RESERVE BANK OF FIJI

QUARTERLY REVIEW

June 2006

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QUARTERLY REVIEW OF THE ECONOMY & FINANCIAL CONDITIONS

OVERVIEW

World economic and financial conditions continued to improve in the June quarter, led by the strengthening US and Japanese economies. The upward growth momentum was also supported by positive economic performances in the non-Japan Asian economies, predominantly China and India, together with signs of a more sustained recovery in the Euro-area. The International Monetary Fund (IMF) projects that the world economy will expand by 4.9 percent this year.

Nevertheless, repercussions of the persistently high and volatile crude oil prices, the recent Avian Flu Pandemic outbreak, coupled with the continuous geo-political tensions and terrorism threats could derail global economic activity.

Growth prospects for our major trading partners are encouraging. Australia, the US, Euro-zone and Japan are anticipated to be buoyed by rising exports, domestic demand and business investment. However, New Zealand's economic growth is anticipated to moderate amid an expected slowdown in consumer spending.

During the review period, various central banks around the globe reacted with a tightening monetary policy stance in response to the inflationary pressures stemming from high crude oil prices. In particular, the US, Euro-zone and some Asian economies increased their policy rates.

World commodity prices surged in the June quarter, underpinned by exorbitant crude oil and gold prices. International financial markets recorded mixed performances. The US dollar weakened against all of Fiji's major trading partner currencies except the New Zealand dollar. Bond prices rose, while equities recorded a mixed performance.

According to the latest provisional data, published by the Fiji Islands Bureau of Statistics (FIBOS), the domestic economy is estimated to have expanded by 0.7 percent in 2005. The main drivers underpinning this growth are the building & construction; finance, insurance, real estate & business services; and transport & communication sectors. For 2006, the economy is projected to grow by 3.1 percent. The transport & communication; agriculture, forestry, fishing & subsistence; and finance, insurance, real estate & business sectors are anticipated to lead growth.

On a sectoral basis, outcomes over the quarter varied. The traditional industries including sugar, tourism, clothing & footwear, mining & quarrying, and copra recorded weak performances. However, performances of the building & construction, fishing, timber and electricity sectors improved during the same period. The tourism industry on the other hand, which showed signs of a slowdown prior to the elections in May, is anticipated to regain momentum in the remaining months of the year.

Consumer spending remains strong, evident by higher Value Added Tax (VAT) collections, a rise in currency in circulation and higher lending to private individuals for consumption purposes.

In the year to June, inflation was at 1.6

percent, while the underlying measure of inflation, the trimmed mean, was 1.5 percent. In the months ahead, high and volatile global crude oil prices and a relatively stronger US dollar are expected to exert inflationary pressures. However, this is anticipated to be partially offset by lower domestic prices. The year-end inflation forecast for 2006 is 3.5 percent.

Employment conditions are improving and are expected to remain firm, as suggested by partial indicators of employment and survey data. The number of newly registered taxpayers rose by an annualised rate of 13 percent during the first half of the year. The Reserve Bank's June Survey of Job Advertisements showed that recruitment intentions also picked up during the quarter while the June Fiji Employers Federation Expectations survey indicates a further increase in employment and wages over the next 12 months.

On the fiscal front, cumulative to June, Government recorded an underlying deficit of $85.0 million, equivalent to 1.7 percent of GDP. Capital expenditure rose by 18.4 percent on an annual basis despite being below target. Revenue collections rose by 10.6 percent over the year, stemming from buoyant collections of direct and indirect taxes.

Latest accrual trade data showed that cumulative to April 2006, merchandise exports fell by around 9.1 percent while merchandise imports rose by around 18 percent. The decline in receipts was largely attributed to lower inflows from garments, sugar and timber. Moreover, the growth in imports was driven by higher imports of goods in all categories comprising intermediate, investment and consumption goods.

Foreign reserves at the end of June were around $649 million, sufficient to cover 2.8 months of imports of goods.

In May, the Reserve Bank raised the Statutory Reserve Deposit (SRD) ratio for commercial banks from 5.0 percent to 7.0 percent and increased the minimum lending rate to 100 basis points above the policy indicator rate. In addition, the policy indicator rate was increased by 100 basis points in June to 4.25 percent. This was deemed necessary after analysing the results of the first hike in February this year as economic indicators suggested that consumption continued to be strong, supported by buoyant credit growth.

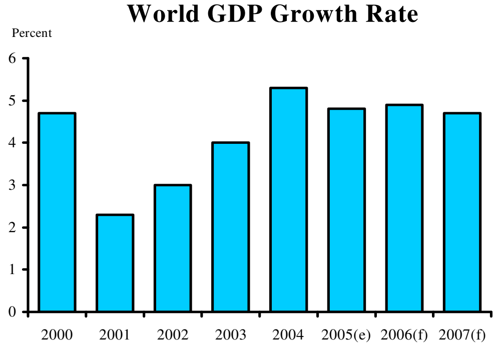
THE INTERNATIONAL ECONOMY

International Economic Conditions

World economic and financial conditions continued to improve in the June quarter, led by the strengthening US and Japanese economies. The upward growth momentum was also supported by positive economic performances in the non-Japan Asian economies, particularly China and India, together with signs of a more sustained recovery in the Euro-area. The International Monetary Fund estimates that the world economy will expand by 4.9 percent this year (Graph 1).

Graph 1[1]

World GDP Growth Rate



Source: IMF World Economic Outlook - April 2006

However, significant downside risks can undermine this year's growth outlook. Firstly, the high and volatile crude oil prices could prompt further interest rate hikes and slow economic activity. Secondly, while the potential risks from the recent Avian Flu Pandemic outbreak are impossible to assess with certainty, a worse-case scenario could have extremely high human and economic costs. Finally, geo-political tensions and terrorism threats could also derail the current growth prospects.

In response to the inflationary pressures stemming from high crude oil prices, some central banks around the world increased their official interest rates. In particular, the US, Euro-zone and some Asian-Pacific economies tightened monetary policy during the quarter.[2]

Over the June quarter, international financial markets recorded mixed performances. The US dollar weakened against all our major trading partner currencies with the exception of the New Zealand dollar. Bond prices fell, while equities recorded mixed performances.

Of our major trading partners, the growth outlook for Australia, the US, Euro-zone and Japan for this year remains positive, buoyed by rising exports, domestic demand and business investment. However, New Zealand's economic growth is anticipated to moderate, amid an expected slowdown in consumer spending (Graph 2).

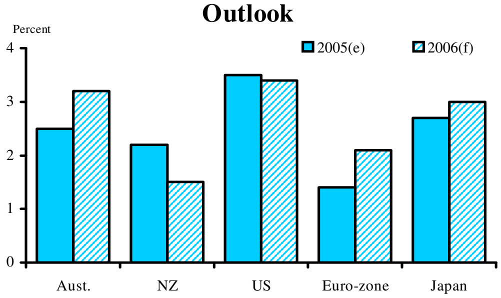
The **Australian** economy grew at a faster pace of 0.9 percent in the March quarter, following a revised 0.7 percent growth during the previous quarter. The pick-up in growth was led by increased consumer spending and business investment.

[1] Note: (e) - estimate, (f) - forecast.

[2] Australia, China and Malaysia increased their benchmark interest rates in the second quarter while New Zealand's benchmark interest rate remains historically high.

Graph 2[3]

Trading Partners' GDP Growth Outlook



Sources: Consensus Forecast & Asia Pacific Consensus Forecast

Recent indicators were generally mixed in the current quarter. Retail sales rose in April, while the trade deficit narrowed during the same month. Moreover, the unemployment rate fell to a 30-year low in May, as companies increased hiring.

However, business and consumer confidence fell in May, driven by record gasoline prices and higher interest rates.

In response to rising inflationary pressures stemming from higher energy prices, the Reserve Bank of Australia (RBA) raised its key interest rate by a quarter percentage point to 5.75 percent, in May.

The economy is forecast to grow by 3.2 percent this year, following a 2.5 percent growth in 2005. Consumer prices are expected to increase by 2.9 percent this year, marginally higher than the 2.7 percent in 2005 and within the RBA's target band of 2.0-3.0 percent.

New Zealand's economy expanded by 0.7 percent in the March quarter, after a 0.1 percent contraction in the previous quarter, with consumer spending as the key driver of growth.

However, economic activity was generally subdued in the June quarter. Consumer confidence fell over the quarter, as high interest rates fuelled expectations of slower economic growth. Furthermore, manufacturing slowed in April, while retail sales fell during the same month.

Consistent with strong inflationary pressures, the Reserve Bank of New Zealand (RBNZ) maintained its key interest rate at 7.25 percent throughout the quarter.

For this year, the economy is forecast to slow to 1.5 percent, after a 2.2 percent growth in 2005. The year-end inflation rate is expected to increase to 3.1 percent in 2006, from the 3.0 percent recorded in the previous year.

The **US** economy grew at a relatively faster rate of 1.3 percent in the first quarter, after a 0.4 percent growth in the final quarter of last year. The pick up in economic activity was mainly led by resurgent consumer spending and business investment.

Recent data showed that economic performance was generally mixed during the second quarter. Consumer spending picked up in April with consumer confidence also rising in May, driven by improving labour market conditions.

However, manufacturing fell in April, while an index of US leading economic indicators fell in May.

The Federal Reserve raised its key interest rate by 25 basis points each time in May and June, to 5.25 percent, prompted by increased inflationary pressures.

The economy is expected to grow by 3.4 percent this year, slightly lower than the 3.5 percent growth estimated for 2005.

[3] Note: (e) - estimate, (f) - forecast.

Inflation is anticipated to be at 3.4 percent, same as the level recorded in 2005.

The **Euro-zone** economy grew by 0.6 percent during the March quarter, after a revised 0.3 percent growth in the previous quarter. The upbeat economic performance was led by buoyant consumer spending and exports.

Latest indicators show that economic performance continues to strengthen. The Euro-regions' retail sales rose in April, while manufacturing activity and the services industry gained momentum in May. Moreover, consumer confidence surged to a 5-year high in June.

Also, prospects for Germany and France, the Euro-zone's two major economies, improved during the quarter. German business confidence rose in June, while French unemployment declined in May, amidst higher export demand.

The European Central Bank (ECB) increased its benchmark interest rate by 25 basis points to 2.75 percent in June, to restrain inflation.

The Euro-zone economy is projected to expand by 2.1 percent this year, after 1.4 percent growth last year. Year-end inflation for 2006 is forecast at 2.2 percent, the same level as recorded last year.

The **Japanese** economy recorded a 0.8 percent growth in the first quarter, following a revised 1.1 percent growth in the final quarter of 2005. The lower growth rate reflected a slowdown in consumer spending.

Nevertheless, latest data indicates buoyant economic activity in the three months to June. Retail sales rose in May, while industrial production and consumer confidence rose in April, on improving employment prospects.

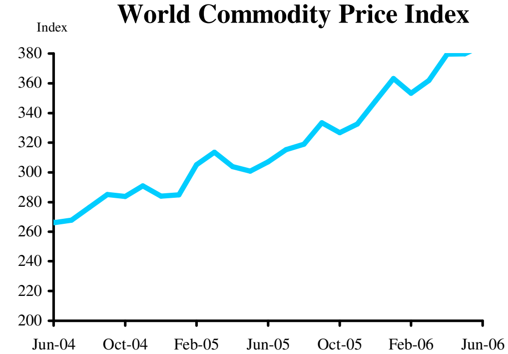
On the other hand, consumer prices rose for the second consecutive month in May, adding to expectations that the Bank of Japan (BOJ) may start tightening monetary policy in the months ahead.

This year, the Japanese economy is anticipated to expand by 2.9 percent, compared to 2.6 percent in 2005. Inflation is forecast at 0.5 percent, compared to -0.3 percent last year.

World commodity prices rose by around 7.0 percent over the June quarter, mainly underpinned by the surge in crude oil and gold prices (Graph 3).

Graph 3

World Commodity Price Index



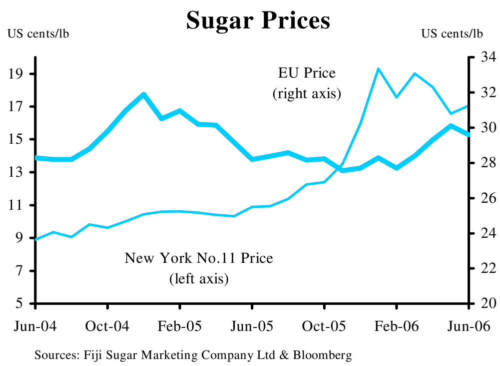
Source: Bloomberg

Over the June quarter, **world market sugar prices** fell by around 10.0 percent (Graph 4). The sugar prices fell during the first two months of the quarter, on speculation of higher exports from Brazil and India.[4] However, sugar prices rose in June quarter,

[4] Brazil is expected to produce 29.2 million tons of sugar this year, up by 10.0 percent from last year. India, the world's biggest sugar consumer, is expected to increase exports, as farmers take advantage of prices that are higher on the international market than domestically.

on concerns of supply disruptions from Australia.[5]

Graph 4



Looking ahead, sugar prices are anticipated to remain above US16 cents per pound, on anticipation that accelerating demand may outpace supply into the world market.

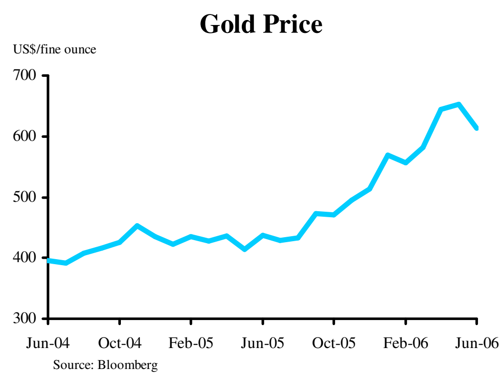
At the end of June, the European Union (EU) sugar price was around US30 cents per pound. Over the first two months of the June quarter, the EU sugar price rose, reflecting a stronger Euro against the US dollar. However, prices fell slightly in the third month of the June quarter, in line with a weaker Euro against the US dollar.

Gold prices rose by around 5.0 percent over the June quarter (Graph 5). Gold prices rallied during the first two months of the June quarter, reaching a new historical high in April, after declines in the US dollar boosted the precious metal's appeal as an alternative investment.

Conversely, the price of gold declined in June, after a stronger US dollar against the Euro reduced demand from European investors.

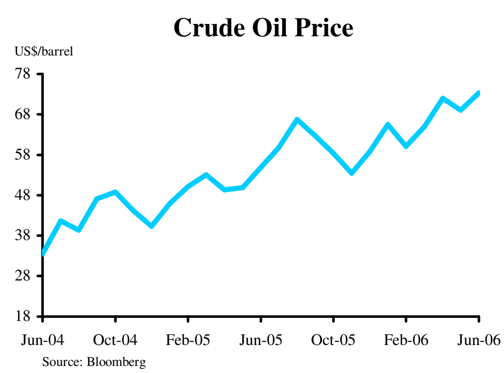
In the months ahead, expectations of inflationary pressures, emanating from high energy prices, and ongoing terrorism concerns are anticipated to maintain the high price for the precious metal.

Graph 5



At the end of June, the **Brent crude oil price** was around US$73 per barrel, an increase of around 13.0 percent when compared to the price recorded at the end of March 2006 (Graph 6).

Graph 6



Crude oil prices rose early in the quarter, reaching a new historical high of US$74.66 per barrel, on concerns of supply disruption,

[5] Around 12 sugar cane farms were quarantined in Queensland, following the discovery of smut disease, which disrupts the growth of sugar cane. Australia's sugar production is expected to be 5.2 million metric tons this year, down by 2.1 percent from last year.

amid peak US demand in summer.[6] However, by May, crude oil prices fell after a less-than-expected decline in US stockpiles and a 10-month high gasoline production eased fears of shortages before the summer driving season.

Nonetheless, energy prices rallied again in the final month of the June quarter, on anticipation that peak gasoline demand during the fourth of July weekend[7] will strain fuel supplies.

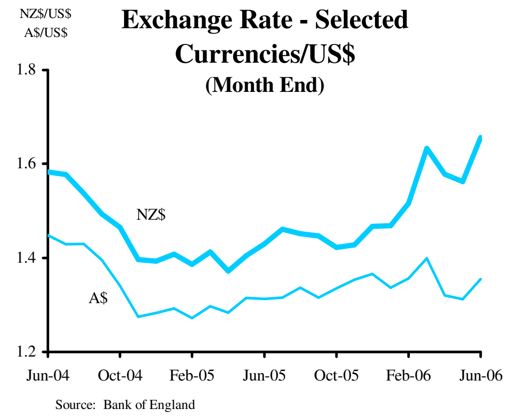
Looking further, the higher energy demand from the US and China, coupled with the escalating tensions in Iran and Nigeria are expected to put upward pressure on crude oil prices.

International Financial Markets

Over the second quarter, the US dollar weakened against all of Fiji's major trading partner currencies except the New Zealand dollar (Graph 7).

During the first two months of the June quarter, the Australian dollar and the New Zealand dollar strengthened against the US dollar on speculation that investors would be attracted to the nation's high yield assets, on expectation that the Federal Reserve may pause its interest-rate increases.

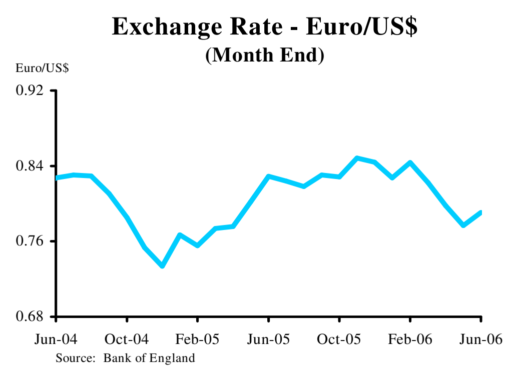
Graph 7



However, the Australian and the New Zealand dollar weakened against the US dollar in June, after an increase in the US key interest rate increased investors' demand for US dollar denominated assets, thus boosting demand for the US currency.

The Euro generally strengthened against the US dollar over the June quarter (Graph 8). The Euro strengthened during the first two months of the quarter, after speculation that inflationary pressures in the Euro-zone will prompt the ECB to raise interest rates, attracting investors to Euro denominated assets and the currency.

Graph 8



However, the Euro weakened in June, after the interest rate hike by the US Federal

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[6] Crude oil prices rose to a record high after a car bomb explosion in the capital of Nigeria's oil-producing region, renewing concern of militant attacks on rigs and pipelines that could disrupt supplies from Africa's largest producer.

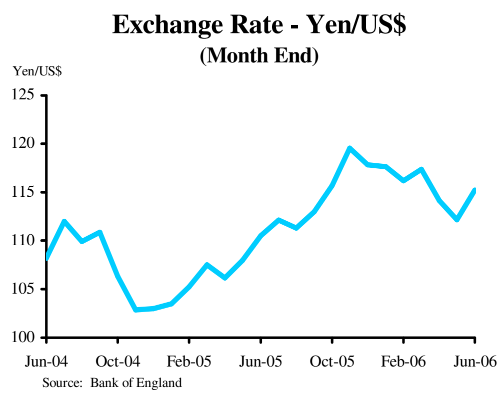
[7] A record 34.3 million Americans are expected to travel during the Independence Day holiday weekend (4 July).

Reserve prompted investors to switch from Euro-denominated assets to US dollar-denominated assets.

The Yen also generally strengthened over the quarter against the US dollar (Graph 9). The Yen appreciated in the first two months of the quarter, after speculation that the BOJ is moving closer to raising interest rates for the first time since 2000, boosting demand for Yen denominated assets.

On the other hand, the Yen weakened in the last month of the quarter, after the US Federal Reserve's decision to raise its key interest rate, luring investors from Yen denominated assets to US dollar denominated assets.

Graph 9

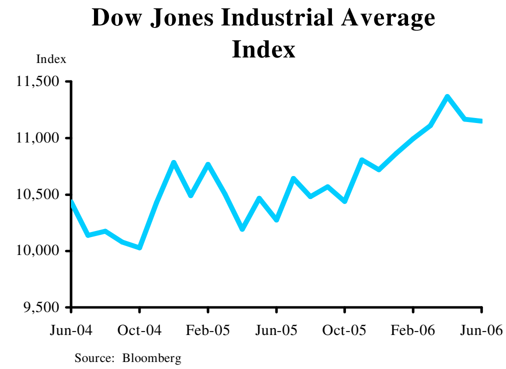


World equity prices trended differently during the second quarter, when compared to the first three months of the year.

Over the June quarter, the Dow Jones Industrial Average Index rose by around 0.4 percent (Graph 10).

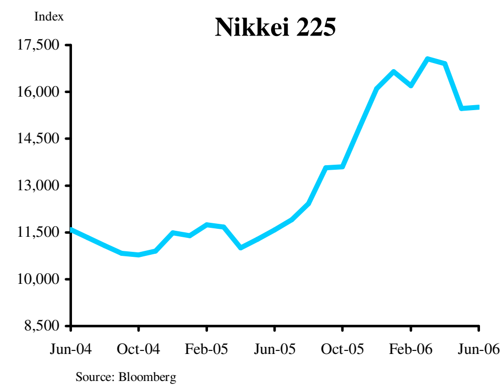
The Dow rose in the first two months of the quarter, as earnings exceeded investors' expectations, thus fuelling demand for stocks. However, the Dow fell in the last month of the quarter after speculation that the Federal Reserve may have to keep raising interest rates, which reduced demand for stocks.[8]

Graph 10



The Nikkei 225 Stock Average Index declined by around 9.0 percent over the quarter (Graph 11). The Japanese stock index declined in April and May, on risks that further interest rate hikes by the Federal Reserve will dampen US demand for Japanese exports. Nevertheless, the Nikkei rose slightly in the last month of the quarter, after indications that economic growth in the world's second largest economy was accelerating, prompting investors to demand more stocks.

Graph 11



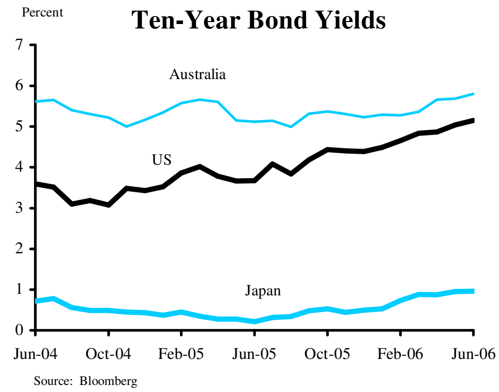
[8] Financial companies, whose earnings are sensitive to rate changes, led the decline.

Over the June quarter, 10-year bond yields for US, Japan and Australia generally rose (Graph 12).

US and Australian bond yields rose in the three months to June, after panic regarding rising inflationary pressures reduced the appeal for the inflation-sensitive[9] debt asset.

Japanese bond yields also rose during the June quarter, on speculation that rising consumer prices may prompt the BOJ to increase its key overnight rate from zero percent soon, thus reducing demand for bonds.

Graph 12



9 Inflation erodes the real return on fixed income securities such as bonds.

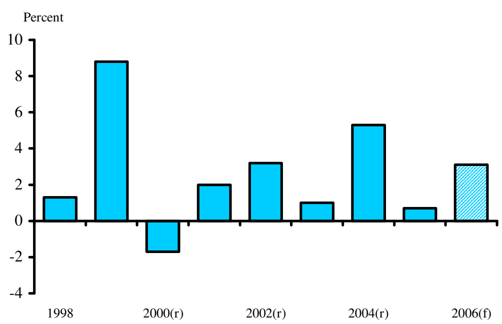
THE DOMESTIC ECONOMY

Domestic Economic Conditions

On the domestic front, Fiji's economy is estimated to have expanded by 0.7 percent in 2005, following growth of 5.3 percent in 2004 (Graph 13).[10] The main drivers underpinning this growth were the building & construction; finance, insurance, real estate & business services; and transport & communication sectors. On the downside, the mining & quarrying, manufacturing and wholesale & retail trade, hotels & restaurants sectors contracted on an annual basis.

Graph 13[11]

GDP Growth Rate



Sources: Fiji Islands Bureau of Statistics & Macroeconomic Committee

For this year, the domestic economy is projected to grow by 3.1 percent. The transport & communication; agriculture, forestry, fishing & subsistence and finance, insurance, real estate & business services sectors are anticipated to lead growth.

[10] According to Fiji Islands Bureau of Statistics 'Statistical News' No. 40, 2006, dated 30 June 2006.
[11] Note: (r) – revised (f) - forecast.

Consumer Spending

In the year to May, consumption remained upbeat as indicated by the partial indicators of **consumer spending**.

Cumulative to May, the net VAT collections from domestic sources totalled $94 million, an annual increase of 13.0 percent over the comparable period in 2005. Consumption activity was further supported by rising income, as Pay As You Earn collections, a partial indicator for incomes, recorded a 12.0 percent growth during the review period. Additionally, currency in circulation and lending to private individuals for consumption purposes also continued to trend upwards during the first five months of the year.

Production

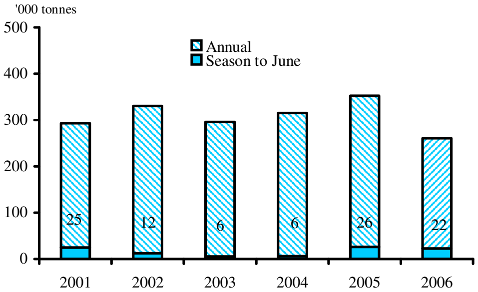
Output in the **sugar** industry was weak during the first month of the season. On a seasonal basis, total sugar production was just over 22,000 tonnes (Graph 14), representing a decline of 14.3 percent over the comparable period last season. Output in the industry was hindered by mill-related problems, poor supply of cane to the mills and unfavourable climatic conditions. The Rarawai and Lautoka mills[12], being the first to begin crushing, have contributed more to the production of sugar up to June.

[12] The four mills commenced crushing as follows: Rarawai mill (31 May); Lautoka mill (5 June); Labasa mill (6 June); and the Penang mill (20 June).

However, production is expected to gather pace later in the season, as the Fiji Sugar Corporation expects sugar output to exceed last year's level.

Graph 14

Sugar Production



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

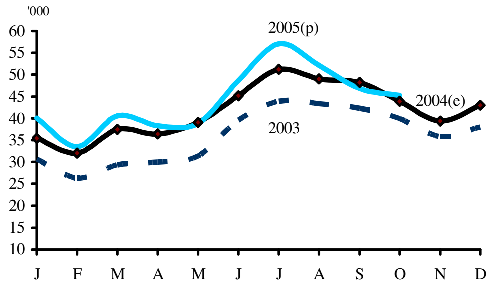
Production is expected to be supported further into the medium-term, as the sugar mills are likely to be refurbished in line with the sugar industry restructure program. The mill upgrades are expected to be completed before the 2007 crushing season.

The outcome of the **tourism** industry was lower-than-expected in the first quarter of the year, when compared with same period in 2005. According to provisional data from the FIBOS, in the first three months of 2006, visitor arrivals totalled around 114,500, a 4.5 percent decline over the corresponding period last year (Graph 15).

According to industry stakeholders, the subdued performance of the sector was due to a combination of factors, principally, the uncertainties surrounding the national elections. With the national elections over, the tourism industry is preparing for an upturn in activity during the remaining months of the year. As such, the Fiji Islands Visitors Bureau projects visitor arrivals for 2006 at around 576,000, representing an increase of around 5.0 percent over 2005.

Graph 15[13]

Monthly Visitor Arrivals



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

The tourism industry is also engaged in talks to introduce an internationally recognised hotel-grading system in Fiji. This would involve conducting assessments on hotels, motels, guesthouses and backpacker entities by an independent body. Industry players are of the view that such a rating system would increase the international profile of tourism operators in Fiji and improve the quality of services provided.

In addition, the hotel turnover tax became effective on 01 June, which involves a 3.0 percent charge on all expenses incurred by a tourist at any hotel.

The **clothing and footwear** industry's performance deteriorated considerably in the first three months of this year. According to the FIBOS, the Industrial Production Index for garments declined by around 40.0 percent on an annual basis in March 2006. Garment export receipts totalled $27.6 million during the March

[13] Note: (p) – provisional, (e) - estimate

quarter, representing a marginal decline over the year.

According to the Ministry of Foreign Affairs and External Trade, the Australian Government has formally responded to the Fiji's Government's submission on the review of the SPARTECA-TCF Rules of Origin. The Australian Government has offered a reduction in the Minimum Local Area Content (MLAC) under the scheme, from 35.0 percent to 25.0 percent.

This reduction would be conditional on the establishment of a credible audit and compliance system in Fiji, improvements in productivity in Fiji's TCF industry, and an increase in industry players taking up opportunities under the Structural Adjustment Package.

Within this offer, the Deeming Provision[14] is to be removed on a 12- month trial basis from 01 August 2006. In addition to these conditions, the Australian Government has added a new feature, for substitutable goods, which would allow textiles of third country origin to be included as local area content in the production of garments under the scheme, provided that there is no direct or substitute production of those textiles in Australia.

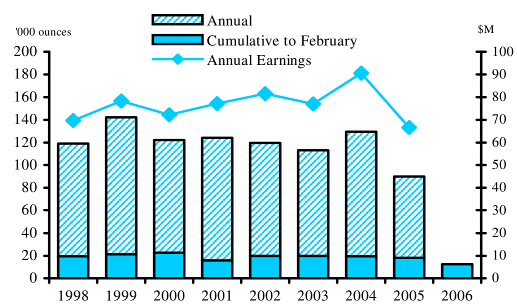
However, the Australian Government has been unable to include wool and wool blend fabrics in the scheme, and this reduces the utility of the other amendments to the scheme from the manufacturers' perspective. Further discussions on this issue are expected on a bilateral basis.

Total **gold** production in the mining and quarrying sector, remained weak (Graph 16). The poor production is attributable to a temporary closure of the mine from mid-April to mid-June, as part of the Emperor Gold Mining Company Limited's ongoing restructure programme during that time.

This low performance comes at a time when world gold prices are at historical highs of around $653 per fine ounce recorded in May. The successful restructure programme is expected to boost quality ore extraction and sustain the mine profitability.

Graph 16

Gold Production



Source: Emperor Gold Mining Company Limited

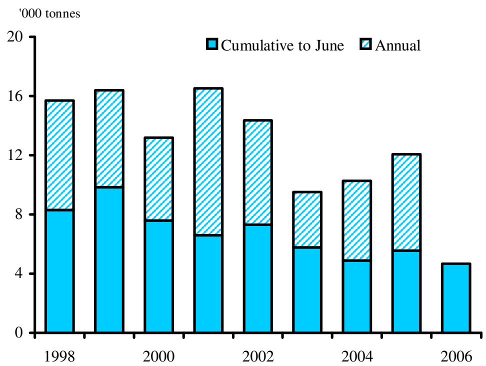
The **copra** industry also recorded low output in the year to June. During the first half of the year, copra production amounted to around 4,700 tonnes (Graph 17), representing a decline of around 16.0 percent on an annual basis.

[14] The Deeming Provision is where a product has Local Area Content (LAC) between 35.0 percent and 50.0 percent, but is treated as if it had only 35.0 percent LAC. To qualify under the scheme, producers would need to build up 15.0 percent worth of points to take it up to 50.0 percent. With the deeming provision removed, this would mean, for example, that a product with 45.0 percent local area content would not revert to 35.0 percent and need 15.0 percent points, but would only need to make up the difference between 50.0 percent and 45.0 percent, that is 5.0 percent.

The minimum mill gate price of copra remained unchanged at $500 per tonne. As at June, Government's subsidy towards the mill gate price was $89.62 per tonne.

Graph 17

Copra Production



Source: Coconut Industry Development Authority

In line with the increasing economic activity, total **electricity** generation by the Fiji Electricity Authority (FEA) cumulative to June, amounted to 385 million-kilowatt hours. This equates to an increase of around 9.0 percent over the comparable period in 2005.

The FEA, as part of its continued investment in electricity infrastructure, has recently opened a $9.0 million, 3.8 megawatts mini-hydro station in Nagado and entered into a $102.0 million joint venture to develop the Nadarivatu 38 megawatt hydro plant.

The outlook for electricity generation is favourable, as several statutory bodies are expected to engage in additional electricity production in the near-term. In particular, the sugar industry restructure is expected to introduce cogeneration of electricity, while Tropik Woods Industries Limited is also anticipated to boost its electricity output in the near-term, with a $15.7 million power generation plant. The supplementary electricity generation will come at an opportune time, as a general increase in demand for electricity is expected, especially from upcoming hotels and shopping complexes in the medium-term.

The **fisheries** sector is forecast to perform favourably this year. Cumulative to March, fish export receipts amounted to around $21.1 million, a rise of around 13.6 percent in comparison to last year. This was despite the Pacific Fishing Company Limited reducing operations during the first six months of the year, due to poor fish supply. Fish production and exports are anticipated to increase for the remainder of 2006.

On other industry developments, the Pacific Islands Trade Ministers have agreed to negotiate a regional multilateral Fisheries Partnership Agreement (FPA) with the EU. Under this agreement, Pacific Island Countries (including Fiji) will offer EU member countries access to fishing rights in the region in exchange for investment in the industry and market access into the EU.

Production in the **timber** industry is estimated to have declined in the review period. Cumulative to April, timber export receipts totalled $10.1 million, 44.0 percent lower than the 2005 level.

In terms of industry developments, the first Strategic Development Plan for Non-Wood Forest Products (NWFP) was drafted by the Department of Forestry in June this year. This Plan focuses on the implementation of sustainable forest management practices, promotion of NWFP research and hopes to increase awareness and implement multiple uses of forest resources. According to the

Department of Forestry, NWFP can contribute to poverty alleviation, food and medicinal supply and provide an alternative source of economic livelihood, particularly for those in rural areas.

The **building and construction** sector continued to display strong performance in the first 3 months of the year. According to the March Building and Construction Survey Report released by the FIBOS, the total value of work put-in-place in the first quarter of this year totalled around $80 million, an annual increase of around 36.4 percent. By category, the total value of work put-in-place by the private and public sectors rose by 40.6 percent and 22.7 percent, respectively.

Amongst some major projects currently in progress, the first phase of the Likuliku Lagoon Resort in the Mamanucas began in May 2006. The total project is estimated to cost $40.0 million and is expected to be completed by December 2006. The Outrigger on the Lagoon is currently developing its spa, health café and wedding facilities. Construction work at other resorts including the Marriot Fiji Resort & Spa in Momi, Intercontinental Fiji Resort in Natadola and renovations to existing hotels continued in the June quarter.

A few other construction projects, such as the Great Pacific Villas, Sovi Bay Resort, Nananu-i-Ra Project, and the FNPF/Tappoo City Retail Complex are expected to commence this year. This is in addition to several other small scale projects expected to be constructed around the country.

A major Government project which is expected to be completed in the third quarter of this year is the Rewa Bridge, the construction of which has been funded jointly by the EU and the Fiji Government. The bridge is scheduled for opening on 17 August.

The healthy performance of the building & construction sector, as well as favourable trends registered by partial indicators support a steady growth in **investment** levels during the review period. Cumulative to May 2006, Overseas Exchange Transaction (OET) basis, imports of investment type goods increased by 44.0 percent on an annual basis. Lending to private individuals for housing purposes and to the construction sector also continued to increase.

Public Finance

Government's fiscal stance continued to be expansionary into the first six months of 2006. Recent cashflow data indicate that cumulative to June, Government recorded an underlying deficit[15] of $85.0 million, equivalent to 1.7 percent of GDP (Graph 18). This compares with a lower deficit recorded in the corresponding period of last year, of $37.2 million (equivalent to 0.8% of GDP).

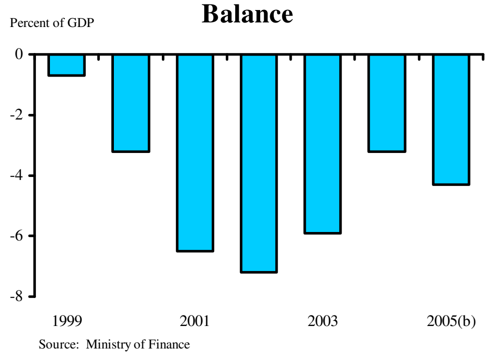
The fiscal outturn in the six months to June was underpinned by an 18.7 percent increase in expenditure payments, which outweighed the 10.6 percent increase in revenue collections (excluding asset sales). Notably, capital expenditure in the review period rose by 18.4 percent on an annual basis. However, capital expenditure was below target by a significant 69

[15] Excludes asset sales of $28.0 million.

percent.

Graph 18[16]

Government Fiscal Underlying Balance



The increase in revenue collections stemmed from buoyant collections of direct taxes and indirect taxes, particularly excise duties and VAT collections.

Against projections, the underlying fiscal deficit was lower than the projected deficit of $277.7 million (equivalent to 5.7% of GDP). This was underpinned by lower expenditure payments (20.7%), largely as a result of the shortfall in capital spending. On a positive note, underlying revenue exceeded projections by 4.9 percent.

The Government's operating/capital expenditure mix stood at 89:11, in the review period compared with the projected mix of 76:24 for the period.

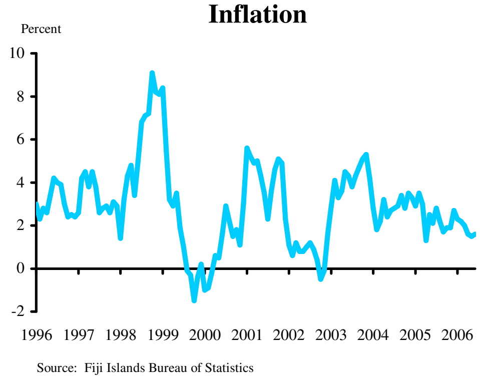
Inflation

In the year to June, inflation was 1.6 percent, compared with 2.0 percent recorded for March (Graph 19). Over the quarter, consumer prices picked up by around 0.2 percent. This is largely due to higher costs of housing, durable household goods, transport, miscellaneous items, heating & lighting and clothing & footwear. Increases in housing rents and domestic fuel prices in May, coupled with changes in import and excise duties also attributed to this outcome.

On the other hand, prices of food items fell as primary produce prices were lower during the quarter, while charges for services and alcoholic drinks & tobacco remained unchanged.

Graph 19

Inflation



The underlying measure of inflation, the trimmed mean, was 1.5 percent in June, up from 1.1 percent registered in the last quarter.

In the months ahead, the high and volatile global crude oil prices and relatively stronger US dollar are expected to exert inflationary pressures. However, this is anticipated to be partially offset by lower domestic prices. The year-end inflation forecast for 2006 is estimated at 3.5 percent.

Labour Market

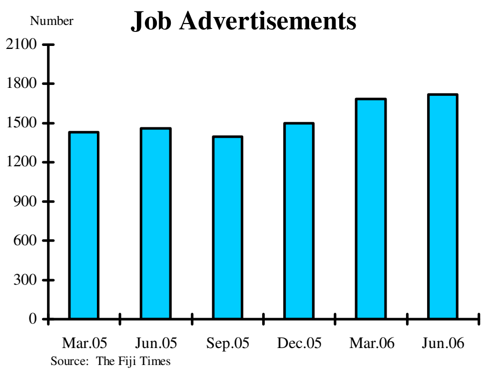
Employment conditions are improving as suggested by partial indicators of employment and survey data. During the first half of this year, around 5,600 private

[16] Note: (b) - budget

individuals were registered by the Fiji Islands Revenue & Customs Authority (FIRCA), an annualised increase of around 13.0 percent. The most number of new taxpayers so far has been registered in the community, social & personal services sector followed by the finance, insurance, real estate & business services; wholesale, retail trade, restaurants & hotels; manufacturing and construction sectors.

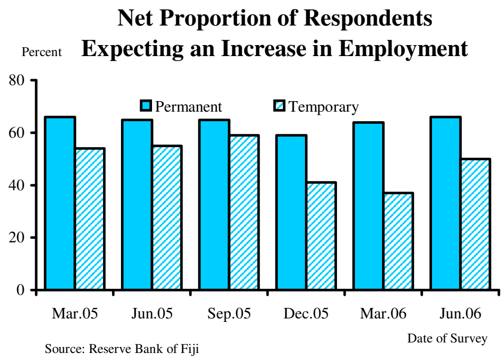
Encouragingly, the Reserve Bank's June Survey of Job Advertisements registered a growth of about 18.0 percent, on a yearly basis (Graph 20). Recruitment intentions was the highest in the wholesale, retail trade, restaurants & hotels sector, followed by the community, social & personal services; finance, insurance, real estate & business services; construction and transport, storage & communication sectors.

Graph 20



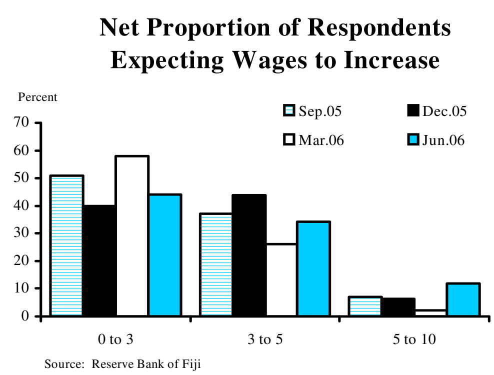
Likewise, according to the latest Reserve Bank's Fiji Employers Federation (FEF) Expectations survey, a net of around 66.0 percent of respondents expect an increase in permanent employment, improving from 64.0 percent recorded in the preceding survey. Similarly, expectations of employment on a temporary basis rose from 37.0 percent of respondents to 50.0 percent (Graph 21).

Graph 21



Wages are anticipated to rise modestly in the medium term (Graph 22). The FEF Expectations survey revealed that a net of 90.0 percent of respondents expect wage levels to rise in the coming months. Of this, around 78.0 percent of the respondents anticipate wages to rise between 0-5 percent, while the remaining 12.0 percent expect a rise between the 5-10 percent range.

Graph 22



The External Sector

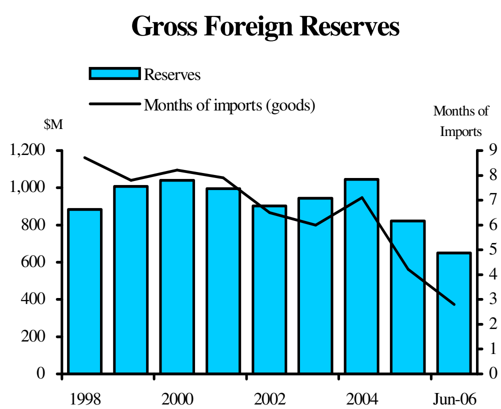
Latest accrual trade data showed that cumulative to April 2006, merchandise exports fell by around 9.1 percent, compared with a growth of around 23.0

percent in the same period last year. The decline in receipts was largely attributed to lower earnings from garments, sugar, timber, textiles, yarn & fabric, molasses, footwear & headgear, gold and coconut oil, which offset higher earnings from re-exports, mineral water, and yaqona.

During the same period, merchandise imports rose by around 18 percent compared with a growth of around 9.0 percent in the corresponding period last year. The increase in import payments was due to higher imports of intermediate goods (9.6%), investment goods (6.8%) and consumption goods (1.5%). The increase in import payments for intermediate goods was led by higher imports of mineral fuels and crude materials, while the higher payments for investment goods was driven by an increase in payments for machinery and chemicals. The rise in consumption type imports was attributed to higher imports of food and manufactured goods.

Foreign reserves at the end of June were around $649 million, sufficient to cover 2.8 months of imports of goods (Graph 23).

Graph 23



Source: Reserve Bank of Fiji

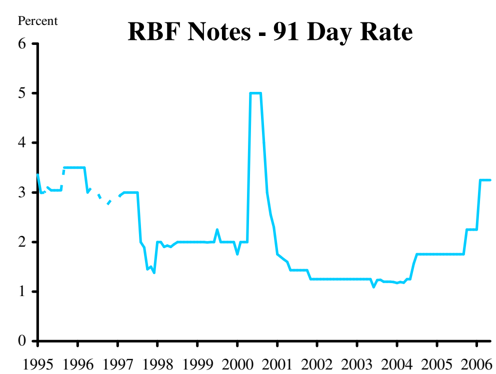
Domestic Financial Conditions

Money Markets

The demand for inter-bank funds rose during the June quarter. Total inter-bank turnover was $635.89 million compared with $15.8 million in the preceding quarter. This marked increase in inter-bank trading is largely the result of the tight liquidity in the market following the rise in the SRD requirement. The weighted average inter-bank rate at the end of the quarter was 4.25 percent.

The Reserve Bank's monetary policy continued on a tightening bias during the review period (Graph 24). To complement the previous interest rate hikes, the Bank in May, raised the SRD ratio for commercial banks from 5.0 percent to 7.0 percent and the minimum lending rate (MLR) to 100 basis points above the policy indicator rate (PIR) to 4.25 percent. More recently, in June, the Bank increased the PIR by another 100 basis points to 4.25 percent (MLR to 5.25%) with the aim of dampening strong credit growth and aligning the PIR to other market interest rates.

Graph 24



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Source: Reserve Bank of Fiji

As part of open market operations, around $14.5 million worth of RBF Notes were allotted during the April to June period, compared with $15.5 million issued in the prior quarter. The outcome was largely influenced by more attractive rates available on other securities in the money market. The yield on the RBF Notes during the review period averaged 3.25 percent.

Issues of Treasury Bills dominated the money market during the June quarter. The Government raised $77.0 million through short-term papers to rollover maturing debt. In line with the notable rise in Treasury Bills issued, yields on all the maturities continued to rise steeply during the review period.

Capital Markets

Government also issued bonds worth $149.5 million during the April to June period compared with $45.8 million issued in the March quarter. The maturities offered were from 3 to 15 years, with weighted average yields ranging from 7.51 percent to 9.89 percent.

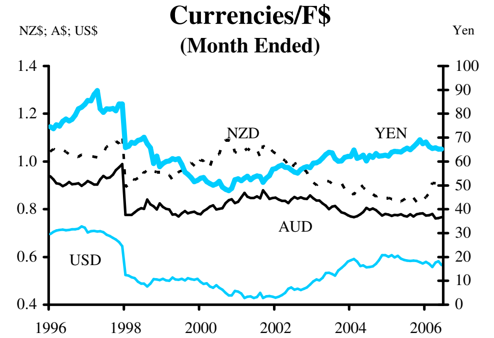
In regards to statutory corporations, the Fiji Development Bank and Housing Authority also raised bonds worth $16.8 million and $3 million, respectively, during the quarter.

Foreign Exchange Markets

Relative to the March quarter, bilateral movements in exchange rates reveal that during the June quarter, the Fiji dollar strengthened against the New Zealand (2.9%) and US (1.5%) dollars, while the domestic currency weakened against the Euro (2.4%), Australian (1.7%) dollar and the Japanese Yen (0.4%), (Graph 25).

Graph 25

Exchange Rates - Selected Currencies/F$
(Month Ended)



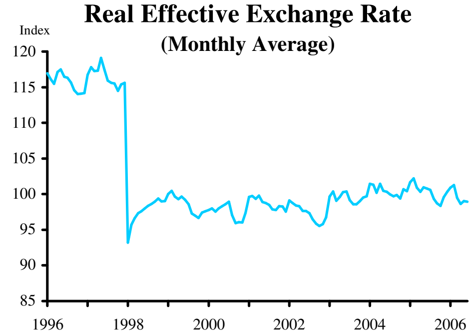
Source: Reserve Bank of Fiji

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

During the same period, the Real Effective Exchange Rate Index (REER) of the Fiji dollar, which adjusts the NEER for inflation differentials across Fiji's major trading partners, fell, implying an improvement in our competitiveness externally (Graph 26).

Graph 26

Real Effective Exchange Rate
(Monthly Average)



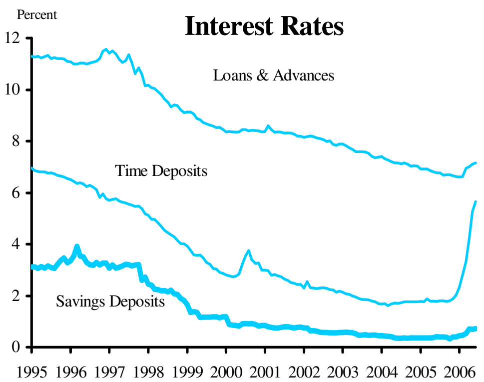
Source: Reserve Bank of Fiji

Financial Intermediaries

Latest movements in commercial bank interest rates reveal an upward trend. As at June 2006, the savings and time deposit rates rose by 19 basis points and 232 basis points, to 0.73 percent and 5.65 percent, respectively, compared with the previous quarter (Graph 27).

The weighted average lending rate on commercial bank outstanding loans also rose by 23 basis points to 7.17 percent during the same period.

Graph 27



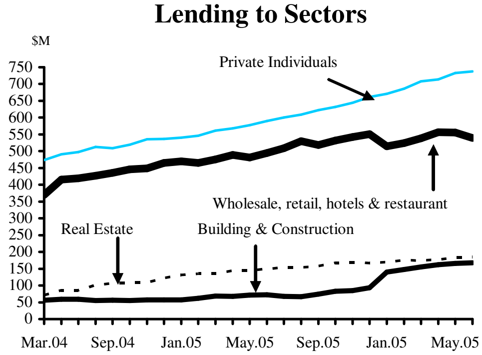
Source: Commercial Banks

In addition, compared with the end of the previous quarter, the weighted average lending rate extended by Licensed Credit Institutions (LCIs)[17] declined by 5 basis points to 10.79 percent, while the interest rate offered on outstanding time deposits increased from 4.22 percent to 6.02 percent at the end of June.

Monetary aggregates continued to strengthen. In June, broad money (M2) rose by an annual growth rate of 19.3 percent after recording average growth rates of 17.5 percent and 17.7 percent in the first quarter of 2006 and the fourth quarter of 2005, respectively. The strengthening in annual M2 growth in recent months largely reflects a stronger accumulation of time deposits relative to demand deposits, in an environment where the interest rates particularly on time deposits have become quite lucrative to depositors. Time deposits rose by 57.0 percent in June. Further impetus is provided by the strong growth momentum in loans to the private sector.

In the year to June, the value of loans outstanding in the banking system rose by 25.9 percent. This was spurred largely by higher lending to private individuals, and to the building & construction, wholesale, retail, hotels & restaurants, and to the real estate sectors (Graph 28).

Graph 28



Source: Commercial Banks

Total outstanding loans and advances by LCIs, rose by 21.1 percent in the year to June to $304.2 million, underpinned mainly by higher lending to the real estate sector and to private individuals.

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

Banking Industry Quarterly Condition Report – March 2006

Overview - Commercial Banks

The **overall** condition of the banking industry remained ***satisfactory***.[18] Total resources continued to grow, with satisfactory asset quality and improved earnings recorded. Banks continue to hold adequate capital.

All banks' **total assets** expanded by 4.8 percent over the quarter to $3.1 billion, largely from loan growth in two main sectors – private individuals and building and construction. On the **liabilities** side, deposits grew by 2.6 percent to $2.7 billion, mainly from deposit holdings of non-bank financial institutions, private sector business entities and private individuals.

Capital adequacy ratios were maintained above the minimum prudential requirement of 8.0 percent, at a ***strong*** average of 11.3 percent.

Asset Quality remained ***satisfactory*** as impaired and classified assets declined while past due loans over 3 months remained steady. Total provisions-to-total loans stood at 1.5 percent.

Management is rated ***satisfactory*** in view of the satisfactory or strong performances in most of the other CAMEL[19] rating components. Minor deficiencies are deemed correctible during the normal course of operations.

Earnings for all banks were ***satisfactory*** with a 14.8 percent growth in pre-tax profits to $32.6 million, which continues to surpass prior quarter profits. Interest spread remained steady at 5.2 percent while the efficiency ratio improved further to 44.8 percent. The annualised weighted average return on assets (ROA) increased by 40 basis points to 4.4 percent while return on equity (ROE) rose by 210 basis points to 40.4 percent.

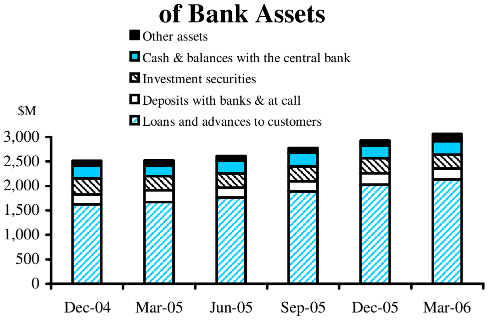
Liquidity is rated ***marginal*** with the ratio of liquid assets to short term liabilities falling by 2.5 percentage points over the quarter to 37.3 percent.

Balance Sheet

On a quarterly basis, banks assets grew by 4.8 percent to $3.1 billion while over the year it rose by 21.6 percent (Graph 29). This expansion was largely the result of an increase in loans and advances.

Graph 29

Structural Change and Growth of Bank Assets



Source: Commercial Banks

Loans and advances expanded over the quarter by 5.2 percent to $2.1 billion. Sectors contributing most to this growth were building & construction ($62.0 million), private individuals ($46.5 million) and electricity, gas & water ($9.7 million). Lending to private individuals

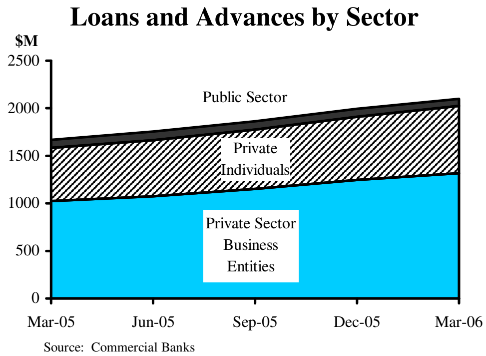
[18] Reserve Bank's rating ranges from strong, satisfactory, marginal, and poor to unacceptable.

[19] CAMEL refers to **C**apital Adequacy, **A**sset Quality, **M**anagement, **E**arnings and **L**iquidity.

was mainly for housing. Other sectors showed a general upward trend, except for wholesale & retail and public enterprises, which fell by $12.7 million and $12.8 million, respectively.

Loans and advances recorded a ***strong*** annual growth of 25.9 percent (Graph 30).

Graph 30



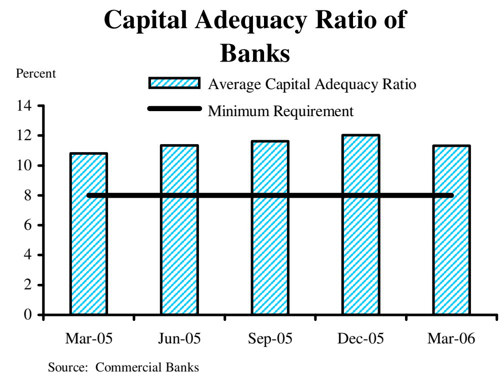
On the liabilities side, deposits increased by 2.6 percent ($68.7 million), to $2.7 billion. There was a general movement of funds from demand to time deposits. The increases in time deposits were from non-bank financial institutions ($33.1 million), private sector business entities ($31.3 million), private individuals ($27.3 million) and central government ($23.3 million). Each of these sectors showed decreases in demand deposits, the largest being central government ($31.3 million).

Capital Adequacy

Banks continued to maintain ***strong*** capital levels with a combined capital adequacy ratio of 11.3 percent (Graph 31). The ratio decreased by 70 basis points over the quarter from 12.0 percent, but was still well above the minimum 8.0 percent. Total risk assets increased by 7.1 percent while capital increased by 0.8 percent.

A year-on-year comparison showed that the ratio increased by 50 basis points from 10.8 percent (risk assets increased by 24.0% while capital rose by 30.0 %).

Graph 31



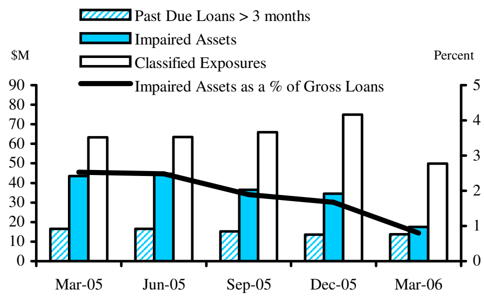
Asset Quality

The asset quality of banks remained ***satisfactory*** during the quarter (Graph 32). The banking industry recorded a notable improvement in overall asset quality with a sharp decline in the level of classified exposures. This was largely attributable to one bank, although another bank had a notable increase in classified exposures over the quarter. The level of impaired assets decreased while past due loans (above 3 months) remained largely unchanged at 0.6 percent of loans & advances.

Total impaired assets at the end of March 2006 were $16.8 million and classified exposures were $50.0 million and represented 0.8 percent and 2.3 percent of total loans and advances, respectively.

Graph 32

Asset Quality



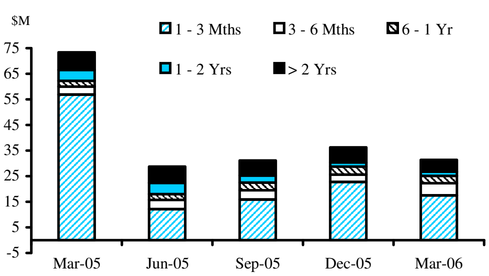
Source: Commercial Banks

Over the quarter, impaired assets declined by 51.5 percent ($17.8 million) and classified exposures declined by 33.3 percent ($24.9 million). The decrease in classified exposures was largely the result of a decrease in doubtful accounts by $17.5 million and to a lesser extent a decrease in substandard accounts by $8.1 million.

Past due loans decreased by $5.0 million to $31.3 million. The decrease was led by one large bank while another bank recorded a notable increase (Graph 33).

Graph 33

Past Due Status



Source: Commercial Banks

The 1-3 months time band decreased by $5.3 million due mainly to one large bank. Banks have experienced a general downward trend in past due loans over the quarter. One bank however, recorded increases in each past due bracket. Total past due loans as a percent of total loans and advances were 1.4 percent.

Problem loans by sectors are concentrated in private individuals (41.9%), the mining and quarrying (31.9%), wholesale & retail (5.9%) and manufacturing sectors (2.5%). Housing for private individuals makes up 33.3 percent of total problem loans.

Banks held $32.4 million worth of provisions, representing 1.5 percent of total loans and advances. This equates to a decline of $1.5 million and also a decrease in coverage by 16 basis points.

General provisions increased by $2.6 million to $22.9 million while specific provisions fell by $4.1 million to $9.5 million in the first quarter.

Though asset quality trends have been positive over the quarter, the tightening of monetary policy could put pressure on loan repayments for over-extended customers. The effects of this on overall asset quality would, however, be more visible in the longer term.

Earnings

The combined banks' **earnings** were ***satisfactory*** during the quarter with a 14.8 percent growth in before-tax profits to $32.6 million. This profit level continues to surpass prior years' profits.

Growth in profits over the quarter was due to an increase in interest income as well as the commission component of non-interest income. The rise in interest income was predominantly the result of growth in interest from housing loans.

Aggregate Banks' Income Statement

	Mar-05	Dec-05	Mar-06	% Change Over Qtr	% Change Over Mar-05
		$M			
Interest Income	33.5	40.3	42.2	4.6	25.7
Interest Expense	4.9	5.8	6.5	11.0	33.2
Net interest income	28.7	34.5	35.7	3.5	24.4
Add: **Non interest income**	21.1	21.8	23.0	5.5	9.0
Income from overseas exchange transactions	7.0	8.8	8.8	(0.8)	25.1
Commission	3.2	2.5	4.3	70.4	34.3
Fee Charges	10.4	9.6	9.8	1.4	(6.4)
Other income	0.5	0.8	0.2	(73.8)	(55.2)
Equals					
Total operating income	49.8	56.3	58.7	4.3	17.9
Less: Operating expenses	23.8	26.7	26.3	(1.7)	10.6
Less: Bad Debts & provisions	2.2	1.1	-0.2	(116.6)	(108.7)
Equals:					
Profit before tax	23.9	28.4	32.6	14.8	36.6
Less: Tax	7.8	8.1	10.2	26.9	31.5
Add Extra ordinary items	0.0	0.0	0.0	Nil	Nil
Equals:					
Net profit after tax	16.1	20.4	22.4	10.0	39.1

Source: Commercial Banks

The annualised ROA increased by 40 basis points to 4.4 percent and the ROE rose by 210 basis points to 40.4 percent.

Earnings are expected to show the effects of the recent monetary policy tightening from the beginning of the second quarter. Much will depend on how returns on assets change as the cost of funds increases.

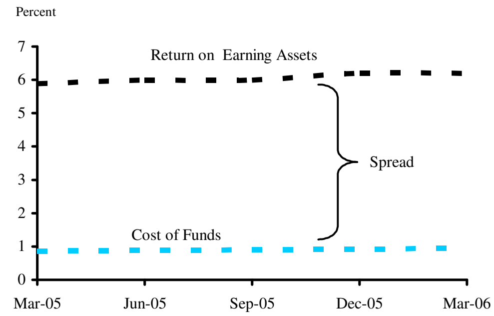
Interest Margin and Spread

The interest spread remained largely unchanged at 5.2 percent (annualised). The return on earning assets remained unchanged at 6.2 percent while the cost of funds moved up one basis point to 1.0 percent (Graph 34).

Leading from the monetary policy tightening and increase in SRD requirement to 7.0 percent, time deposit rates have shown notable increases. This is expected to push the cost of funds up in the second quarter of 2006.

Graph 34

Margins and Spreads



Source: Commercial Banks

Efficiency

The efficiency ratio of banks' (operating costs-to-operating income) improved a further 2.7 percentage points to 44.8 percent, thus contributing to improved earnings. Similar improvements are noted in comparison to the same period last year.

Liquidity and Funding

For the quarter ending March 2006, the combined banks' liquidity position was considered ***marginal***.

Liquid asset levels decreased over the quarter by $24.1 million to $655.4 million, causing its coverage of short term liabilities[20] to drop.

Short term loans and advances represent 29.1 percent of the total loan portfolio,

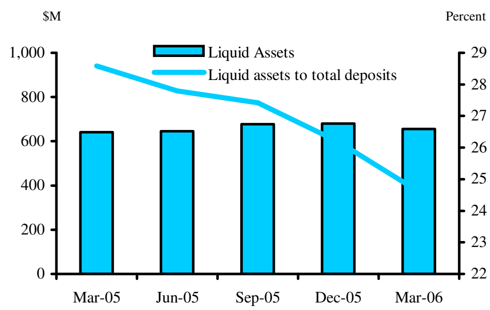
[20] Term deposits maturing in less than 12 months plus demand deposits.

down by 3.2 percentage points. These should nonetheless supplement liquid asset in the short term (Graph 35).

The ratio of liquid assets to short term liabilities was 37.3 percent for the quarter, decreasing by 2.5 percentage points from the previous quarter. Other liquidity ratios also recorded declines.

Graph 35

Liquid Assets to Total Deposits



Source: Commercial Banks

Contributing to the increase in short term liabilities was the build up of large deposits, which had previously shown large variances. Banks need to build up their stock of less volatile funding. The 15 largest depositors of all banks represented 21.8 percent of total deposits at the end of the quarter.

Liquidity is expected to decline in the second quarter as banks increase their SRD from 5.0 percent to 7.0 percent. The increased SRD holding requirement for May is $54.9 million higher than the requirement for April 2006.

The immediate maturity mismatch (i.e. less than 1 month) between loans and time deposits is positive, suggesting a positive flow of funds in the first month. However, the same is negative for the 1-3 months, 3-6 months and 6-12 months bands. This was caused by increases in time deposits in these time bands and is expected to grow as funds move from demand to time deposits, to capitalise on the increasing interest rates.

Overview - Credit Institutions

Overall, credit institutions continued their ***satisfactory*** performance during the quarter. Aggregated assets increased by 4.8 percent. This increase was underpinned by the growth in loans.

Capital adequacy remained ***strong***. Credit institutions' capital adequacy ratio was 22.5 percent as at quarter end, compared to the minimum requirement of 10.0 percent.

Credit institutions' **asset quality** continues to be rated ***marginal***. Impaired assets grew to $17.0 million and represented 5.8 percent of total loans.

Earnings were ***satisfactory***. Net profit-after-tax dropped slightly by $0.7 million over the quarter, mainly due to the rise in interest expense and operational overheads. On a yearly basis, profit-after-tax was up by 25.2 percent. The annualised ROA dropped by 104 basis points to 4.5 percent and the ROE decreased by 552 basis points to 27.6 percent.

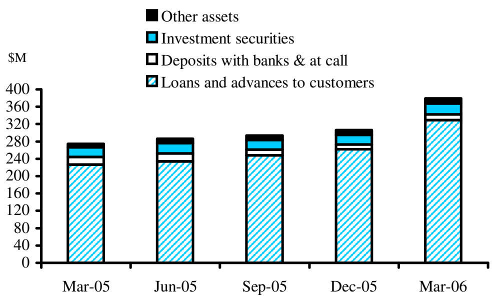
Liquidity is considered ***satisfactory,*** reflected by a 5.6 percent increase in liquid assets over the quarter and an improving maturity mismatch on a quarterly and annual basis. Liquidity risk is further mitigated by stable funding sources for existing borrowings and stand-by arrangements from banks and parent companies.

Balance Sheet

The combined assets of credit institutions' grew over the quarter by 4.8 percent to $321.3 million, and were up by 16.9 percent over the year (Graph 36).

Graph 36

Structural Change and Growth in Credit Institutions' Assets



Source: Credit Institutions

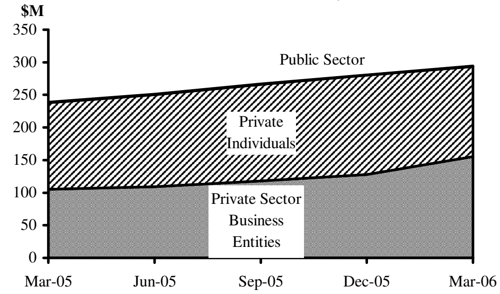
This expansion was mainly the result of an increase in loans and advances which grew by 4.7 percent ($12.4 million) to $274.2 million. New loans approved increased marginally (0.5%) over the quarter to $15.7 million. Compared to the same quarter last year, new loans approved grew by 85.7 percent. Close to a third of the increase was for home mortgages. Strong new loan growth was also recorded for the real estate and the transport and storage sectors.

Funding this expansion on the liabilities side was an increase in borrowings from a parent company by one institution, up by 31.6 percent to $123.7 million. Over the year, parent company support was up by 57.2 percent (Graph 37).

Term deposits dropped over the quarter and over the year by 8.7 percent and 1.7 percent, respectively to $138.6 million.

Graph 37

Loans and Advances by Sector



Source: Credit Instituitions

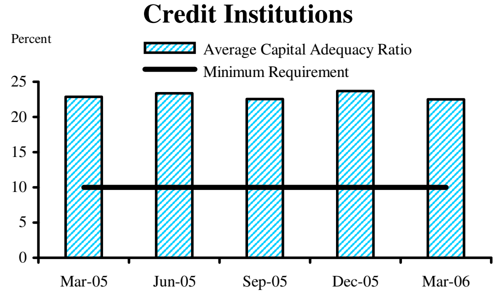
Capital Adequacy

The minimum capital adequacy requirement for credit institutions is 10 percent of their risk-weighted assets. The actual capital adequacy ratio for the quarter stood at 22.5 percent. This remains ***strong***, despite a drop of 118 basis points over the quarter. The fall resulted from increases in risk weighted assets, fuelled by growth in loans to the private business sector (with a 100% risk weight).

Over the year, the capital adequacy ratio grew by 104 basis points (Graph 38). Core and supplementary capital were higher by $8.9 million (20.5%) and risk weighted assets grew by 22.4 percent. Credit institutions are expected to remain well capitalised in the coming quarters.

Graph 38

Capital Adequacy Ratio of Credit Institutions

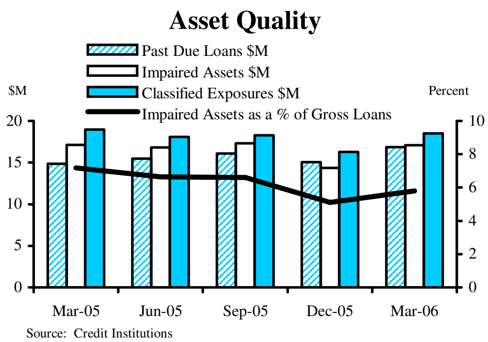


Source: Credit Institutions

Asset Quality

Credit institutions' asset quality is rated ***marginal*** for the quarter. Asset quality declined over the quarter with increases in classified exposures, impaired assets and past due levels (Graph 39).

Graph 39



Classified exposures increased by 13.7 percent to $18.5 million driven by the general rise in classified accounts, but was propelled more by the growth in accounts classified as Substandard (up by 51.0%). Doubtful accounts grew by 11.6 percent while Loss accounts were up by 4.0 percent. Furthermore, impaired assets grew by $2.6 million (18.1%) to $17.0 million over the quarter (March 2005: $17.1 million).

Past due accounts grew to $16.9 million, registering an increase of $1.8 million (12.1%). The bulk of the past due accounts are in the over 2 years bracket, and this further grew by $1.3 million over the quarter.

Given the growth in classified and impaired assets, provisioning grew by a modest 3.4 percent or $0.5 million to $15.1 million. The bulk of the increase was for general provisions.

Earnings

Despite a slight drop during the quarter, earnings are assessed to be ***satisfactory***.

Aggregate Credit Institutions' Income Statement

	Mar-05	Dec-05	Mar-06	% Change	
		$M		Over Qtr	Over Mar-05
Interest Income	7.9	8.8	9.0	2.0	14.8
Interest Expense	2.3	2.1	2.6	22.6	10.0
Net interest income	5.5	6.7	6.5	(4.4)	16.9
Add: **Non interest income**	0.6	0.9	1.1	14.26	73.9
Commission	0.1	0.1	0.1	36.7	72.1
Fee Charges	0.3	0.7	0.4	(33.3)	7.6
Other income	0.2	0.2	0.5	161.4	146.7
Equals					
Total operating income	6.1	7.7	7.5	(2.1)	22.6
Less: Operating expenses	2.3	2.5	2.7	(6.3)	15.4
Less: Bad Debts & provisions	0.5	0.2	0.6	(193.2)	(35.8)
Equals:					
Profit before tax	3.4	5.0	4.2	(14.5)	25.8
Less: Tax	0.5	0.8	0.7	(12.5)	(29.2)
Add Extra ordinary items	Nil	Nil	Nil	Nil	Nil
Equals:					
Net profit after tax	2.8	4.2	3.5	(14.9)	25.2

Source: Credit Institutions

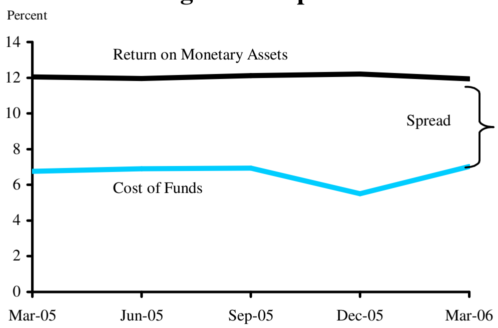
The consolidated net profit for all credit institutions stood at $3.5 million compared to $4.2 million in the December 2005 quarter and $2.8 million in the same period last year. The drop in net profits was due to higher interest expense and operational overheads incurred during the quarter.

Interest income grew by 2.0 percent over the quarter to $9.0 million. Compared to the same period last year, interest income increased by 14.8 percent, equivalent to $1.2 million.

The annualised ROA declined by 104 basis points to 4.5 percent and the ROE decreased by 552 basis points to 27.6 percent (Graph 40).

Graph 40

Margins and Spreads



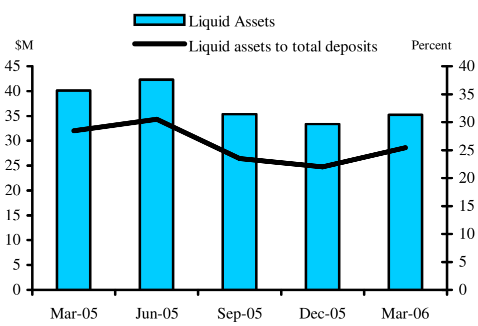
Source: Credit Institutions

Liquidity

Liquidity for the quarter was assessed to be ***satisfactory*** (Graph 41). Credit institutions' liquid assets increased to $35.2 million (up by 5.6%). The rise in liquid assets was underpinned by the growth in deposits with banks recording a 17.2 percent increase to $12.8 million (March 2005: $17.9 million).

Graph 41

Liquid Assets to Total Deposits



Source: Credit Institutions

The combined deposits of the 15 largest depositors for credit institutions stood at $37.3 million, a drop of $24.7 million over the quarter. This accounts for 105.9 percent of liquid assets.

The combined maturity profile for credit institutions shows a cumulative positive mismatch of $169.6 million. This represents an improvement both over the quarter and year. Liquidity risk is further mitigated by stable funding sources for existing borrowings and stand by arrangements with banks and parent companies.

Insurance Industry Quarterly Condition Report – December 2005

Overview of Insurance Industry Performance

An assessment of the Insurance Industry was carried out based on the "**CARAMELS**[21]"methodology. For the quarter ending December 2005, the insurance industry continued to register positive growth.

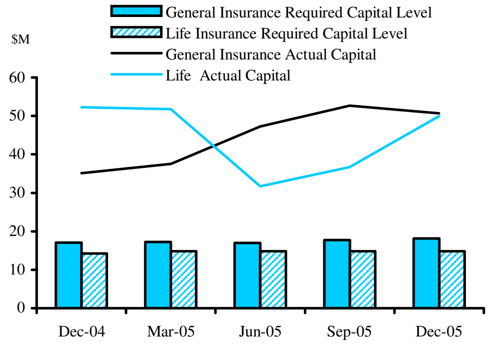
The industry's required **capital** level was $32.9 million. However, the total capital available was $100.5 million, a 14.0 percent increase from December 2004 (Graph 42). The main contribution to this outcome came from general insurers' admissible assets which grew by $15.0 million.

Combined **assets** of the industry rose by 8.3 percent over the year to reach $722.4 million. The growth was driven by both the life and general sectors with life insurers accounting for 71.0 percent of the total industry assets.

[21] **"CARAMELS"** stands for: **C**apital, **A**ssets, **R**einsurance, **A**ctuarial Liabilities, **M**anagement, **E**arnings, **L**iquidity and **S**ubsidiaries, a new reporting insurance supervision methodology.

Graph 42

Insurance Industry Actual Capital & Required Capital Levels



Source: Insurance Companies

Total assets of the life insurance industry rose by 6.7 percent over the year to $514.9 million in 2005 (2004: $482.7 million). The asset distribution pattern remained largely unchanged over the year.

The significant increase in total assets was attributed to a 141.0 percent annual increase in current assets to $57.4 million.

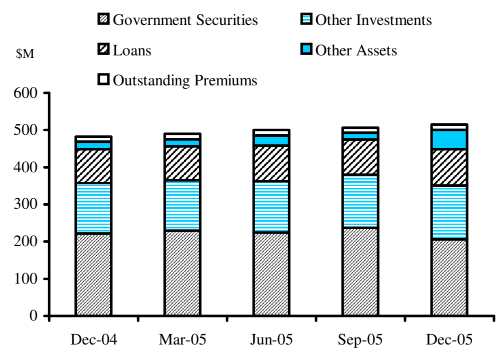
Government securities continued to dominate the asset base of the life insurance industry at 40.1 percent of total assets, followed by loans to policyholders (19.0%) and property (12.0%). Of the total loans, 98.6 percent are secured loans (Graph 43).

Total assets of the general insurance sector expanded at a rate of 13.0 percent over the year to $207.5 million as at December 2005.

General insurers continued to pursue more active investment management strategies during the year, resulting in lower cash holdings and larger investment portfolios. Total investment holdings rose by $25.4 million to $135.8 million, up by 23.0 percent from December 2004, to command more than half of the allocations of general insurers' assets.

Graph 43

Distribution of Assets for Life Insurance Companies



Source: Insurance Companies

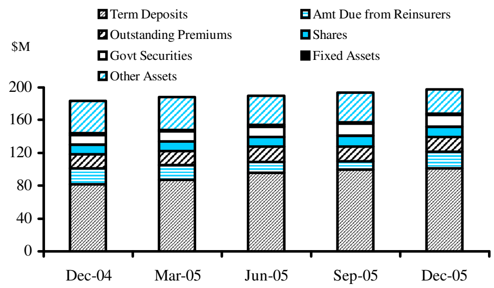
Of this amount, investments in bank deposits increased further to $101.5 million, comprising 48.9 percent of total assets (2004: $82.2 million or 44.7%).

Cash and deposit holdings of $112.5 million were more than sufficient to cover provisions for outstanding claims of $72.0 million. The other major assets include outstanding premiums, amounts due from reinsurers, government securities, shares in related persons and cash on hand (Graph 44).

All insurers satisfactorily complied with the **reinsurance** requirements indicating that their reinsurance arrangements are in place.

Graph 44

Distribution of Assets for General Insurance Companies



Source: Insurance Companies

The insurance industry's combined **liabilities** (excluding shareholders funds) increased to $604.8 million, recording an annual increase of 8.0 percent. This was underpinned by growth in the life insurers' balance of revenue account[22] which continues to form the bulk of insurance industry liabilities at $438 million, representing 72.0 percent of total liabilities.

Management is assessed to be ***satisfactory*** with adequate processes and practices in place. However, this will be further assessed during on-site examinations.

After providing for tax of $13.2 million, the insurance industry reported an overall **profit-after-tax** of $10.8 million for the December 2005 quarter, a ***marginal*** improvement when compared with the 2004 performance. The overall net profit emanated primarily from the positive underwriting performance by the insurance industry as well as favourable investment returns.

The industry's **liquidity** position is considered ***satisfactory*** as the major assets are concentrated in bank deposits and government securities.

Subsidiaries of insurance companies are currently assessed to pose no major risk.

Insurance Brokers

Total earnings by insurance brokers for the December 2005 quarter decreased by 7.0 percent to $3.6 million over the corresponding period in 2004. During the same period, net profit for the insurance brokers' industry increased to $0.9 million compared to $0.3 million in December 2004. The increase was due mainly to the reduction in total expenses and taxation which more than offset the small decline in total revenue.

The Reserve Bank of Fiji processed and approved 104 offshore applications over the review quarter with premium remittances totalling $11.3 million, compared to 75 approved applications worth $9.6 million in the same quarter in 2004.

[22] The Balance of Revenue Account – The balance of funds remaining at any point in time is what is available to satisfy obligations under life policies in force. This fund belongs to policyholders, not shareholders, and is therefore a liability of the insurer.

For the Record

REVISED ECONOMIC PROJECTIONS

Statement by the Chairman of the Macroeconomic Policy Committee and Governor of the Reserve Bank of Fiji, 13 April 2006

The Chairman of the Macroeconomic Policy Committee and Governor of the Reserve Bank of Fiji, Mr. Savenaca Narube, today announced that, "economic growth for 2006 is now projected at 2.7 percent, up from the 2.0 percent announced in November last year. The upward revision is mainly based on an anticipated improvement in the transport & communications; manufacturing and community, social and personal services sectors. Apart from these, the agriculture, forestry, fishing & subsistence sector will also contribute strongly towards this year's growth".

Unlike the previous years, the contribution of the wholesale & retail trade industry is expected to decline as the monetary policy tightening by the Reserve Bank is expected to slow down consumption. Nonetheless, continuing strong visitor arrivals, which is projected at 576,000 for 2006, is expected to sustain the current expansion in the tourism industry – this will have strong flow-on effects to other sectors of the economy. Moreover, the sugarcane and gold industries are expected to record a turnaround in production this year.

Speaking on last year's growth, the Governor said that, "Fiji's economy is estimated to have grown by 1.5 percent in 2005, lower than the 1.7 percent forecast in the 2006 National Budget. The downward revision to last year's growth resulted from the base effect arising from the stronger-than-expected economic growth of 5.6 percent in 2004, as well as weaker-than-expected performances in the garments, sugarcane and gold industries".

Last year's growth was led by the building and construction sector. This was clearly evident by the robust construction activities in the private sector, where the value of work put-in-place increased substantially by 100 percent on an annual basis in 2005. This was followed by the wholesale & retail trade, hotels & restaurants; and the finance, insurance, real estate & business services sectors.

The Chairman added that, "the real GDP growth projections for 2007 and 2008 have also been revised. We expect the economy to grow by 2.2 percent in 2007, and by a slightly higher rate of 2.9 percent in 2008".

On the external front, Mr. Narube explained that, "exports (excluding aircraft) are projected to expand by 9.3 percent this year. On the other hand, imports (excluding aircraft) are expected to grow by a much stronger 13.3 percent in 2006. Higher payments for mineral fuels are contributing to strong import growth".

Mr. Narube stated that, "official foreign reserves at the end of March were at adequate levels of $793 million, equivalent to around 3.4 months of imports of goods". Mr. Narube also highlighted that "inflation at the end of the first quarter was 2.0 percent, while the year-end inflation is currently projected at 3.5 percent".

For the Record

THE RESERVE BANK RELEASES ITS FIRST MONETARY POLICY BOOKLET

Statement by Governor, Mr. S Narube, 25 May 2006.

"The stance of monetary policy will remain on a tightening bias in the foreseeable future", the Governor of the Reserve Bank of Fiji, Mr. Savenaca Narube said while releasing the inaugural edition of the Bank's Monetary Policy Booklet. "This policy strategy is necessary to protect the two objectives of Monetary Policy", the Governor added.

In retrospect, the twin objectives of monetary policy were met in the first four months of this year with inflation low and foreign reserves at adequate levels. At the end of April, inflation was 1.6 percent while foreign reserves were $744 million sufficient to cover 3.2 months of imports of goods.

The Governor also noted that in the past five years, growth in the Fiji economy has been driven largely by domestic demand. While it is very encouraging to see the rise in investment in the last five years from its historical low level, consumption has been extremely buoyant, financed largely through borrowing from commercial banks and credit institutions. This has resulted in rising demand for imports which has been exacerbated by the hikes in oil prices.

"With commodity exports underperforming, the trade deficit continues to widen and this is a concern", the Governor emphasised.

To safeguard the objectives of monetary policy, the Reserve Bank began to tighten monetary policy in May 2004 with a 50 basis points rise in its policy indicator rate. This was followed by another 50 basis points increase in October 2005 and a one percentage point rise in February 2006. In addition, effective 8 May, the Reserve Bank also raised its statutory reserve deposit ratio from 5 to 7 percent. As a result, liquidity has declined and interest rates have risen. "We need to see interest rates move up to suppress consumption demand and address the imbalance in our net exports position", the Governor said.

Looking ahead, the growth in the Fiji economy is expected at 2.7 percent this year and 2.2 percent in 2007. Results from the Business Expectations Survey conducted at the end of 2005 indicated that the general outlook for business sentiments in the next 12 months is relatively more encouraging. Expectations for domestic sales, production and employment improved in comparison to sentiments expressed in the previous survey. Inflation is forecast to be 3.5 percent at the end of 2006.

In conclusion, the Governor said that in considering future monetary policy actions, the Bank will take into account a host of factors including the performance of our exports, the growth in domestic credit, performances of major sectors/industries, the stance of fiscal policy and trend in crude oil prices. "In particular, the Reserve Bank will be monitoring very closely the development in the trade balance of the Balance of Payments", the Governor added.

The Monetary Policy Report will be released bi-annually. The Report will contain a detailed account of monetary policy decisions and will provide a comprehensive summary of key economic developments. An integral part of the Report will be on how developments in economic indicators will impact upon future monetary policy decisions.

For the Record

RESERVE BANK RAISES OFFICIAL INTEREST RATE

Statement by Governor, Mr. S Narube, 30 June 2006.

At its monthly meeting yesterday, the Reserve Bank Board decided to raise the official indicator rate from 3.25 to 4.25 percent. In line with this, the Reserve Bank's Minimum Lending Rate will also increase to 5.25 percent. The new interest rates will be effective from today.

The Governor of the Reserve Bank and Chairman of the Board Mr. Savenaca Narube said that in raising interest rate for the second time this year, the Board noted that the pattern of growth in Fiji continues to be unchanged, driven by strong domestic demand which has led to buoyant imports while we have yet to see improvement in exports. This situation has been worsened by the high oil prices.

The Governor emphasised that "The one percentage point interest rate rise underlines the Bank's efforts to safeguard macroeconomic stability. This decision supplements the recent actions by the Bank to slow down the rise in credit and dampen demand by raising interest rates and tightening domestic liquidity".

The Governor added that "The Bank is fully aware of the potential impact of interest rates on investment spending. To minimise this impact, the Bank has issued lending guidelines to commercial banks and credit institutions to continue to support priority sectors of the economy particularly investment. At the same time, our interest rates are at the lower to middle end of the spectrum in relation to our trading partners. As such, the Bank is of the view that the level of interest rate is not likely to deter investment spending in the economy.

The decision to raise interest rates also takes into account that the current levels of short term rates are higher than the policy rate and that interest rates particularly lending rates have been slow to adjust to earlier policy announcements. With existing liquidity conditions, the Bank expects that this time around, lending rates will be more responsive to the change in the official rate".

The Governor concluded by stressing that one thing is clear and that is for the country to do all it can to correct the imbalance in our net exports position.

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).