Unconventional Monetary Policy Measures in Fiji

Monetary policy is the process by which the central bank of a country, such as the Reserve Bank of Fiji (RBF), controls and manages the level and rate of growth of money supply in the economy. This is conventionally done by targetting interest rates or the supply of money usually via commercial bank reserve requirements (or statutory reserve deposits (SRD) in Fiji's case) and open market operations (OMO).[1]

For example, if the economy is growing too fast, the RBF, in order to keep inflation and foreign reserves stable, could tighten monetary policy by raising its key interest rate to make borrowing more expensive. Alternatively, the RBF may raise its SRD – the level of reserves that commercial banks must hold with the RBF – thereby reducing banks' ability to generate new loans. In addition, the central bank could issue its own securities to withdraw money from the banking system.

In contrast, to support economic growth, these policy measures may be implemented in reverse to raise the demand for money or credit in the economy.

The use of such *conventional monetary policy measures and tools* has proved to be a reliable way of providing sufficient monetary stimulus to the economy during downturns, or containing inflationary pressures during upturns and ensuring the sound functioning of the money market and the stability of the financial system.

While conventional monetary policy tools are widely used, their usefulness is limited in times of economic crises. This may happen if nominal interest rates cannot be lowered further to provide economic stimulus as they may be close to zero and bank reserve requirements cannot be made so low without increasing the risk of banks going into default. In such situations, monetary stimulus may be undertaken by resorting to *unconventional monetary policy tools*. In simple terms, these tools or measures help pump money into the financial system through the purchase of Government and other securities to encourage credit to support expansion in economic activity. This could take the form of central banks providing additional liquidity to banks to directly target liquidity shortages in the banking system. A reversal of these measures may be undertaken should the need to restrain money and credit growth from an overheating economy be warranted.

During the global financial crisis (GFC) in the 2008/2009 period, central banks in advanced economies (the Federal Reserve Bank, the Bank of England, the Bank of Japan as well as the European Central Bank) resorted to 'quantitative easing'. This saw these central banks buying

[1] SRD and OMO were discussed in previous RBF newspaper articles, namely 'Monetary Policy in Fiji', 'What are OMO' and 'Liquidity in Fiji'.

Government bonds and other market securities to inject liquidity into the financial system and ease credit conditions.

In Fiji's case, the economy was sheltered from the direct effects of the GFC, relative to advanced economies. Nevertheless, Fiji felt the indirect effects of the GFC through spillovers from its trading partners. In line with lower performances of trading partner economies in 2009, Fiji's growth declined by an estimated -1.4 percent. Foreign reserves fell to a pre-devaluation level of around $418 million in April while inflation hovered at close to 7 percent during the year. As such, the Fijian economy needed measures that would ease financial conditions and support economic growth post-2009. Consequently, the RBF resorted to unconventional monetary policy measures to support the existing accommodative policy stance indicated by the overnight policy rate being maintained at a low 0.5 percent since November 2011.

These measures included the Import Substitution Export Finance Facility (ISEFF)[2], the Small Medium Enterprise Credit Guarantee Scheme (SMECGS), Housing Facility Scheme, the Agriculture (ALR) and Renewable Energy loans ratios (RELR) and the Natural Disaster Rehabilitation Facility (NDRF) which are available through various financial institutions. These facilities provided financing to businesses affected by natural disasters and aided activities in the SME, housing, agriculture and renewable energy sectors that eventually contributed to increased economic activity and shoring up foreign reserves.

Under the ISEFF, all exporters are eligible to obtain credit at concessional rates of interest. In addition, businesses in the agricultural sector that produce imported goods can also tap into this Facility. The ISEFF provides maximum loan terms of five years and is available through commercial banks, licensed credit institutions (LCIs) and the Fiji Development Bank (FDB). These lending institutions obtain funds from the Reserve Bank at an interest rate of 1.0 percent per annum, and on-lend the same to eligible businesses for up to a maximum of 5.0 percent per annum. Applications for funding under the Facility are subject to normal credit screening processes by the respective lending institutions.

The amount allocated to ISEEF by the RBF is $80.0 million. To date, a total of $88.9 million has been utilised, the majority of which is allocated to exporters (75%), followed by those involved in import substitution (25%). On a sectoral basis, most lending is extended to the manufacturing sector ($38.2m) followed by agriculture ($24.7m) renewable energy ($23.5m), and the timber ($2.5m) sectors.

In an effort to promote and develop local industries, improve private sector lending to SMEs and stimulate growth, the Fiji Government allocated funds for the establishment of the SMECGS in 2012. Government has provided a total allocation of $4.0 million to fund the Scheme, which is administered by the RBF.

Under the Scheme, Government guarantees to pay 50 percent of the principal outstanding on defaulted SME loans up to a limit of $50,000 per business. The guarantee covers lending to all sectors except for loans to sugar cane farmers and Government-subsidised businesses. The SMECGS has improved SME access to

[2] The RBF initially had two separate facilities namely the Export Finance Facility and the Import Substitution Facility which was rationalised into one Facility in May 2010 as ISEFF.

finance and enabled lending institutions to share part of the risk with Government. Similar to the ISEFF, the SMECGS Scheme is accessible through commercial banks, LCIs and the FDB. Cumulative to February 2017, a total of 1,467 active SME loans were registered under the Scheme totalling $84.90 million. Currently, two claims valued at $0.03 million and $0.01 million have been settled under the SMECGS with $3.96 million remaining for new claims.

The RBF also has a Housing Facility Scheme to assist low and middle income home buyers. A total of $35 million was allocated to the Housing Authority (HA) and the Public Rental Board (PRB). As of now, the HA ($25.0m) allocation has been fully utilised.

Another initiative by the RBF to support economic growth and foreign reserves included the introduction of the ALR and the RELR in February 2012 requiring commercial banks to extend credit to the agriculture and renewable energy sectors. At inception, the ALR and the RELR were set at 4.0 percent and 2.0 percent of commercial banks' deposits and similar liabilities, respectively and these have remained unchanged following annual compliance reviews. On a consolidated basis, the actual ALR and RELR stood at 3.4 percent and 2.9 percent respectively, for January 2017.

In April 2009, the RBF temporarily established a Flood Rehabilitation Facility (FRF) to assist businesses affected by floods to obtain credit at concessional rates of interest. The Facility was later reintroduced in January 2012 following flash floods that occurred around the country and was made available until 31 December 2012. In January 2013, the Bank renamed the Facility to the NDRF and extended eligibility to businesses affected by tropical cyclone (TC) Evan and was made available until 30 September 2015.

The Facility was also reactivated and expanded to assist businesses as well as home owners affected by TC Winston. Post-TC Winston, 142 homeowners and nine business applications with a combined value of $3.0 million were approved prior to the expiry of the Facility in early July 2016. As at February 2017, the outstanding loans amounted to $14.5 million.

In summary, the RBF implements relevant unconventional monetary policy measures at its disposal in a targeted way, to achieve its macroeconomic objectives. Moreover, the Bank closely monitors the effectiveness of such measures and makes necessary adjustments to ensure that overall economic and financial stability are achieved.