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"Leading Fiji to Economic Success"



**PRESENTATION TO PUBLIC AND PRIVATE
SECTOR CONSULTATIVE FORUM ON THE 2010
BUDGET**

**STATE OF THE ECONOMY AND MONETARY
POLICY**

BY

**MR. SADA REDDY,
GOVERNOR,
RESERVE BANK OF FIJI.**

**Venue: Novotel, Lami.
Date: 17th September, 2009.**

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Thank you Master of Ceremony. The Prime Minister, members of cabinet, ladies and gentlemen; good morning to all of you.

I have been requested to speak to you on the state of the economy and monetary policy and I have been given only 10 minutes. I don't think I will be able to do that in 10 minutes but I will try and refocus my presentation so that we to stick to some of the core issues that I want to present to you this morning.

What I intend to do is to highlight the point which the Prime Minister made this morning. We need to grow our economy on a very sound and sustainable foundation. This means that we need to benchmark our upcoming budget and our future policies on some key fundamentals, which will determine the budget framework for this year and also for the next 3 years.

In my presentation, I will have a quick look at the performance of the global and domestic economies. I will then talk at length on Fiji's macroeconomic challenge, as we see it. I will also discuss some of the past problems with Fiji's balance of payments and how to avoid these in the future. I will then talk on monetary policy and government finances and finally, conclude. I hope I will be able to generate enough discussion through this presentation.

With the collapse of the Lehman Brothers around this time last year, governments and central banks around the world were faced with very difficult times. It was a time of great instability in all the countries. Since then, of course through various measures put in place by various countries, the economies have started to turn around and I am pleased to say that the worst is over and the economies around the world are turning around. According to the IMF, the global economy is expected to decline by 1.4% this year, and recover with a growth of 2.5% next year.

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All of Fiji's trading partners are also expected to recover next year, from the contraction that most are facing this year.

There have been quite remarkable revisions upwards for some countries recently. China, India and Korea are also showing very positive signs and countries such as, Malaysia, Hong Kong, Mauritius are all turning around.

I want to highlight in particular Singapore's contraction, which now stands at around 5 percent, compared with around 10 percent 3-4 months ago. The Monetary Authority of Singapore is also surprised at the speed at which their economy has grown in the last 2 months. This is a very good sign because Singapore is at the forefront of trade and a lead indicator in terms of how international trade and the global economy is picking up.

Looking at the domestic economy, there are some positive signs and also some negative ones. We will take all of that into account in our revised projections and announce a new figure in the near future. But for next year, we expect the Fiji economy to grow by 1.8 percent and by 2.0 percent in 2011. However, these are very low growth rates and we really need to lift them.

In terms of the various sectors, almost half have declined this year, but for next year there is only 1 sector which is forecast to decline. That is because of the reduction in Government's expenditure. Government has been cutting back a lot on its operating expenditure. We note that capital expenditure has not kept track with the budget and if Government moves on that, we may see that contributing positively to growth.

As I mentioned, growth of 2% is very low. With a 2% growth rate, we cannot employ all of the unemployed at present and as well as those that will be joining the workforce in the coming years. We need to raise our growth rate to 5 % or above, otherwise we will not be able to deliver what we are promising our people. There is a need to focus on that.

Now, how can we raise growth to about 5%? To start off, we need to increase our investment to 25% of GDP. For certain periods of time, Fiji's investment reached 25% of GDP. Since about 1997/1998, the investment to GDP ratio has come down substantially. We need to raise it to 25% of GDP in order to take our GDP growth to 5%. We can do this by improving business conditions and the business environment, accelerating reforms in the key sectors, raising productivity and also by diversifying our economy.

I will now touch on the performance of some of the key macroeconomic indicators.

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In the past, inflation averaged around 2 to 3%, but because of the oil price increase in 2007 and 2008, it increased sharply. Then it dropped substantially as oil prices came down. However, because of the devaluation in April we expect prices to increase substantially. It is expected to increase to about 9.5% by the end of this year and then fall pretty rapidly next year to around 2%, provided we do not have any other price shocks.

I am pleased to say that foreign reserves have now reached around \$992 million, only \$8 million short of a billion. We reached a low of around \$440 million in mid April but following the devaluation and various policies put in place and the recent assistance by the IMF through a \$188 million allocation of S.D.R, which was not only for Fiji but to the rest of the member countries of the IMF as well, our reserve levels have recovered to comfortable levels. In months of imports, reserves are looking very healthy, but this needs to be built up some more. I will speak more on this later.

Liquidity in the banking system fell to almost \$12 million in April. Since then, various policies put in place have raised the banking system liquidity to over \$300 million. We are keeping a very close eye on that because sometimes having too much liquidity in the banking system can be harmful. I will also explain what we will be doing in case this excess liquidity is going into non-priority sectors.

Banks' lending rates were coming down in 2008. However, in the first three months of this year, they went up substantially. In April, we introduced some lending rate policies which have now brought the weighted average lending rate down to about 7.8%. I expect it to go down further because we have asked the banks to take their own average lending rates down to December 2008 levels.

Up to September last year, the weighted average bank deposit rate was declining. However, it started rising after that. I expect the deposit rates to continue recovering because by introducing the policy on bank spreads, we expect the deposit rates to go up and the lending rates to go down.

The spread on commercial banks interest rates used to be around 5.5% to 6% in the past. However, since April, it has been trending down. It is now around 5.1% and we have asked the banks to bring it down to 4 percent by the end of this year.

These are very tough decisions that we had to take to assist the growth of the economy. The banks are co-operating very well with the Reserve Bank. I know that they are not very happy but in the interest of the country, I am seeking their co-operation to continue to bring interest rates down.

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Now let me go to the major challenge - our balance of payments. Fiji's current account deficit at present is about 17% of G.D.P. We need to fix this, otherwise Fiji will not be able to lift its economic growth. We have a two billion dollar trade deficit. It is huge for a country of our size. We cannot sustain this kind of trade balance.

In many countries, when the current account deficit goes to 1-2% of G.D.P, they react very strongly. We need to correct our deficit otherwise whatever policies we put in place will not work in the future. When the current account balances are compared, Fiji is right at the bottom of selected countries. Other countries have much higher BoP balances. Malaysia and Trinidad and Tabago have current account surpluses of around twenty five to thirty five percent of G.D.P. Mauritius has a current account deficit of about ten percent. So we need to get back close to the zero line if our economy is to grow in a sustainable manner.

In terms of Fiji's challenges,

- we need to improve the trade balance; and
- we need to bring our current account deficit down from 17% to below 5% in the next three years.

This is the broad macroeconomic framework within which we have to work. If we work outside of it, our growth will not be sustainable in the future. We need to bring the current account deficit down from 15-17% to below 5%. If we are able to bring it to less than 5%, that would be great.

If, and only if, the current account deficit is brought down to around 5%, will the Reserve Bank consider relaxing monetary policy.

Now how do we reduce the current account deficit?

We have to raise exports and where possible we need to reduce imports. We suggest that we focus on our existing traditional exports while working on various strategies to develop new exports.

Let's look at tourism for instance. Tourism has one of the greatest potential for us at this point in time. We know that visitor arrivals were down by 28 to 30% percent in the first 3-4 months of the year, but I am pleased to say that this decline has really slowed down and the visitor arrivals are recovering very well. This is very good news for Fiji. If we continue that trend then I think we will be back to our normal levels in a short time.

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The tourism master plan is targeting one million arrivals by 2016. I would like to challenge the industry to raise that target to 3 times the current level in the next 3 years, that is to 1.5 million tourists. We can do that if we put the right strategies in place.

As the Prime Minister said, we need to leap frog and we need to do a few things outside the box to make sure these things happen. One of the key things we need to do is to have a world class airport. You cannot have 5 star resorts with a 1 star airport. In a recent visit to Asia, we met with a few people from both the government and the private sector. According to them, the success of Asia has been largely through investment in infrastructure and mainly in world class airports. There is a lot to learn from Asia in this regard and I am also pleased to say that government is actively looking at this area.

The sugar industry is a very sad case for us. In 1994, the industry had a peak performance, with 516,000 tonnes of sugar produced. The decline in the industry since then is very disappointing. We need to ask ourselves why we let this industry go to that level. We need to fix the problems of this industry very quickly. At present sugar prices are very high in the global market and are expected to remain high in the next two to three years. Slightly above this is where the EU price is.

There is huge potential in the sugar industry; it is one of those crops which you plant this year and harvest next year. It is a very resilient crop. We just have to fix the problems in the sugar industry, make it viable and we can, within a year or two, start to earn much more foreign currency.

I am actually putting some targets for the sugar industry. We need to raise our production by 300,000 tonnes in the next 3 years. I am pleased to say that we met with some key stakeholders of the industry yesterday. The chairman and the Chief Executive informed us that by next year, the milling capacity will be there for us to crush not only five hundred thousand tons, but even more. This means that all the teething problems at the mills will be over. From next year, the mill should be running very well. The only problems they will have are in terms of supply of cane and the availability of land.

I will leave it to government to think about those issues. How do we make available enough land to start planting cane almost immediately?

Gold production suffered badly when the Emperor gold mine closed in late 2006. Since then, the new owners have done extremely well. Next year, they expect 110,000 ounces of gold to be produced. There is great potential in gold and also other types of mining - copper, bauxite, and we believe there is exploration going on in other areas of gold potential as well. We need to see how we can increase gold production to about

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150,000 ounces and also increase other mining activities. Gold prices are at a record high and we need to take advantage of this.

We do visit various industries. I must say all the industries are very cooperative with us in explaining their problems and we do convey their concerns to government and various ministries. One of the issues the mining industry has been facing is electricity supply. We need to look at removing that bottle-neck.

Forestry is also a very sad case. Comparing the 1995 productions to current levels shows the huge potential that exists in forestry. The production can be increased by 150,000 cubic meters in 3 years and that can be done if we put the right strategies in place. We have noted down for your benefit how this should be done. We are just raising these issues and want you to focus on some of these areas to find solutions.

The decline in fish production is also obvious. Despite Fiji having one of the best marine zones and resources, we are unable to capitalize on this. For instance, why are we unable to meet the standards of the E.U. I know they had a revisit here and again, we failed the test in certain areas. While some improvements were made, we still could not meet the overall standards. The market is there, the product is there but are we not getting our processes right. These are the things we need to look at.

I can understand that garment exports declined because of the changes in the global trading agreements, but for the other industries there is absolutely no explanation. There is a lot of potential in the garment industry. We met with the industry and they think they can raise production by 50% with some assistance from government in terms of marketing and training.

Although I did not touch on mineral water and other sectors, our bottled water exports have been doing very well. While these have been affected by the global crisis, declining by almost 50%, we think this will start to pick up as the global economy recovers.

Let me now focus on imports. This is very important for us because quite a few of the policies that the Reserve Bank is putting in place now are to address some of these issues.

Fuel imports are one third of our total import bill. Very few countries in the world have that kind of import bill. In the next 3 years, we must reduce our fuel imports by \$300 million and we need to put strategies in place for that to happen.

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Amongst our suggestions, we need to promote renewable energy and encourage energy conservation practices. If financing is an issue, RBF will see whether we can put a special financing facility for renewable energy.

In the agricultural sector, we need to identify short, medium and long term targets to reduce agricultural imports. Land reform is critical to this. We need to improve infrastructure - roads, wharves, storage facilities etc.

Our staff have been involved in an Import Substitution Taskforce which the government set up. These are some of the things we identified, rice imports need to be reduced from \$40 million per annum to \$5 million, potatoes from \$19 million to \$3 million, dairy from \$60 million per annum to \$10 million, sheep meat from \$28 million per annum to \$10 million and beef from \$7 million per year to almost zero. We can do all these things if we get our act together.

We would also like to promote value adding as much as possible in all industries. Government and statutory bodies should incorporate a culture of using local resources in all operations including social functions. I would like to suggest we launch a nationwide “Buy Fiji Made” campaign, to promote locally made products.

Mr Prime Minister Sir, in terms of implementation, we are suggesting that the government appoint a high level task force to drive and monitor all the strategies we are suggesting as well as what will come out of the audience today. This task force needs to be headed by a competent senior personnel at the permanent secretary level. Performance targets of permanent secretaries and chief executives of statutory bodies should be linked to these targets. I strongly recommend to government that they look at a monitoring system of this nature and that it is properly empowered by the Prime Minister.

Now let me turn your attention to monetary policy. As I said earlier, monetary policy will be anchored on the reduction of the current account deficit from 17% of G.D.P to below 5% in the next three years. It will be focused on raising foreign reserves to five months of imports. As you are aware, we have been targeting our import cover at 3 months in the past.

We are now raising it to 5 months and the Reserve Bank will ensure that there is sufficient liquidity in the banking system at all times, which would be linked to the interest rate policy of the Bank from time to time.

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We will review our exchange control as we go along. There are various issues in the exchange control area - as the economy improves, as the balance of payment improves, as reserves improve, we will look at relaxing some of these. We do not take pride in putting on exchange controls, but they are sometimes necessary.

Our credit policy will be focused on high priority sectors. I would like to re-emphasize that any new credit will go into productive areas. If this does not happen, we will be going back to the same balance of payments problem that we have been facing.

I said I will speak more on the import cover. Reserves were adequate to cover as much as 4.6 months of imports in 2000, but this has fallen substantially up to 2006. Our import cover dropped to 1.7 months of imports in 2006 and then went up to 2.8 in 2007. It went down to 1.6 months of imports at the end of 2008 and in April just before devaluation it was 1.3 months. In actual fact, the useable reserves of the Reserve Bank were below one month of imports.

We reached a very critical situation in the country in mid April and had to take a lot of actions very quickly to turn this around. I am pleased to say the current levels are around 3 months of imports and still increasing.

We in the Bank have been thinking about the risk of targeting reserves to 3 months. As you know, various shocks can hit our economy at different times. Some of them are economic shocks, natural disasters and other kinds of shocks. In the past, we have been unable to react in a timely manner to correct these shocks. We would like to avoid letting our reserves go down to that level again and take very drastic actions, like we did with the devaluation and a few other policies. It is absolutely necessary that we conduct our monetary policy in the right way.

Therefore, in the future, the Bank is going to focus on 5 months of import cover so that we have a 2 month cushion to work with. It will effectively work within a band of 4-5 months of imports, which we are planning to legislate. This will ensure that in future, the Board and the Governor of the Reserve Bank will be held accountable if they allow the reserves to fall below a sustainable level. Even if we do not legislate this, we will put a framework in place which is so transparent to the public and to the Government that the Reserve Bank will have to act at the right time.

So even though reserves have improved, we would like it to go up further. Therefore, people should not become complacent and tell the Reserve Bank to start relaxing policies. We will not, because we want to see the current account deficit coming down from 17% to 5% percent. Only then will we relax policies.

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The Permanent Secretary Finance will be talking about fiscal policy but I just want to touch on some macroeconomic benchmarks that we from the Reserve Bank would like the government to focus on in terms of budget preparation. I have to say government finances have been doing very well so far.

The Government deficit has been below three percent in the last few years. In terms of cash flow, Government has been managing well, without any recourse to the Reserve Bank. That is a good performance and should continue. I would ask that government continues to target a deficit of three percent of G.D.P. It should only be exceeded marginally if the additional money is going into capital expenditure, and certainly not for operating expenditure. We fully endorse all the reforms that government is doing; we encourage those reforms to continue.

So ladies and gentlemen, in conclusion, the Reserve Bank will be anchoring monetary policy on 5 months of import cover. This is likely to impact you in one way or another. From hereon, the scope of monetary policy to correct the balance of payments and lift growth is very limited.

Hence, a large role will need to be performed by fiscal policy. I have already mentioned that in terms of fiscal policy, government needs to speed up efforts to grow exports and look at all initiatives to substitute imports. The current fiscal consolidation should also continue. With these measures, ladies and gentlemen, I believe we will be able to put in a framework that would allow for the economy to grow on a sustainable basis in the future. We are also putting in measures to avoid irresponsible policies in the future.

Thank you very much.

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