery. He further comments that there is no doubt that investment levels have been directly affected by the political uncertainty and inconsistency of policies by subsequent governments.*

   I totally agree investment is the key and we have been struggling since the mid 1980's to even get close to the targeted 25% of GDP which we feel will bring us sustainable growth.

   Political uncertainty and inconsistency would be only one of a number of reasons why an investor would hold back or sit on the fence. Availability of land for long leases, land use and ownership issues have also been particularly problematic for investors here over the years. There is the need to work together to provide the right environment where investors are comfortable enough to jump down from the fence.

Government is working hard in a number of areas, including land reforms, so this will be the opportunity that is needed. I note we have a presentation on the reforms later this afternoon which should be very interesting. It is still pleasing to note that there are a number of large investors, which we have noted from media reports this week, who continue to see the positives in Fiji.

It is also encouraging to note from our own Survey of Business Expectations that there is a definite improvement in investment intentions, with most respondents expecting investment in plant & machinery and buildings to improve this year.

Inflation

3. *Pg 6 Prof. Prasad comments that Fiji is likely to end up with a higher level of inflation in 2010 as a result of the devaluation*

The statement is correct to the extent that the devaluation effect would work through and peak by April 2010. At the end of April inflation was 10.5 percent. The rate as of June 2010 was 5.5 percent and our forecast for the end of year is 5.0 percent. These rates are, of course, lower than last year's levels.

Exchange Rates

4. *Pg 6 Prof. Prasad suggests that the 2009 "one-off" devaluation of the Fiji dollar led to a substantial depreciation against Fiji's major trading partners, as follows: Australian dollar (-29.9%), New Zealand dollar (-24.0%)……".*

This should be clarified, as apart from the 20% devaluation, the impact of a weakening US dollar over this period pulled down the Fiji dollar further against the Australian and New Zealand dollars. This of course has benefitted Fiji by making our exports of goods and services to our Australian and New Zealand neighbours much more competitive. As the major source of our tourists, this further depreciation has been an added incentive.

Fiscal Policy Responses

5. *Pp 8 and 10 Prof. Prasad discusses the likely impact of a bullet repayment of the Government US$150m loan due in September 2011. He says that on the external front, the bond repayment will reduce foreign reserves. This could create a foreign reserves crisis, nullifying the gains made through the 20%*

devaluation. This would be followed by a money supply contraction, a rise in domestic interest rates and, in effect, reduced domestic lending. A further devaluation of the dollar cannot be ruled out if the economy does not make a turn-around very quickly.

Prof. Prasad will know there is always an option of rolling over the loan offshore and if this is the case the issues he mentions will not arise (at least not for now). However in a scenario where payment is made from onshore funding, the process will have to be managed very carefully. The Government cannot, and should not, expect to raise the funds if it goes to the market in August 2011. It should rather be creating a sinking fund and building it up over a period of time to enable the bullet repayment come September 2011.

The Reserve Bank is, of course, fully aware of the call that will be made on our foreign reserves and will liaise closely with the Ministry of Finance. If we are not comfortable with a big hit on the reserves then the Government's sinking fund could be slowly built up in US dollars. Currently our Reserves are around $1.14bn (US$500m) and while there continue to be downside risks, we are looking at no significant reduction by end 2010.

While the repayment option will impact financial system liquidity, which is currently just in excess of $200m, there are additional balances totaling more than $300m held in the form of Statutory Reserve Deposits, which can be released to keep liquidity at appropriate levels.

Monetary Policy

6. *Pg 10 Prof. Prasad rightly notes that the 2009 devaluation was done to address a serious decline in the foreign reserves. However, he goes further and uses the argument of Mahadevan (2009) that devaluation has not led to substantial benefits to the Fiji economy. It is further stated that devaluation in a crisis, as in Fiji's case, is unlikely to lead to the expected response of rebounding exports and agricultural production. Dr Prasad suggests the response to date has been weak and is unlikely to change unless there is political certainty and tangible evidence of reforms, such as those relating to land. Dr Prasad, while further stating that the devaluation has been positive in attracting tourists, backs down by suggesting that it may have been the impact of the global crisis which prevented Australians and New Zealanders going further afield and therefore, by default, choosing the alternative closer destinations, such as Fiji.*

We have noted earlier the additional competitive edge the devaluation and subsequent further depreciations of the Fiji dollar have given us. Admittedly there have been one-off large inflows, such as the IMF's allocation of SDR's to it members. We benefitted to the tune of around $188m.

However a hefty part of the increase in reserves stems from tourist and remittance inflows and traditional primary products like gold and fish exports. Domestic export data to February do show an increase of 54 percent over the corresponding year ago period.

The suggested weak early response to the devaluation can be attributed, in part, to the fact that the global economy, including most of our trading partners, was still coming out of the worst recession of our lifetimes.

Apart from the recently stated land reforms, Government is putting in a lot of work towards reviving and building our agriculture sector. We have to be positive about this and not expect production to be transformed overnight. A trip into the field will give one a better appreciation of the effort going into the ground. I just make the comment that the devaluation is only one part of what is needed to revive our industries.

7. *Pp 10 and 12 Prof. Prasad suggests that the raising of the Statutory Reserve Deposit of banks recently, to address excess system liquidity, can be seen as a departure from open market operations by the Reserve Bank and therefore a regressive step in how The RBF conducts monetary policy. Prof. Prasad further states these actions suggest that there is a pessimistic expectation of the future by the RBF and interest rates may not reflect the real situation on the ground.*

As much as the RBF would like to use market instruments in implementing monetary policy, I would like to think that, as policymakers, we still have the discretion to explore other tools if the primary tool in our arsenal (in this case Open Market Operations or OMO) does not have the desired effect on our ultimate objectives. We have utilized both instruments in recent times and the SRD allows us to sterilize funds for longer periods without going back to the market.

In as far as the suggestion that the Reserve Bank has a pessimistic expectation of the future, our current monetary policy setting is formulated in consideration of both the situation on the ground and our external (Balance of Payments) conditions. At the current level of the overnight policy rate (OPR) of 3%, there is a negative real interest rate, given inflation is more than 5%. This would signal to the market that we have adopted a relatively expansionary Monetary Policy stance, which should facilitate economic recovery. The effect on prices and our external reserves should be minimal because there is spare capacity in the economy and we are still operating below potential given the decline in growth for 3 consecutive years.

So while it is encouraging that Government is sticking to the 3.5% deficit recently announced in the revised budget, we are mindful of the need to spur growth and have left interest rates at a lower band even with higher inflation prevailing.

Having said this, going forward the implementation of the new operational framework for Monetary Policy would hopefully align us more to market based mechanisms.

Sectoral Growth Prospects

8. *Pp 12-15 Sugar Industry. Prof. Prasad notes the long term decline in all aspects of the sugar industry and the Government's firm commitment to lead the revival. He states that the Fiji Sugar Corporation has been a strategic failure over the past 20 years and that it has continued to bleed through inefficiency and mismanagement.*

I think there is general agreement all round that the sugar industry has been (to use Prof. Prasad's term) allowed to "bleed" for much too long. The costly mills capital upgrade utilizing Indian assistance, which was meant to boost the efficiencies, has not materialized and the FSC, and the rest of Fiji, is paying the price. All the stumbling blocks facing the industry are well documented and we need not re-raise them here. Suffice to say that this is an industry which governs the lives of so many of our citizens and as such, it must be revamped to bring back the days when Fiji was producing in excess of 4m tones of cane and 500k tones of quality sugar.

The Government's land reforms will hopefully provide the incentive to raise the area under cultivation, while the FSC has just recently launched its own strategic reforms to get the farmers to raise their efficiencies on the farm.

I don't have to stress that it will be essential, as well, that the FSC critically looks at itself to ensure the mills are in a ready state to efficiently crush all the cane that will come through its gates. Action is needed, as for too long there has been a lot of talk about this crucial industry, but little else.

9. *Pg 15 Non-Sugar Crop Sectors. Dr Prasad notes the positive actions of the Government to try to boost agriculture output by improving rural infrastructure, providing more extension support and targeting financial support to develop new crops. He cautions that such assistance should not be too inward-looking in terms of import substitution strategies, but should also be directed towards export strategies as well.*

   The new found effectiveness of the Agriculture Ministry is now being seen throughout many districts of Fiji. We are seeing tremendous farm development, for example in the Sigatoka Valley. I have first hand information that hoteliers visiting the area were pleasantly surprised and impressed by the quality and quantity of vegetables now being produced under some new farm schemes. These vegetables, which in most cases they have had to import, are good enough to be of exportable quality.

   Given the Government's will to encourage and foster this important sector, it is all our fervent hope that Fiji's farmers can duplicate these successful schemes across the country. With the appropriate guidance and support, this will go a long way towards bringing down our current account deficit.

10. *Pg 16. Tourism. Prof. Prasad makes the observation that the importance of tourism cannot be overstated and that it will continue to be the key industry driving Fiji's economic growth. He cautions that our current tourism infrastructure, including the airport, will need to be upgraded to cater for the expected growth in visitor numbers. He further states our operators continue to overprice their services and products compared to similar destinations in Australia, New Zealand and many parts of Asia.*

    I agree that infrastructure needs to be upgraded to cater to expected future visitor numbers. This issue has been raised a number of times in the past and will need to be addressed, more sooner than later I would suggest.

    However, I am not sure if the overpricing statement is a fair assessment of what has been happening on the ground over the past few years. It is common knowledge that our tourist plant has been offering significant discounts to attract visitors, especially since the imposition of travel bans by our major source markets. When you couple this with significant airfare reductions by our national airline, it is hard to see how we may have overpriced ourselves.

11.*Pg 18. Politics, Confidence and Economic Growth. Prof. Prasad states that it is clear that during periods of extreme political uncertainty and turmoil, the growth rate is badly affected. He further notes that the impact is not temporary and that it takes a long time to return confidence and certainty to an economy.*

There is no question that political events can bring about uncertainty and affect investor confidence and these people will inevitably cash up and sit on the fence for a while. The question on how long are they prepared to wait is dependent on how they see the risk. All investors individually decide on the level of risk they can live with against the returns to be made. This is why you see investment happening in other territories with known human rights violations. I noted earlier that there continue to be a number of larger investors in Fiji (Sonaisali being a prime example), who are confident enough to keep going.

As policy makers, institutions like the Reserve Bank need to continue to run their ship and be as transparent as possible. We need to ensure our policies are clear and give confidence by not moving the goal posts too often. By ensuring this, we will hopefully get the "not so confident" investors to return more sooner than later.

Ladies and Gentlemen, I fear I have taken more than my share of allocated time and will finish here. I would like to thank Prof. Prasad for his paper and presentation and for being given the opportunity to provide a response.

Vinaka.