

RESERVE BANK OF FIJI

QUARTERLY REVIEW

September 2007

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OVERVIEW

As in the June quarter, great optimism for the global outlook continued into the September quarter. Global economic and financial conditions remained upbeat as China, India and Russia helped to support global growth during the quarter, and to some extent replaced the United States (US) as the engine for world economic growth. Furthermore, global growth has been further supported by above-trend performance in the Euro area and Japan, where domestic demand is driving the expansion.

The International Monetary Fund (IMF) has forecast that in 2007 the world economy will expand by 5.2 percent in the July update of the World Economic Outlook. Nevertheless, there are a few factors that could derail this positive global prospect. The risk of an oil price spike remains a concern, especially in light of the limited spare production capacity. Furthermore, geo political tensions could also disrupt global growth prospects.

In response to an upbeat global economy and its associated inflationary pressures, some central banks have tightened monetary policy or remained on a tightening bias. Positive growth is expected for most of Fiji's major trading partners in 2007 albeit with a slowdown in the US and the Euro zone economies.

Domestically, the performance of the Fiji economy remained subdued in the September quarter. Revised projections point to a contraction of 3.1 percent for 2007, largely underpinned by lower Government spending as reflected in a

decline in the community, social & personal services sector.

For 2008, economic growth is forecast at 1.9 percent. Growth is projected to be led by the finance, insurance, real estate & business services, wholesale & retail trade, hotels & restaurants and agriculture, forestry, fishing & subsistence sectors.

During the September quarter, partial indicators and survey data suggest that consumer spending remained weak. In the year to September, Value Added Tax (VAT) declined while a slowdown was noted in lending for consumption purposes and currency in circulation.

The Reserve Bank's June Business Expectations Survey suggested that prospects for general business conditions in the short term remained relatively negative, although not as pessimistic as the previous survey, conducted in December 2006.

The general performance of all the major sectors has been poor. The cane & sugar, tourism, copra and building & construction sectors registered declines over the review period. However, the clothing, textile & footwear, electricity, fishing and timber industries, grew in the same period.

The weak performance of the building & construction sector was in tandem with the sluggish performance of investment during the review period. In the year to July, accrual data from the Fiji Islands Bureau of Statistics (FIBOS) show that imports of investment type goods decreased while lending for investment

purposes and to private individuals for housing purposes slowed.

Inflation fell to 4.1 percent in September compared to 7.1 percent in June. Since July 2007, prices of food items, which comprise a significant share in the Consumer Price Index (CPI) basket, have been declining on a monthly basis as the supply of market produce has improved and demand has adjusted accordingly. Moreover, the reduction in the mark-up of basic food items in September lowered the costs of food items further. Given these unexpected factors, the year end inflation projection has been revised down to 3.5 percent.

Employment conditions remain weak in some sectors that have been the most affected by the current economic contraction. However, the latest Fiji Employers' Federation (FEF) Expectations Survey results suggest some improvement in employment expectations in the next 12 months. This is in line with the recovery expected in the economy in 2008.

Recent cashflow data indicate that cumulative to June, Government recorded a net deficit of \$26.4 million, equivalent to 0.5 percent of gross domestic product (GDP). The fiscal outturn in the six months to June was underpinned by a decline of 6.8 percent in expenditure

payments and 2.2 percent in revenue collections (excluding Government VAT). Against projections, the net fiscal deficit was much better than the budgeted deficit of \$246.5 million (equivalent to 4.4 percent of GDP), underpinned by lower-than-budgeted expenditure, largely as a result of a shortfall in total investment spending.

Despite showing an increase in the September quarter, export earnings continue to be dwarfed by a huge imports bill. Merchandise imports, however, have continued to decline, underpinned by the weak economy and tight domestic credit conditions.

At the end of September 2007, official foreign reserve holdings were provisionally around \$878.5 million, sufficient to cover 4.0 months of imports of goods.

During the review period, the Reserve Bank kept monetary policy unchanged, with the indicator rate at 4.25 percent. However, certain exchange control limits delegated to commercial banks for import payments were increased, in order to help facilitate payments by importers to their suppliers.

The Bank will continue to monitor developments in the economy and align monetary policy accordingly.

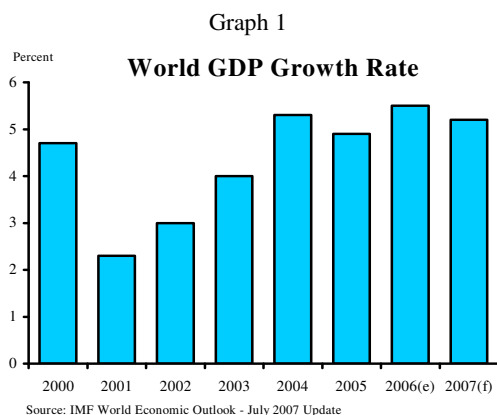
THE INTERNATIONAL ECONOMY

International Economic Conditions

Global economic and financial conditions remained upbeat in the September quarter, with great optimism for this year's outlook.

China continues to be the engine for world growth, helped by emerging markets such as India and Russia. World growth is also supported by above-trend performance in the Euro area and Japan, where domestic demand is driving the expansion. The US is currently recovering from the effects of the slump in its housing market. However, recent indicators suggest that the US economy managed to regain momentum in the second quarter.

In their July update of the World Economic Outlook, the IMF estimates that the world economy will expand by 5.2 percent this year (Graph 1).



Nevertheless, there are a few factors that could derail this positive global prospect. With sustained strong growth, supply constraints are tightening and inflation risks have edged up, increasing the

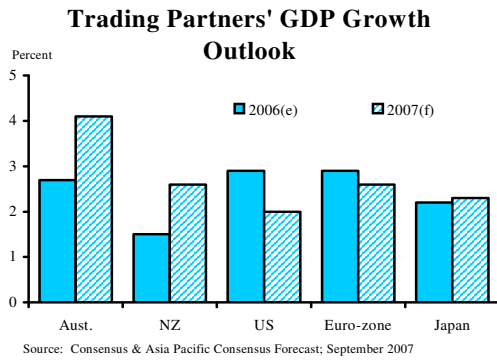
likelihood that central banks will tighten monetary policy further. The risk of an oil price spike remains a concern, especially in light of the limited spare production capacity. Finally, geo-political tensions could also disrupt the global growth prospects.

With the backdrop of an upbeat global economy, inflationary pressures have edged up. In response, some central banks have tightened monetary policy or remained on a tightening bias. In particular, Australia and New Zealand increased their official interest rates, while the Euro area and Japan kept theirs unchanged during the review period. The US lowered its key interest rate, aimed at halting a pronounced slowdown emanating from the housing-market collapse.

Over the September quarter, mixed performances were recorded in the international financial markets. In the global stock markets, US equities rose while its Japanese counterpart fell. In the bonds market, US and Japanese yields fell, while Australian yields rose. On exchange rates, the US dollar generally strengthened against all of Fiji's other major trading partner currencies except for the New Zealand dollar.

Positive growth is expected for Fiji's major trading partner countries in 2007, albeit with a slowdown in the US and the Euro-zone economies. Economic growth rates for Australia, New Zealand and Japan for 2007 are expected to be stronger than the preceding year (Graph 2).

Graph 2



The **Australian** economy grew almost twice as fast as forecast in the second quarter as business investment surged. Increased spending and rising exports also helped Australia withstand the global fallout from the US sub-prime mortgage rout.

In the June quarter, Australia's real GDP grew by 0.9 percent. The economy grew by 4.3 percent from a year earlier, the fastest pace in three years.

More recent economic indicators over the September quarter suggest that the country's 16-year expansion will be sustained. Building approvals continue to improve while both retail sales and business confidence were strong on growing jobs and rising wages and exports. The jobless rate was unchanged at a 33-year low of 4.3 percent in August as Australian employers hired almost twice as many extra workers, fearing a labour shortage may drive wages higher.

Furthermore, consumer confidence rose in September despite a rise in interest rates, while an index of leading economic indicators increased in July, albeit at a slower pace.

The Reserve Bank of Australia (RBA) raised its benchmark interest rate to 6.5 percent in July, an 11-year high, to curb inflation and cool the biggest surge in lending since 1989. During the remaining months of the September quarter, the RBA kept the rate unchanged at 6.5 percent.

The economy is forecast to grow by 4.1 percent this year, supported by business investment, rising exports and household consumption. Consumer prices are expected to ease from an estimated 3.5 percent last year to 2.4 percent in 2007, within the RBA's target band of 2-3 percent.

Economic growth for **New Zealand** remained firm in the second quarter, rising by 0.7 percent, although slower than the revised growth of 1.2 percent in the first quarter. The economy expanded by 3.2 percent on an annual basis, fuelled by home building and consumer spending.

Recent indicators showed that business confidence rose for a second straight month in September, buoyed by a drop in the currency and increased earnings of dairy farmers. On the downside, retail sales were flat in July, after declining in June. This supported signs that the current high interest rates have started to impact domestic demand, weakening the prospect of another increase in borrowing costs.

The Reserve Bank of New Zealand (RBNZ) raised the key interest rate by 25 basis points to 8.25 percent in July, as the falling currency and rising commodity export prices are expected to fan inflation. No further changes were made by the RBNZ to the key interest rate during the

September quarter.

Economic growth is expected to pick up to 2.6 percent this year, compared with 1.5 percent achieved in 2006. The growth is expected to be driven by anticipated increases in business investment and, despite some recent signs of slowing, household consumption. Year-end inflation is expected at 2.3 percent this year, down from 3.4 percent recorded in 2006.

The US economy expanded at the quickest pace in more than a year in the June quarter. Gross domestic product rose at a revised 3.8 percent annual rate in June, propelled by a surge in exports, commercial construction and Government spending.

The latest economic indicators for the September quarter were generally mixed. While the service industries were buoyant in August and there was a general rise in retail sales, consumer confidence fell to the lowest level in a year. In addition, the index of leading US economic indicators also fell in August, the highest decline in six months.

The Federal Reserve lowered its benchmark interest rate in September by 50 basis points to 4.75 percent. This was their first cut in four years, aimed at preventing a recession that the fallout from the housing-market collapse could cause.

The economy is expected to slow to 2.0 percent this year, largely attributed to the expected decline in private consumption, business investment and industrial production. Inflation is anticipated to slow from 3.2 percent last year to 2.7

percent in 2007.

Euro zone economic growth rose in the June quarter at the slowest pace since the beginning of 2005 as an investment boom petered out. Gross domestic product growth slowed to 0.3 percent in the June quarter compared with 0.6 percent in the March quarter. The slowdown was attributed to slower business investment and construction activity.

Latest economic indicators in the September quarter suggested some slowing in the Euro zone area although the performance of the two largest economies, Germany and France, were mixed.

Overall European investor confidence fell in August to the lowest level in almost two years on concerns that the US housing slump will dampen global economic growth. Business and consumer confidence also fell in July on high oil prices led by a loss in German confidence. German business confidence reached a 19-month low in September, consumer confidence fell to the lowest level in five months and investor confidence fell to a nine month low. The loss in German consumer confidence occurred despite the unemployment rate falling to a 14 year low in September.

On the whole, retail sales growth slowed in September although French retail sales accelerated in the same month at the fastest pace in five months, as the country staged the Rugby World Cup.

Manufacturing and the service industries in the Euro zone grew at the weakest pace since September 2005 after a sudden

increase in credit costs.

The European Central Bank kept its benchmark interest rate unchanged at a six year high of 4.0 percent in September.

Growth for the Euro region is projected at 2.6 percent this year, supported by industrial production and retail sales. Year-end inflation for 2007 is forecast at 2.0 percent, compared with 2.2 percent estimated for 2006.

The Japanese economy contracted in the June quarter by 0.3 percent. On an annual basis, economic growth contracted by 1.2 percent. The decline was led by a slump in business investment and industrial production despite gains in consumer spending.

More recent data has also revealed that Japan's consumer confidence declined in August, to a three year low, as consumers were discouraged by declining wages and financial market turmoil. Weak confidence was reflected in low retail sales numbers. Although, Japan's retail sales rose in August, the increase followed two months of declines. Nevertheless, industrial production surged in August, at the fastest pace in almost four years, as exports rose. Also, Japan's index of leading economic indicators signalled the economy will rebound from the second-quarter contraction.

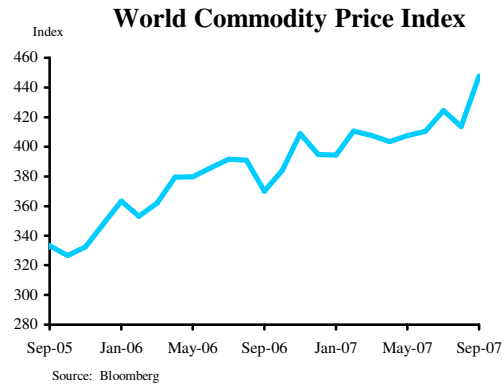
The Bank of Japan kept its benchmark interest rate at 0.5 percent in the September quarter, after the economy contracted in the second quarter.

Japan is projected to grow by 2.3 percent this year, supported by private consumption and industrial production. Inflation is forecast to fall marginally

from an estimated 0.2 percent in 2006 to 0 percent in 2007.

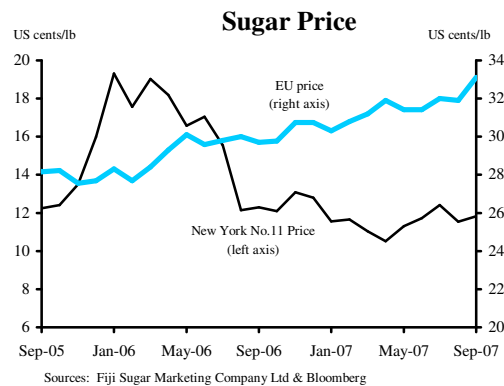
World commodity prices rose by 9.1 percent over the third quarter, underpinned mainly by the increases in gold, crude oil, coconut oil and sugar prices (Graph 3).

Graph 3



Over the second quarter, **world market sugar prices** rose by around 0.9 percent (Graph 4). World market sugar prices rose strongly in the first month of the second quarter after an announcement by Brazil that it will use more sugar for ethanol production.

Graph 4



Then in August, prices reversed the previous month's gains, on speculation

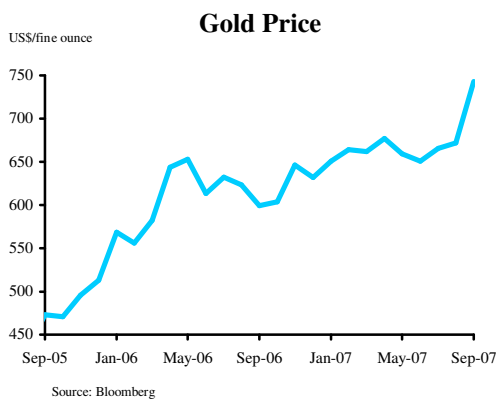
that India's rising output will increase the global surplus. Finally, in September, prices rose again, albeit marginally, as production in Brazil lagged (when compared to last year's pace) and a weaker US dollar made the commodity cheaper for buyers of other currencies.

Prices are expected to remain low in the coming months, on expectations of increases in production from India, Brazil and Thailand, that will add to the global surplus.

At the end of September, the European Union (EU) sugar price was around US33 cents per pound, having risen by 5.2 percent over the quarter with a weaker dollar.

Gold prices rose significantly over the third quarter by around 14.2 percent (Graph 5). Gold prices rose throughout the quarter, after a decline in the value of the dollar raised demand for the metal as an alternative asset. Buoyant growth in India also spurred demand for the metal from investors and jewellers.

Graph 5



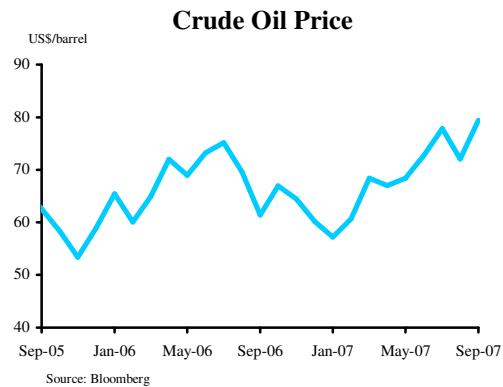
Towards the end of the quarter surging energy costs featured and boosted the

appeal of the precious metal as an alternative investment.

In the months ahead, gold prices are anticipated to remain high.

The Brent crude oil price was around US\$79.40 per barrel at the end of September, an increase of 9.0 percent when compared to the price recorded at the end of June 2007 (Graph 6).

Graph 6



Crude oil prices rose in July, after a Government report showed that the US economy grew more than expected in the second quarter, indicating fuel demand would likely rise in the world's largest energy consuming country.

However, crude oil prices declined in August, as Iran slowed uranium enrichment and improved cooperation with United Nations inspectors and expectations of lower US economic growth raised the prospect of lower demand for gasoline and other fuels.

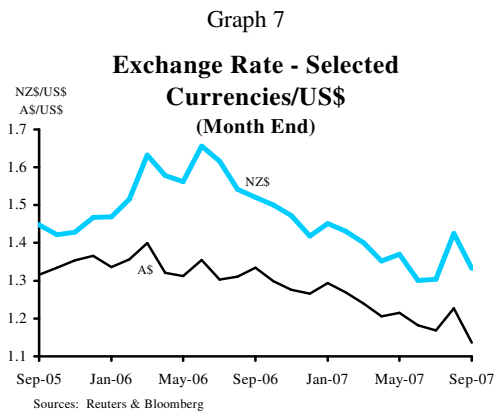
Crude oil prices then rebounded in September, after the US Government reported that consumer spending climbed in September and a decline in the US dollar to a record low against the Euro,

prompted investors to invest in commodities.

International Financial Markets

Over the September quarter, the US dollar generally weakened against all of Fiji’s major trading partner currencies, except for the New Zealand dollar. The Australian dollar and the Euro moved in the same direction against the US dollar throughout the period, strengthening in the first and last months of the quarter but weakening mid-quarter. The Yen strengthened throughout the period, while the New Zealand dollar weakened in the first two months and then strengthened in the last month of the quarter.

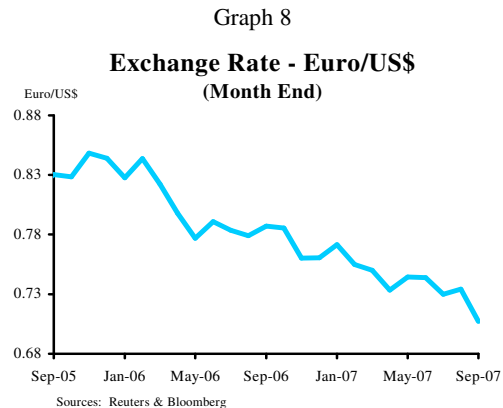
The Australian dollar strengthened against the US dollar in July and in September, after expectations of further interest rate hikes by the RBA boosted the appeal of high-yielding Aussie dollar denominated assets. The weakening of the Aussie dollar in August was due to a surge in credit costs, which prompted investors to reduce their holdings of Australian assets (Graph 7).



The New Zealand dollar depreciated

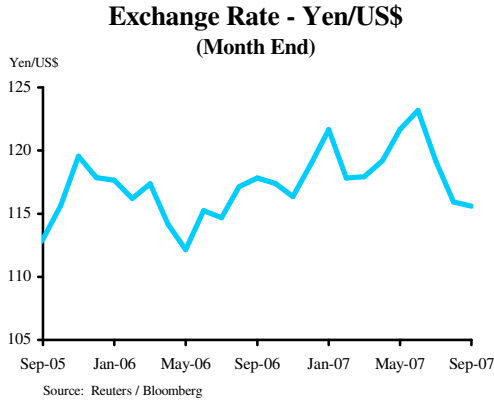
against the US dollar in July and in August, as falling global stock markets and the US sub-prime mortgage losses prompted investors to avoid riskier assets. Nonetheless, the Kiwi dollar appreciated in the last month of the quarter, as upbeat economic activity boosted the prospect of higher interest rates, and therefore the appeal of New Zealand dollar denominated assets.

The Euro, similar to the Aussie dollar, appreciated in the first and last months of the quarter, after reports of weaker price pressures in the US prompted expectations that the Federal Reserve will keep interest rates unchanged, weakening the allure of the US dollar. However, the Euro weakened mid-quarter, as growth in the manufacturing and service industries slowed, fuelling concerns that the economy will stall (Graph 8).



The Yen strengthened against the US dollar throughout the quarter, on expectations that a slump in stocks will prompt investors to repay loans in Japan which was used to finance investments in higher-yielding assets elsewhere (Graph 9).

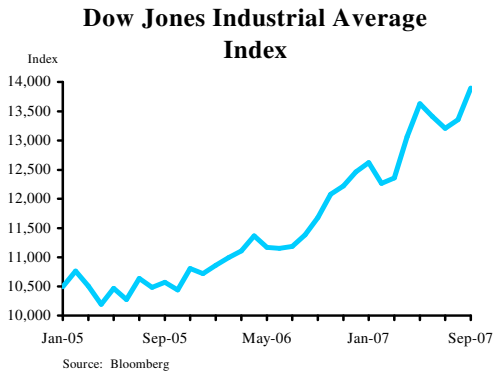
Graph 9



There were mixed performances in the equity market.

Over the September quarter, the Dow Jones Industrial Average Index rose by 3.6 percent (Graph 10). The Dow fell in July, amid concerns that the drop in US consumer confidence would hamper profits. However, it rallied in the last two months of the quarter, on optimism that increased demand from abroad would boost growth and company profits.

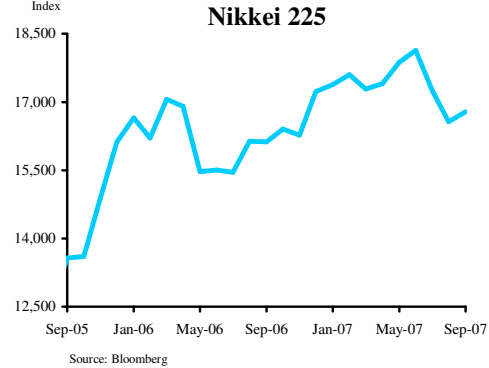
Graph 10



The Nikkei 225 Stock Average Index fell by 7.5 percent (Graph 11) over the third quarter. The decline came after a stronger Yen fuelled expectations of reduced demand for Japanese exports and

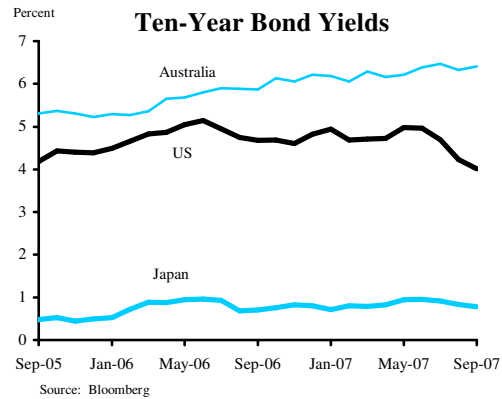
therefore profits for Japanese firms.

Graph 11



Over the third quarter, bond yields for the US and Japan fell, while that for Australia rose (Graph 12).

Graph 12



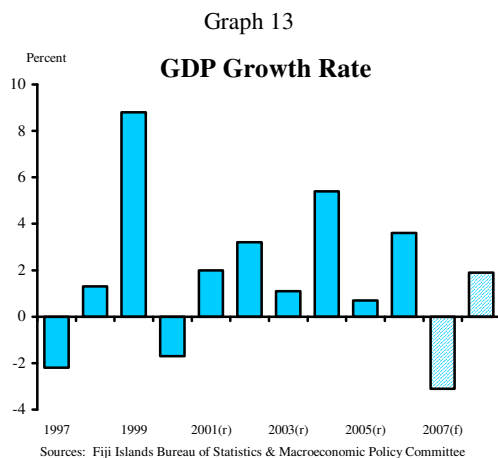
US and Japanese bond yields fell throughout the period, after a surge in demand, as investors moved to the safety of Government debt assets in the wake of the US sub-prime market crisis.

Australian bond yields rose in the September quarter, as stronger economic growth prompted investors to switch from fixed-return Government debt instruments to other assets.

THE DOMESTIC ECONOMY

Domestic Economic Conditions

The performance of the Fiji economy was subdued in the September quarter. Revised projections point to a contraction of 3.1 percent (Graph 13) in the domestic economy this year, largely underpinned by lower Government spending reflected in a decline in the community, social & personal services sector. Other sectors projected to contract are building & construction; wholesale & retail trade, hotels & restaurants; mining & quarrying and transport & communication.



For the upcoming year, economic growth is forecast at 1.9 percent. Growth in 2008 is projected to be led by the finance, insurance, real estate & business services; wholesale & retail trade, hotels & restaurants and agriculture, forestry, fishing & subsistence sectors.

Consumer Spending

In the review period, consumer spending

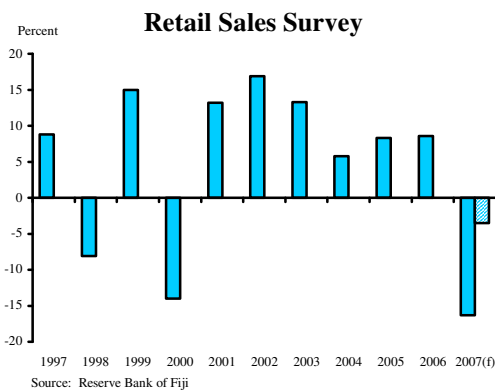
remained weak as indicated by the performance of partial indicators of consumption. In the year to September, Value Added Tax (VAT) collections¹ recorded a decline of 9.4 percent over the comparable period last year. In addition, a slowdown was also noted in lending for consumption purposes and currency in circulation.

However, in terms of individual incomes, partial indicators suggest positive results. Pay as You Earn (PAYE) collections, a partial indicator of individual income, recorded a marginal increase of 1.3 percent in the year to September.

Looking at industry sentiments, the results of the Reserve Bank of Fiji (RBF) June 2007 Retail Sales Survey (RSS) indicate that gross retail sales are expected to decline by 3.5 percent this year. This is an improvement in retail sales sentiment when compared to the 16.3 percent decline projected in the December 2006 survey (Graph 14). The more negative outlook expressed in the previous survey may have been due to the fact that the December 2006 survey immediately took into account the political events of 5 December 2006 and thus reflected the unfavourable sales expectations at that point in time.

¹ There are 3 broad categories of VAT collections. These include import VAT, cash collections and Government collections.

Graph 14



The projected decline of 3.5 percent in retail sales for this year is underpinned by lower sales prospects within the household goods & appliances, motor cars, building materials & hardware, jewellery, pharmaceuticals & chemicals, and footwear categories.

The retail industry has been affected this year by a range of factors including the political events of December 2006, RBF and Government policies (fiscal duties on various luxury goods and second hand Liquefied Pressure Gas vehicles), the fall in tourist arrivals and the floods in the Northern and Western Divisions. In addition, the temporary closure of the Vatukoula gold mine and the Fosters Group, coupled with the nation wide strike by the nurses and teachers are also expected to have dampened retail sales. The projected decline of the domestic economy is also expected to affect consumer demand.

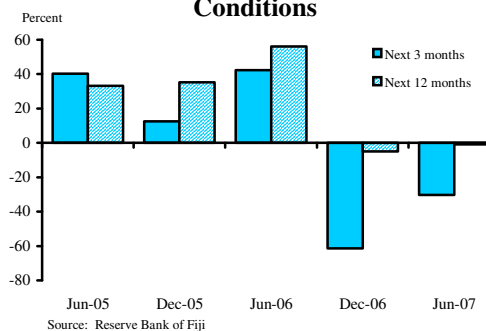
Business Expectations Survey (BES)

The RBF also conducted its BES in June this year. The survey results suggest that prospects for general business conditions in the short-term remained

negative, with a net² 30.3 percent of respondents expecting business activity to decline in the next three months of 2007 (Graph 15). This represents a much weaker decline from expectations expressed in the previous survey. Negative sentiments from the real estate, transport, finance, garment, insurance, wholesale & retail trade, tourism and building & construction sectors more than offset the positive expectations from the manufacturing and others sectors.

Graph 15

Outlook for General Business Conditions



Sentiments for general business conditions for the medium-term remained consistent with sentiments expressed in the December 2006 survey. A net 0.8 percent of respondents were still pessimistic about the medium-term outlook, with the insurance, transport, finance, building & construction, tourism and garment sectors dominating this unfavourable outlook.

Production

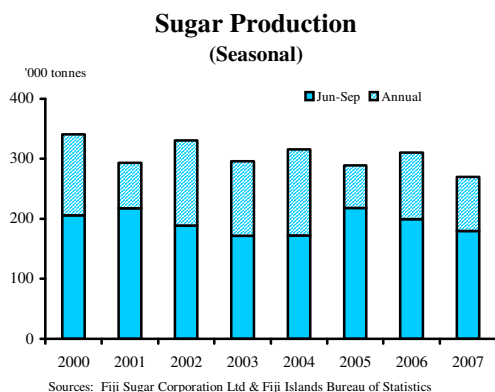
The general performance of all major sectors has been poor. The cane & sugar,

² The net is calculated by subtracting the number of respondents expecting a decrease from the number of respondents expecting an increase.

tourism, copra and building & construction sectors registered declines over the review period. On a brighter note, growth was noted in the clothing, textile & footwear, electricity, fishing and timber industries.

On the **cane & sugar industries**, latest statistics from the Fiji Sugar Corporation Limited indicate that around 1.3 million tonnes of cane was crushed up to August, representing a 3.2 percent annual decline. Consequently, total sugar produced during the same period totalled 126,807 tonnes, 3.9 percent lower than the output during the previous corresponding season (Graph 16). The lower sugar production was underpinned by low cane supply coupled with operational and plant problems at the country's sugar mills.

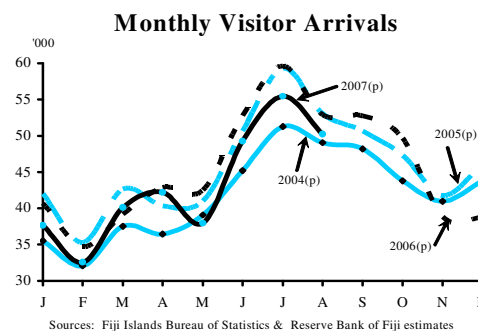
Graph 16



According to industry contacts, the drought conditions faced earlier in the Western Division is expected to affect this and next year's cane production as the mature crop and newly planted seed cane are beginning to dry up. Requests have been made to extend the planting season, normally from March to October, by an extra month, this year.

For the **tourism** industry, provisional data from the Fiji Islands Bureau of Statistics (FIBOS) indicate that cumulative to August, visitor arrivals totalled 345,386, representing an annual decline of 5.4 percent over the corresponding period in 2006. Actual visitor arrivals was better than the projections by 3.8 percent (Graph 17).

Graph 17



Occupancy rates for the March quarter was 47.4 percent, compared with 53.5 percent recorded in the same period last year. Geographically, the highest occupancy rate was recorded for the Coral Coast, at 59.7 percent.

On industry developments, the Radisson Resort opened for operations during the quarter, adding to the country's room inventory. According to the FIBOS, the number of rooms available in the March quarter 2007, increased by 15.1 percent over the same period in 2006. Room nights sold for the March quarter rose by 2.0 percent on an annual basis. However, given the increase in room inventory, occupancy rates were lower than in the March quarter 2006.

Looking at *tourism earnings* in the first two quarters of the year, the reduction in

visitor days contributed to an annual decline in tourism earnings of 9.0 percent in the review period. As per the categories, earnings from business related visits fell by an annualised 8.6 percent while earnings under the personal category declined by 9.0 percent.

The lower occupancy rates were largely due to increased room inventory over the same period in 2006, combined with a recent trend of shorter average length of stay by tourists. In addition, the recent increasing number of visitors under the *Visiting Friends & Relatives (VFR)* category, due to the discounts currently offered in Fiji, means that visitor arrivals are not directly translating into hotel activity and hotel occupancy.

Notably, the national carrier – Air Pacific Ltd – reported a drop in bookings in the first six months of this year, particularly on its Australia-Fiji routes. In addition, the company experienced a decline in business travel largely as a result of reduced travel of Government officials and diplomats.

The re-activation of the Public Safety Regulations during the quarter saw both Australia and New Zealand revising up their travel advisories to Fiji and cautioning their citizens about visiting Fiji.

However, on a positive note, the award of “Best Destination” to Fiji by international accommodation provider *Hotel.com* has boosted the image of Fiji as a tourist destination. Fiji was voted best destination by consumers in the Pacific Region including Australia, New Zealand and the Pacific Islands. Additionally, the visa exemption for Chinese nationals intending to visit Fiji, gazetted during the

quarter, is expected to support attempts to attract visitors from one of the world’s fastest growing economies.

Little change in output was noted in the **textiles, clothing and footwear** industry. In the year to August, textiles, clothing and footwear export earnings totalled \$71.7 million, representing a marginal increase of around 1.9 percent.

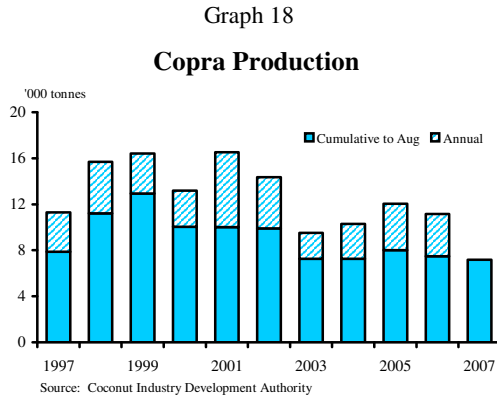
Officials from Australia are to visit Fiji to discuss possible assistance to the Textile, Clothing and Footwear (TCF) industries and to progress an audit and compliance program for the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA) TCF Provisions Scheme.

If all conditions set by the Australian Government - including the establishment of a credible audit and compliance system and improvements in productivity – have been met, when evaluated in early 2008, the Minimum Local Area Content³ will be reduced from 35 percent to 25 percent.

Developments in the **mining & quarrying** sector have been optimistic. The new owner of the Vatukoula Gold Mine (Westech Gold Pty Ltd) has settled the Garnish order imposed by the Fiji Islands Revenue & Customs Authority (FIRCA). In terms of progress at the mine, a total of 150 workers have been employed to date to carry out rehabilitation and maintenance work. An additional 600 workers are expected to be employed in 3 - 4 months time, when the mine is expected to commence operations.

³ This is the minimum local area content required for eligible goods to gain preferential access under SPARTECA TCF Provisions Scheme.

Output in the **copra** industry remained weak in the review period. Cumulative to August, copra production totalled 7,178.9 tonnes (Graph 18), representing a decline of 4.2 percent over the corresponding period in 2006.



In the review period, the producer price (\$616.96) was higher than the Government support price (\$500.00). Therefore, no subsidy was provided by Government.

An improved performance was noted in the **electricity** industry. Cumulative to September, total electricity production increased by 2.2 percent over the corresponding period of 2006.

The **fishing** industry performed well in the first 8 months of the year. Trade data for the period indicated that total fish export receipts amounted to around \$68.6 million, representing a 4.6 percent increase over the corresponding period last year.

Also buoyant was the performance of the **timber** industry. Export receipts in the first 8 months of 2007 totalled \$27.9 million, a 21.2 percent increase over the corresponding period last year. According to industry stakeholders, the opening of

the Wairiki, Bua Port is likely to result in an increased volume of sawn timber and round wood being processed in Vanua Levu; this is expected to underpin the 8.0 percent growth projected for the forestry industry this year.

The **building & construction** sector showed no signs of improvement in the second quarter of 2007. The total value of work put-in-place, cumulative to the June quarter, totalled \$113.4 million, representing a decline of 27.2 percent over the comparable period last year.

By categories, work put-in-place by the private sector registered a decline of 25.9 percent (to \$92.5m) while the public sector recorded a fall of 32.6 percent (to \$20.9m).

Similarly, forward looking indicators have shown declines. Cumulative to June 2007, the number and value of building permits issued had declined by 25.2 percent and 74.0 percent, respectively, on an annual basis. During the same period, the number and value of completion certificates issued contracted by 10.9 percent and 1.4 percent, respectively.

Major projects that are ongoing include construction work at the Carpenters Tower, the FNPF/Tappoo Retail Outlet, the Great Council of Chiefs complex, FIRCA's new headquarters, Laucala Island Resort and Funworld Centre. Moreover, the Natadola Bay Project has recommenced construction after being on hold for nearly half the year.

In line with the weak performance of the building & construction sector, **investment** has also been sluggish during the review period.

In the year to July, accrual data from the FIBOS show that imports of investment type goods decreased by around 16.0 percent on an annual basis. In addition, lending for investment purposes (which includes lending to the real estate and building & construction sectors) and to private individuals for housing purposes also slowed.

Public Finance

Recent cashflow data indicate that cumulative to June, Government recorded a net deficit of \$26.4 million, equivalent to 0.5 percent of GDP. This compares with a net deficit of \$57.0 million (equivalent to 1.0 percent of GDP) recorded in the corresponding period last year (Graph 19).

Against projections, the net fiscal deficit was much better than the budgeted deficit of \$246.5 million (equivalent to 4.4 percent of GDP). This was underpinned by lower-than-budget expenditure (29.0%), largely as a result of a shortfall in total investment spending (78.2%).

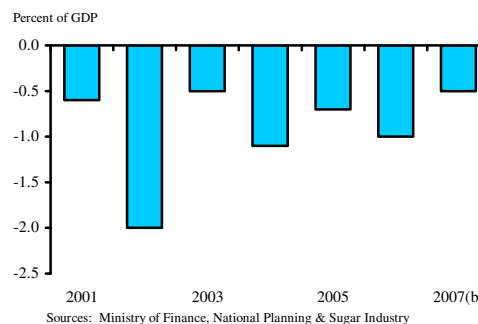
The fiscal outturn in the six months to June was underpinned by a 6.8 percent decline in expenditure and a 2.2 percent decline in revenue collections.⁴

In the review period, Government expenditure declined on an annual basis by 6.8 percent, underpinned by a 40.4 percent decline in total investment payments. Notably, capital expenditure in the review period decreased by an annual 25.9 percent and was below budget by a significant 72.8 percent.

⁴ Revenue data in the Cashflow excludes Government VAT (which Government pays to itself).

Graph 19

Government Fiscal Underlying Balance



Operating payments fell by 2.5 percent on an annual basis. Personnel payments, however, increased by an annualised 5.4 percent and were above the budgeted level by 4.4 percent.

Cumulative to June, Government revenue (excluding Government VAT) declined by 2.2 percent when compared with the corresponding period in 2006. The decline in revenue collections stemmed from annually lower indirect taxes, particularly VAT collections.

Notably, revenue collections were lower by 4.0 percent when compared with the budgeted level. While Pay As You Earn (PAYE) were better than the budgeted levels, VAT collections, fiscal duties,⁵ import excise, excise duties and company tax collections were lower-than-budgeted.

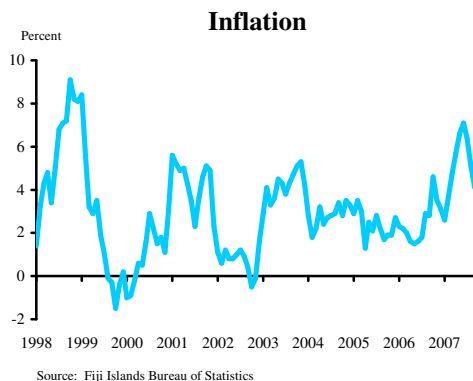
Government's outstanding debt at the end of August 2007 totalled around \$2,819.0 million, equivalent to 50.0 percent of GDP. This compares with the outstanding debt level at August 2006 of \$2,585.1 million, or 47.6 percent of GDP.

⁵ Fiscal duties reported in the Cashflow are expressed as 'net of rebate'.

Inflation

Inflation fell to 4.1 percent in September compared to 7.1 percent registered in June (Graph 20). On a quarterly basis, consumer prices fell by 1.8 percent. During the September quarter, prices of food items and alcoholic drinks & tobacco fell. The reduction in these prices outweighed the marginal increases in costs of heating & lighting, miscellaneous items, transport, durable household goods, clothing & footwear and housing items. Lower costs of vegetables & root crops, yaqona, fats & oils, fresh fish, spices and cereal featured prominently in the food items category while reduced prices for certain alcoholic spirits and warm beer underpinned the decline in prices in the alcoholic drinks & tobacco category.

Graph 20



The trimmed mean, a measure of core inflation, fell to 3.0 percent in September from 3.2 percent recorded in June.

Since July this year, prices of food items, which comprise a significant share in the CPI basket, have been declining on a monthly basis as the supply of market produce has improved and demand has adjusted accordingly.

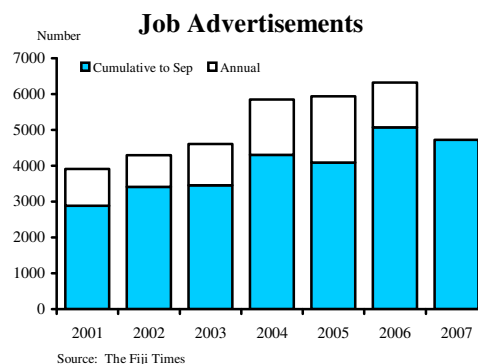
Moreover, a reduction in the mark-up of basic food items in September lowered the costs of food items further. These large and downward price wings were not envisaged in June when the inflation forecast was revised up to 7.0 percent.

Looking ahead, price pressures emanating from higher global crude oil prices and average trading partner inflation are expected to be mitigated by lower domestic inflation and a relatively weaker US dollar. Hence, in balancing the above factors, the year end inflation projection is now revised down to 3.5 percent from 7.0 percent.

Labour Market

According to survey data, employment conditions remain weak in certain industries, largely accredited to the contraction in the economy. Cumulative to September, recruitment intentions fell by around 6.8 percent (from 5,068 to 4,725) over the comparable period in 2006 (Graph 21).

Graph 21

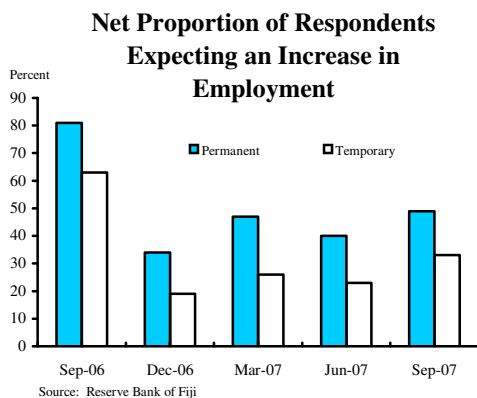


Lower employment prospects were mainly underpinned by the finance, insurance, real estate & business services; construction; electricity & water; mining

& quarrying; wholesale & retail trade, restaurants & hotels and transport, storage & communication based companies.

However, the Reserve Bank's Fiji Employers' Federation Expectation Survey, which was conducted in September, showed an expected improvement for the next twelve months (Graph 22).

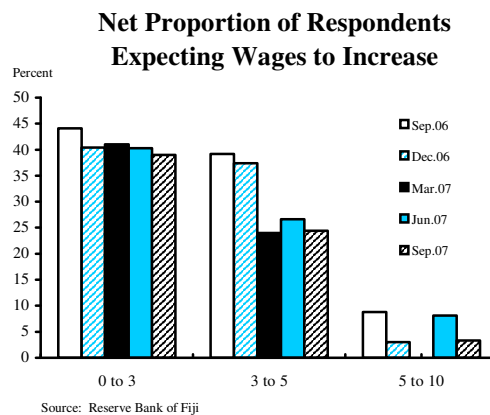
Graph 22



A net of around 49.0 percent and 33.0 percent of respondents expect an increase in permanent and temporary employment, respectively. Both temporary and permanent employment prospects have improved over the June survey.

Unlike sentiment in the previous quarter, fewer respondents are expecting wages to increase in the coming months (Graph 23). This is in line with the weak investment prospects in the economy and lower sales turnover of firms as reported in the RBF's Retail Sales Survey.

Graph 23



The External Sector

Despite showing an increase over 2006, export earnings continue to be a concern. Latest accrual trade data showed that merchandise **exports** rose by a marginal 0.6 percent cumulative to August 2007. This compares with a growth of 2.7 percent in the corresponding period last year. Domestic exports⁶ declined by 0.2 percent compared with a 0.5 percent growth in the same period last year.

Leading the increase in export receipts were mineral water, timber, fish, fruits & vegetables, garments, uncooked pasta, flour, re-exports and other domestic exports. These more than offset declines recorded for earnings from exports of sugar, molasses, footwear & headgear and corned meat of bovine animals.

Merchandise **imports** declined during the same period by 9.8 percent, compared with growth of 20.1 percent in the corresponding period in 2006.

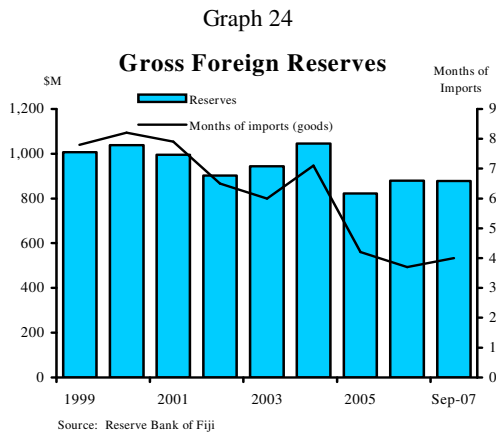
All categories of imports declined with the main drivers being investment goods

⁶ Domestic exports are total exports less total re-exports.

(-4.7%) such as machinery & electrical equipment and chemicals, intermediate goods (-2.9%) which was led by mineral fuels and crude materials and consumption goods (-2.2%) mainly consisting of manufacturing goods, miscellaneous manufactured articles and beverages & tobacco.

Excluding re-exports of mineral fuels, exports increased by 1.2 percent cumulative to August 2007, compared with 1.7 percent growth in the same period in 2006. Excluding mineral fuels, imports declined by 10.5 percent compared to 11.6 percent growth in the same period last year.

At the end of September 2007, **official foreign reserve** holdings were provisionally around \$878.5 million (Graph 24), sufficient to cover 4.0 months of imports of goods.



Domestic Financial Conditions

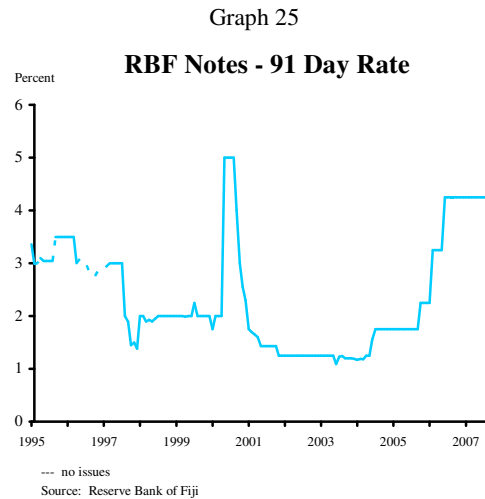
Money Markets

There was no interbank activity recorded in the September quarter as a result of historically high liquidity conditions in the financial system.

During the review period, the Reserve Bank kept monetary policy unchanged, with the indicator rate maintained at 4.25 percent (Graph 25).

There were no issues of RBF notes in the September quarter following the suspension of open market operations earlier in mid June.

Government, however, raised \$136 million via Treasury Bill issues during the review period, \$55.7 million lower than that traded in the June quarter. The interest rate on Government 91-day T-Bills averaged 2.08 percent during the review quarter, down from 4.56 percent in the previous quarter. However, at the end of September, the T-Bills rate was 0.89 percent.



Capital Markets

Government issued bonds worth \$22 million during the third quarter of 2007, compared with \$19.3 million issued in the June quarter. Maturities were 3, 5, 7, 10 and 15 years.

The Fiji Development Bank also issued

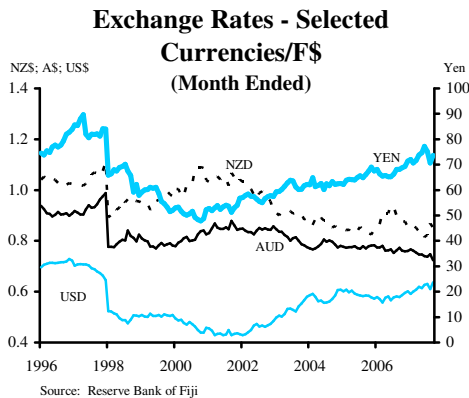
bonds with maturities ranging from 1 to 3 years, totalling \$26 million, compared to \$24.2 million in the previous quarter.

Foreign Exchange Markets

Quarterly comparisons of bilateral exchange rates (Graph 26) show that the Fiji dollar strengthened against the New Zealand (4.2%) and US dollar (1.7%) but weakened against the Japanese Yen (4.5%), Euro (3.4%) and the Australian dollar (2.3%).

The Nominal Effective Exchange Rate Index (NEER), which reflects aggregate exchange rate movements between the Fiji dollar and the currencies of Fiji’s major trading partners, declined over the quarter by 0.3 percent, indicating a depreciation of the Fiji dollar against the basket of currencies.

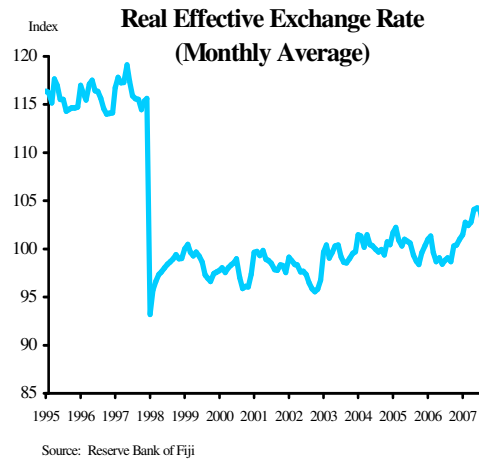
Graph 26



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 by 3.1 percent (Graph 27). The fall in the REER reflects improvements in Fiji’s international competitiveness. The decrease was underpinned by the lower domestic

inflation which was 4.1 percent in September compared to 7.1 percent at the end of the previous quarter.

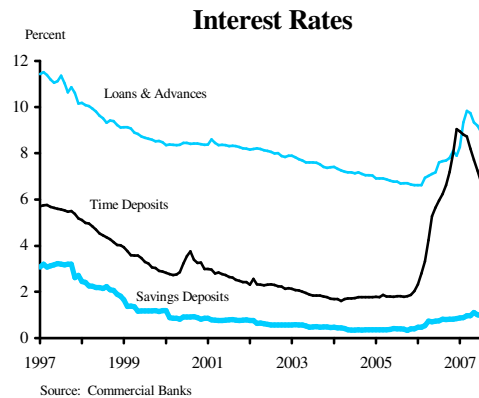
Graph 27



Financial Intermediaries

Due to the high liquidity conditions in August, commercial banks’ interest rates continued to fall. The time deposit rate fell by 63 basis points, to 6.64 percent, compared with rates prevailing at the end of the June quarter (Graph 28).

Graph 28



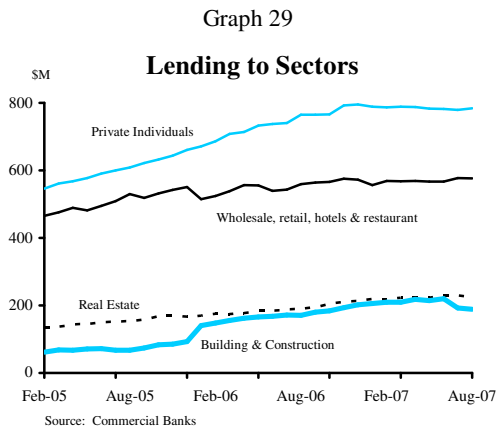
During the same period, the weighted average lending rate on outstanding loans declined to 8.84 percent. The

savings deposit rate also declined by 17 basis points to 0.84 percent over the quarter.

Furthermore, interest rates on new time deposits fell by 90 basis points over the quarter to 4.33 percent in August 2007. Similarly, the new lending rate declined by 64 basis points over the June quarter to 9.38 percent in August.

Movements in Licensed Credit Institutions' (LCIs)⁷ interest rates were mixed. The weighted average lending rate rose by 13 basis points to 12.91 percent in August, while the interest rate on time deposits decreased to 6.96 percent in August, from 7.41 percent in June.

The growth in commercial banks' outstanding credit slowed during the September quarter and grew by only 7.9 percent in the year to August, down from 11.4 percent in June (Graph 29).



Lending to private individuals (mainly for housing and other purposes), and to the wholesale and retail trade, manufacturing,

⁷ LCIs' include Merchant Finance Investment Company Limited, Credit Corporation (Fiji) Limited and Home Finance Company Limited.

real estate and building and construction sectors continue to drive credit demand.

Lending by LCIs also slowed in August with the annual growth rate of loans at 2.6 percent, compared to growth of 5.8 percent in the year to June.

Banking Industry Quarterly Condition Report – June 2007

Overview – Commercial Banks

The **overall** condition of the banking industry was assessed as *satisfactory* in the June quarter, with growth noted in the combined balance sheet and improvement in profitability.

The **capital adequacy** ratio for all banks was above the minimum prudential requirement of 8.0 percent, and recorded a strong ratio of 12.4 percent in the quarter.

Asset quality remained *satisfactory*, although impaired and classified loans increased. As a result, general provisions were raised by all banks over the quarter. Closer monitoring is still warranted considering the rise in past dues and special mention accounts.

Management was rated as *satisfactory*, supported by strong capital positions and capable management of liquidity and asset quality over the quarter.

Earnings remained *marginal* despite a slight improvement in all profitability ratios. Pre-tax quarterly profits increased to \$26.5 million from \$24.0 million in March which led to an improvement in the efficiency ratio from 52.6 percent in the previous quarter to 49.0 percent.

Liquidity was classed *marginal* despite an improvement in the combined banks' stock of liquid assets over the June quarter. The turnaround in the aggregate liquidity position was reflected in improved liquidity ratios recorded by all commercial banks. This easing of liquidity pressure on Banks was in part a result of the reduction in the Statutory Reserves Deposit (SRD) requirement from 7.0 percent to 6.0 percent in May. This was also augmented by an improved level of foreign reserves over the period.

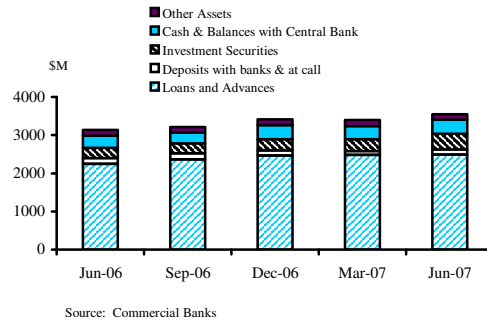
Balance Sheet

Recovering from a contraction of 0.5 percent in the March quarter, the Banking Industry's balance sheet grew by 4.6 percent over the quarter to \$3.5 billion.

On an annual basis, the combined bank's balance sheet grew by \$415 million recording an annual growth rate of 13.2 percent, picking up from 10.7 percent in March. However, on an overall basis, annual growth has slowed compared to the average rate of 15.7 percent in the past 4 quarters (Graph 30).

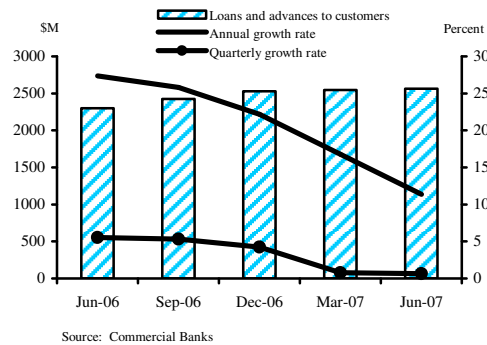
The rise in total assets over the quarter mainly stemmed from investments (\$99.4m), cash & settlement account (\$44.9m), deposits with banks (\$26.4m) and loans (\$16.9m). However, following the 1.0 percent reduction in the SRD requirement, funds held as statutory reserves declined by \$23.8 million to \$177.6 million. Annual comparisons depicted similar trends in asset movement, except for deposits with banks, which reduced by \$20.5 million over the year.

Graph 30
Structural Change and Growth in Bank Assets



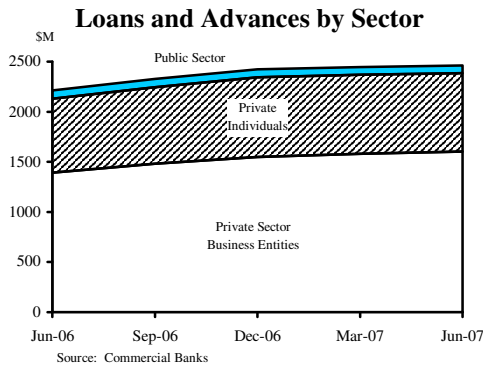
Total loans and advances increased by 0.7 percent over the quarter, and 11.4 percent over the year, to \$2.6 billion. A general slowdown in the growth rate of loans and advances disbursed has been noted from June 2006, reflecting the implementation of the credit ceiling (Graph 31).

Graph 31
Banking Industry's Loans and Growth Rate



Loans to private individuals fell marginally by 0.8 percent over the quarter, while loans to private sector business entities and the public sector declined by 1.4 percent and 1.6 percent, respectively (Graph 32).

Graph 32



The June quarter saw high priority sectors gaining importance with the majority of these sectors recording increases, while lending to low priority sectors declined. Among the high priority sectors, the electricity, gas and water sector increased by \$20.6 million, building & construction by \$10.0 million, agriculture by \$6.8 million while manufacturing and transport & storage recorded declines of \$15.3 million and \$0.2 million, respectively.

With the exception of the real estate sector and professional business, which rose by \$7.3 million and \$6.5 million, respectively, loans to low priority sectors decreased. Among these, the wholesale/retail sector and private individuals declined by \$0.2 million and \$6.6 million, respectively.

On the liabilities side, deposits registered growth of \$175.5 million over the quarter and \$358.1 million over the year, to \$3.1 billion. Growth over the quarter mainly stemmed from demand deposits (\$183.8m) and savings deposits (\$14.8m) whereas time deposits fell by \$23.1 million.

Annual comparisons showed that time deposits grew by \$281.8 million, demand

deposits by \$85.8 million, while savings deposits dropped by \$9.4 million. The hike in time deposits was mainly due to higher interest rates offered in the earlier quarters.

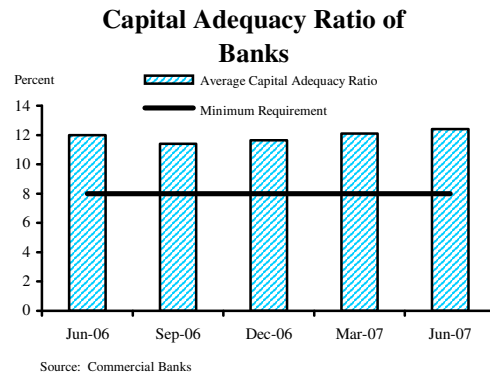
Balances due to banks and bills payable recorded marginal reductions over the quarter (\$27.4m and \$8.4m, respectively) and with the investment of additional capital by a Bank, assigned capital registered a \$2.5 million increment over the quarter.

Capital Adequacy

As at June 2007, the industry recorded a capital adequacy ratio of 12.4 percent. This compares to 12.1 percent recorded in the previous quarter and 11.9 percent in June 2006 (Graph 33).

The ratio has improved by 20 basis points over the quarter mainly due to a higher rate of growth in capital (+2.7%) than risk-weighted assets (0.8%).

Graph 33



The growth in total capital flowed from an additional injection of funds by one bank, as well as increases in un-audited profits, asset revaluation reserves and general provisions in tier 2 capital. Risk weighted

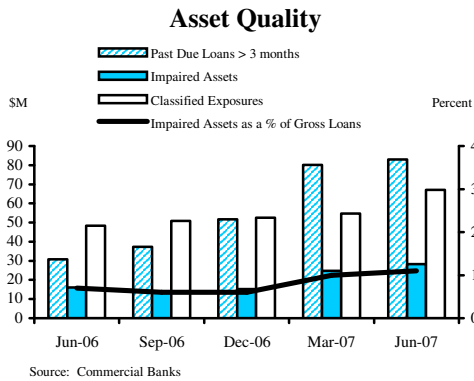
assets recorded decreases in all risk categories except those with 0 and 20.0 percent risk weighting.

Asset Quality

In spite of the sluggish economic background, banks' asset quality was maintained as satisfactory. Banks recorded a slight decline in the quality of their loan book for the quarter with increases in past due status and classified accounts. Corrective and recovery actions initiated by banks have also been on the rise, with the peak recorded in the month of May (Graph 34).

Commercial banks' level of classified assets grew by 23.0 percent over the quarter to \$67.2 million underpinned by a rise in substandard and doubtful accounts (which have doubled over the year). This is in line with the general weakness in certain economic sectors as a result of the overall contraction in the economy.

Graph 34

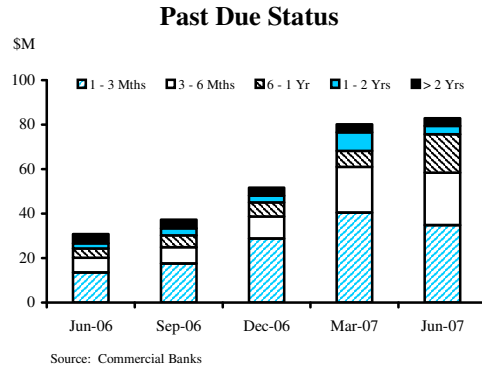


Performing but classified loans totalled \$107.2 million, up by 17.0 percent over the quarter. This has nearly doubled over the year, showing the rise in perceived credit risk in the economy. However, the current level of classified assets is still a

low 2.6 percent of the total loan portfolio of banks.

Impaired loans stood at \$28.3 million compared to \$24.8 million in the March quarter (June 2006: \$16.1m). Interest in suspense grew moderately to \$3.5 million, up by 6.0 percent over the year (Graph 35).

Graph 35



With exception of one bank, all other banks' past due levels have grown, with the total reaching \$82.9 million from \$80.2 million in March 2007 and \$30.7 million in June 2006 (Graph 36). The rise in arrears is generally a result of higher lending rates being applied as loans are re-priced.

Problem loans were concentrated within the household sector, which accounted for slightly more than half of outstanding problem loans, similar to the last few quarters. Loans to the wholesale & retail sectors (including hotels) accounted for about a fifth of problem loans. The increase in problem loans suggests that certain segments of the household sector have been affected by the higher interest rates in recent years.

Provisioning levels for banks stand at

\$52.1 million (of which \$10.5m are specific provisions). Provisioning has grown by 39 percent over the year (with specific provisions up by 27.0%). Specific provisions coverage of classified assets stands at 15.7 percent, a slight drop from the March quarter cover of 17.3 percent. Specific provisions cover 37.2 percent of impaired loans.

General provisions represented 1.6 percent of gross loans and advances, an increase from 1.3 percent in June 2006.

The current level of classified and past due loans is considered moderate, however, given the economic outlook, asset quality would require closer monitoring as banks aim to control credit related losses.

Earnings

The banking industry earned \$26.5 million profits (before tax) in the current quarter. This compares to \$24.0 million in the previous quarter and \$32.3 million in June 2006.

Non-interest income fell both over the quarter and over the year mainly due to a decline in fee income from lending and savings accounts. This is a reflection of the general decline in lending over the year. Income from foreign exchange recorded minimal growth.

Table 1. Banks' Combined Income Statement

	Jun 06	Mar 07	Jun 07	% Change	
	\$M			Over Qtr	Over Jun 06
Interest Income	50.9	70.5	71.0	0.6	39.3
Interest Expense	16.7	34.3	30.6	-10.9	83.1
Net interest income	34.2	36.2	40.3	11.5	17.9
Add: Non interest income	23.3	22.2	21.1	-5.1	-9.5
Income from overseas exchange transactions	9.0	8.8	9.3	5.5	3.2
Commission	3.1	3.5	2.6	-26.7	-17.2
Fee Charges	11.1	9.8	7.9	-19.4	-28.9
Other income	0.09	0.1	1.3	1012.8	1354.1
Total operating income	57.6	58.4	61.4	5.2	6.8
<i>Less: Operating expenses</i>	26.0	30.7	30.1	-2.1	15.6
<i>Less: Bad Debts & provisions</i>	-0.9	3.6	4.8	32.8	-658.8
Profit before tax	32.3	24.0	26.5	10.4	-17.9
<i>Less: Tax</i>	7.3	8.1	8.3	2.6	13.4
<i>Add Extra ordinary items</i>					
Net profit after tax	25.0	15.9	18.2	14.3	-27.1

Source: Commercial Banks

Other operating expenses declined over the quarter mainly due to a decrease in other management expenses, reflected in head office supervision charges. Over the year, operating expenses were higher due to legal costs incurred by one bank.

Bad and doubtful debt expenses were further raised this quarter, arising from the increase in past due levels. This compares with a write-back in June 2006 when asset quality had recorded improvements.

The return on assets ratio (before tax) improved to 3.0 percent from 2.8 percent in March 2007 but remained lower than the 4.2 percent recorded in June 2006. Return on equity recorded similar trends and stood at 27.0 percent in the current quarter.

Interest Margin and Spread

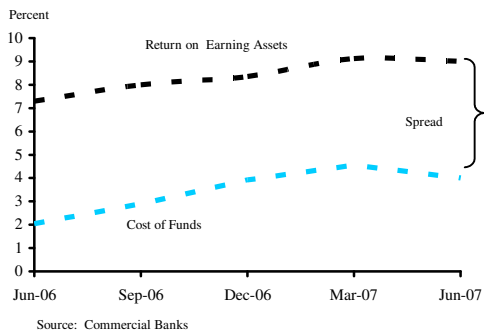
Following periods of high interest rates, carded interest rates on deposits and loans began to decline in the beginning of the June quarter with interest rates on deposits declining more rapidly (Graph 36).

As a result of this, the cost of funds declined at a faster rate than the yield on earning assets, causing the overall spread to widen further in the June quarter (from 4.6% to 5.0%).

The yield on earning assets decreased to 9.0 percent from 9.1 percent in the previous quarter. This compared to 7.3 percent recorded in the same quarter in 2006.

Graph 36

Margins and Spreads



The cost of funds declined to 4.0 percent from 4.6 percent in the previous quarter and 2.0 percent in June 2006.

With banks decreasing carded interest rates, it is envisaged that the return on earning assets and the cost of funds would decline further in the upcoming quarters. Competition among banks and refinancing may lead to further decreases in lending rates. This general fall in interest rates will also ease pressure on the household sector and its ability to service its loans.

Efficiency

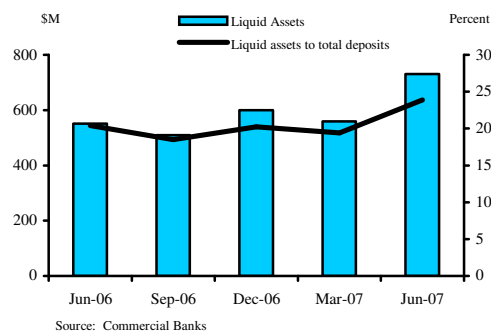
An improvement in operating income over the quarter and a decline in operating expenses, led the efficiency ratio (ratio of operating expenses to operating income) of all banks to improve to 49.0 percent. This compares to 52.6 percent in the previous quarter. However, comparison with the 45.3 percent recorded in June 2006 suggests that the banking industry was more efficient a year ago.

Liquidity and Funding

All banks' liquidity position is assessed to be marginal for the June 2007 quarter in spite of an overall increase in liquidity. Stable reserves, the credit ceiling and the reduction in the SRD requirement all contributed positively to the build up in the stock of liquid assets (Graph 37).

Graph 37

Liquid Assets to Total Deposits



The level of liquid assets during the quarter stood at \$730.1 million, representing an increase of \$170.8 million over the March quarter. On an annual basis, liquid assets registered a rise of \$178.8 million. The growth was underpinned by a healthy increase in all three categories of deposits with banks, cash & settlement accounts and investment.

The liquid assets coverage of total liabilities also rose to 20.6 percent from 16.5 percent in the previous quarter and 17.6 percent in June 2006, as a result of the increase in liquid assets during the review period.

The industry's coverage of total deposits also strengthened both over the quarter and over the year (23.9% in June 2007 compared to 19.4% in March 2007 and 20.4% in June 2006).

The loans to deposits ratio also improved to 83.8 percent in the June quarter from 88.3 percent in the March quarter and 85.2 percent in June 2006.

As at June 2007, \$784.1 million in deposits were held by the 15 largest depositors in the industry. The current level of liquid assets would not be able to fully cover for these deposits should they be drawn at the same time.

The maturity profile of the banking industry as at June 2007 shows a negative mismatch of \$638.8 million within the next 12 months, a rise from \$494.4 million recorded in the previous quarter. This can be met by the current level of liquid assets.

The outlook for liquidity within the banking industry is envisaged to improve in the upcoming quarters.

Overview – Credit Institutions

The **overall** performance of credit institutions was assessed as *satisfactory* during the June quarter.

Capital adequacy remained *strong* at 19.8 percent, well above the 10.0 percent minimum requirement.

With increases in past due levels, **asset quality** was rated as *marginal*. All institutions envisaged a deterioration in asset quality and consequently raised their general provisions.

Management of credit institutions was assessed as *satisfactory*.

Earnings were assessed as *marginal* with a slight increase in quarterly profits to \$3.1 million from \$2.8 million in the previous quarter and \$2.9 million in June 2006. An improvement in profitability ratios and efficiency was also noted.

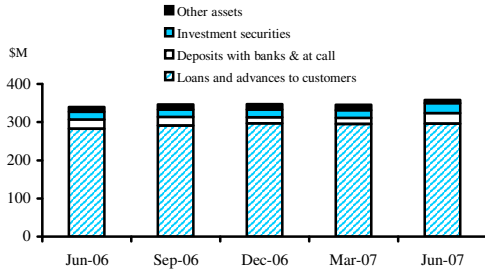
Liquidity of credit institutions remained *marginal* despite an increase in the level of liquid assets. It was noted that a heavy dependence on borrowings to meet maturing obligations was still prevalent.

Balance Sheet

As at June 2007, the combined balance sheet of credit institutions stood at \$364.3 million, representing a 4.7 percent rise over the quarter (Graph 38).

Graph 38

Structural Change and Growth in Credit Institutions' Assets



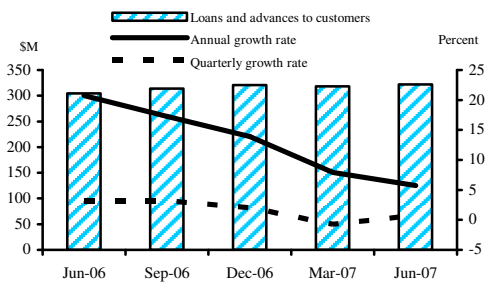
Source: Credit Institutions

The growth over the quarter was a result of a 26.8 percent increase in investment, largely recorded by one institution. On the liabilities side, this was funded by a rise in term deposits, by 15.8 percent, placed in one institution.

Gross loans expanded by \$2.4 million (0.7%) over the quarter to \$321.7 million. The loan portfolio for two institutions increased slightly while it remained at March levels for the third, as a result of a credit ceiling directive. The annual growth rate of 5.7 percent was the lowest since December 2002 (+5.6%) but has picked up slightly over this quarter from a decline of 0.7 percent in March 2007 (Graph 39).

Graph 39

Credit Institutions' Loans and Growth Rate

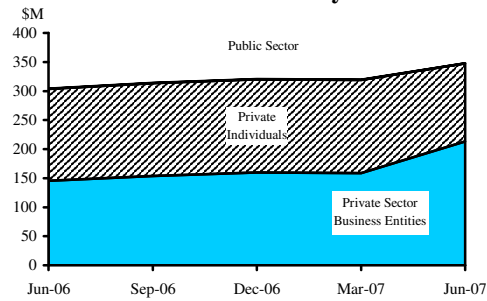


Source: Credit Institutions

On a sectoral comparison, private sector business loans increased by \$33.3 million (18.6%) over the quarter while private individual loans declined by \$30.3 million. Increases in business loans stemmed from the manufacturing and transport & storage sectors. Reclassification of private individual loans to private sector by one institution caused the movement between the two categories (Graph 40).

Graph 40

Loans and Advances by Sector



Source: Credit Institutions

Credit institutions recorded an increase in their deposit levels (\$30.1m) over the quarter to \$220.3 million on the back of a decline in the March 2007 quarter. Lower interest rates offered by banks following the SRD reduction during the quarter, led to depositors moving their funds back to credit institutions.

Whilst deposit levels were high (\$51.9m) on an annual comparison, amounts owing to holding companies showed a reduction (\$27.8m). On a quarterly comparison, amounts owing to holding companies declined by \$13.4 million (14.7%).

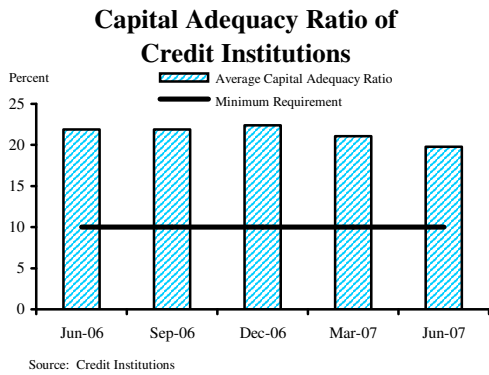
Capital Adequacy

As at June 2007, combined credit institutions recorded a strong capital adequacy ratio of 19.8 percent. Although

this was 125 basis points lower than the previous quarter and 108 basis points lower than June 2006, it was still well above the minimum requirement of 10 percent (Graph 41).

The decline in the capital adequacy ratio over the quarter resulted from an increase in risk-weighted assets (\$11.2m) while total capital decreased by \$1.2 million. The deterioration over the year was due to a faster rate of growth in risk-weighted assets (20.0%), while total capital grew by 13.8 percent.

Graph 41

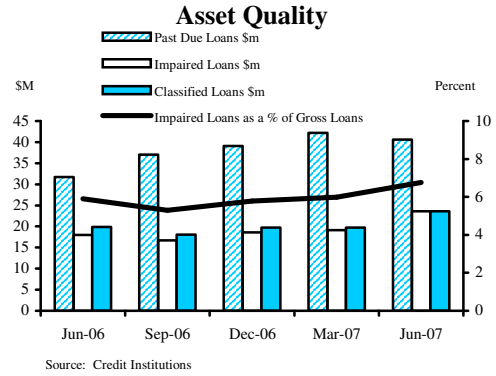


Total risk-weighted assets stood at \$287.5 million. This was an increase of \$11.2 million, largely caused by growth in the 20.0 percent risk-weight category. Over the year, all risk weight categories, except for the 50.0 percent category, registered growth. The 100 percent risk weighted category recorded the highest growth.

Asset Quality

Credit institutions’ asset quality remained marginal. There was a slight deterioration in asset quality with growth in classified loans. However, the level of past due loans has slightly declined (Graph 42).

Graph 42



Classified loans for credit institutions stood at \$23.6 million (June 2006: \$19.9m). There was a \$3.3 million increase over the quarter and this was driven by a rise in doubtful accounts.

Provisioning levels for credit institutions amounted to \$16.9 million. This compares to \$16.5 million in March 2007 and \$15.9 million in June 2006. Specific provisions stood at \$6.1 million, comprising 25.6 percent of impaired loans, slightly lower than the average coverage held in the last five quarters.

Past due levels for credit institutions slightly dropped over the quarter to \$40.6 million from \$42.2 million. This compares to \$31.7 million recorded in June 2006.

As expected, credit institutions’ asset quality deteriorated. However, similar to banks, this is somewhat mitigated by recovery and corrective actions taken by the respective institutions, which increased during the quarter. This is envisaged to continue as credit institutions endeavour to control credit risk and any potential loss that may arise.

In the June 2007 quarter, credit institutions recorded a marginal profit (before tax) of \$3.1 million. This compares to \$2.8 million in the previous quarter and \$2.9 million in the same quarter last year.

Table 2. Credit Institutions' Combined Income Statement

	Jun 06	Mar 07	Jun 07	% Change	
	\$M			Over Qtr	Over Jun 06
Interest Income	9.3	10.8	11.4	5.8	23.3
Interest Expense	2.7	5.3	5.3	-0.2	94.1
Net interest income	6.5	5.5	6.1	11.6	-6.4
<i>Add: Non interest income</i>	<i>0.8</i>	<i>0.7</i>	<i>0.7</i>	<i>-8.3</i>	<i>-15.3</i>
Commission	0.1	0.1	0.1	54.2	4.8
Fee Charges	0.4	0.3	0.2	-25.7	-45.9
Other income	0.2	0.3	0.3	-6.2	35.7
Total operating income	7.3	6.2	6.8	9.3	-7.4
<i>Less: Operating expenses</i>	<i>3.4</i>	<i>2.8</i>	<i>2.9</i>	<i>2.1</i>	<i>-14.7</i>
<i>Less: Bad Debts & provisions</i>	<i>1.0</i>	<i>0.5</i>	<i>0.7</i>	<i>45.2</i>	<i>-30.5</i>
Profit before tax	2.9	2.9	3.1	10.1	9.8
<i>Less: Tax</i>	<i>2.5</i>	<i>0.4</i>	<i>2.6</i>	<i>532.2</i>	<i>0.1</i>
<i>Add Extra ordinary items</i>					
Net profit after tax	0.3	2.4	0.6	-76.2	91.8

Source: Credit Institutions

Net interest income improved over the quarter with an increase in interest income. However, on a yearly comparison, net interest income was lower by \$0.4 million because of the significant increase in interest expenses. Non-interest income declined both over the quarter and over the year.

A rise in personnel expenses led to the

increase in operating expenses over the quarter. However, on an annual basis this declined by \$0.5 million caused by a reduction in depreciation and other expenses.

An anticipated deterioration in asset quality led credit institutions to increase bad and doubtful debt expenses over the quarter.

Tax expenses this quarter were 532 percent higher than the previous quarter, causing a substantial decline in net profit after tax.

The return on assets (before tax) improved to 3.5 percent from 3.3 percent in March 2007 and 3.4 percent in June 2006. This was mainly due to improved profits (10.1% over the quarter and 9.8% over the year) while average assets increased by 2.4 percent over the quarter and 7.8 percent over the year.

Similarly, the return on equity ratio rose to 22.1 percent from 19.7 percent in March 2007 and 21.4 percent in June 2006.

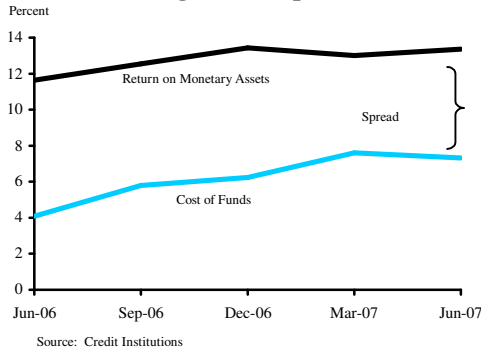
The operating expenses to operating income ratio improved this quarter to 42.9 percent from 45.9 percent in the previous quarter and 46.6 percent in March 2006.

Interest Margin and Spread

Similar to banks, the credit institutions' spread widened over the quarter to 6.0 percent from 5.4 percent in March 2007 and 7.2 percent in June 2006 (Graph 43).

Graph 43

Margins and Spreads



However, in contrast to banks, the yield on earning assets increased whereas cost of funds declined over the quarter. This is attributed to the rise in lending rates and decline on deposit rates offered by credit institutions.

Credit institutions' spread is expected to come under pressure as a portion of their loan portfolio is tied up with fixed interest rates. As such, while their returns on monetary assets would show a slight increase with increases in variable rates, their cost of funds would continue to rise as they could be compelled to raise interest rates on deposits to compete with commercial banks.

Liquidity

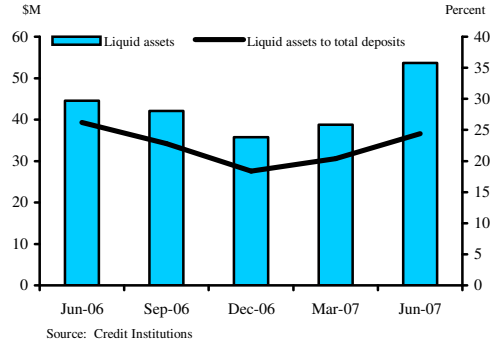
Due to a heavy reliance on borrowings from shareholders, the liquidity position of credit institutions remained marginal in June 2007, despite an increase in liquid assets.

Total liquid assets recorded an increase of \$14.9 million over the quarter and \$9.3 million over the year to \$53.8 million (Graph 44). This led to an improved coverage of 24.4 percent of total deposits (March 2007: 20.4%). This however,

remains lower than the June 2006 coverage (26.4%).

Graph 44

Liquid Assets to Total Deposits



Liquidity ratios improved slightly over the quarter with an increase in the level of liquid assets. It was also noted that monies owing to holding companies declined over the quarter.

Credit institutions' maturity profile shows negative mismatches of \$96.1 million within the next 12 months. Borrowings from shareholders decreased over the current quarter by \$13.4 million to \$77.5 million after an increase of \$6.6 million last quarter.

Balances of the 15 largest depositors make up \$111.2 million or approximately 51 percent of total deposits of credit institutions. Furthermore, the largest depositor holds 29.6 percent of total credit institutions' deposits.

Outlook

Credit growth is expected to continue to be slow with the credit ceiling in place.

The effect of the decline in the SRD requirement and the current stable reserves position will keep liquidity

levels buoyant and consequently impact the interest rates offered by banks. The maintenance of banks' interest margin would mean a more rapid decrease in deposit interest rates than lending rates.

Insurance Industry Quarterly Condition Report – March 2007

Overview

The insurance industry continued to perform satisfactorily in terms of positive growth in solvency and after tax surpluses in the March quarter.

The surpluses were mainly attributed to the improvement in the underwriting performance of insurers combined with reported increases in investment returns.

Most of the licensed insurers continued to meet the solvency requirements under the Insurance Act 1998. Further supervisory consultations continue with insurers who reported shortfalls and satisfactory work is currently underway to address these issues (Graph 45).

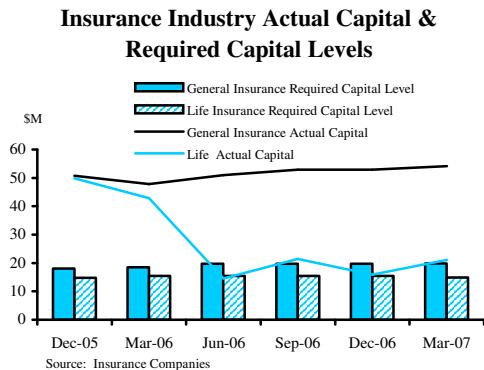
Licensed Insurers

The **capital** requirement for the insurance industry for the quarter ended March 2007, was assessed as satisfactory. Total capital available for the industry was \$75.1 million, well above the required capital level of \$34.7 million. The main contribution to this growth was an increase of 13.0 percent in general insurers' admissible assets, reflected mainly by higher investments.

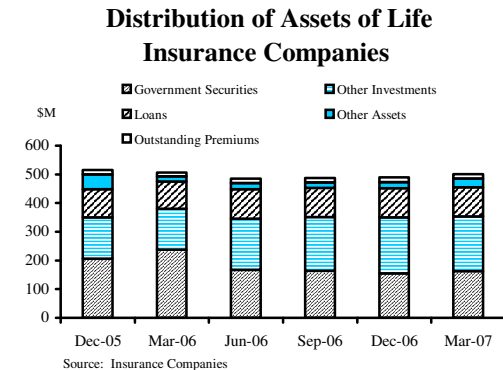
The combined insurers' **assets**, declined marginally to \$721.9 million on account of a reduction within the life insurers holdings, which comprise the bulk (69.3%) of total industry assets.

Total assets of the life insurance industry decreased slightly by 2.0 percent to \$500.4 million in the March 2007 quarter (March 2006: \$510.4m). Holdings of Government securities declined by \$30.9 million to \$162.5 million over the year. This is because life insurers were required to produce a fair value on their investment holdings, with the introduction of International Financial Reporting Standards (IFRS) and at a time when interest rates were high (Graph 46).

Graph 45



Graph 46

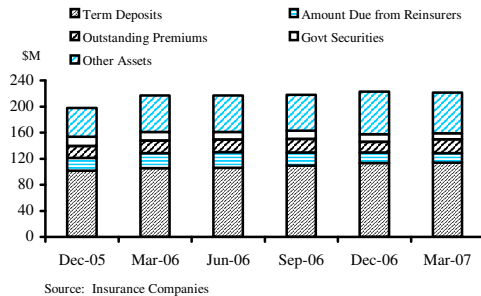


The distribution pattern of assets remained consistent. Government securities continued to dominate the asset base of life insurers at 32.5 percent of total assets, followed by loans to policyholders (20.0%) and property (13.0%). Of total loans, 99.9 percent are secured.

A marginal growth of 2.0 percent was reported in total assets for the general insurance sector over the year to \$221.5 million (Graph 47).

Graph 47

Distribution of Assets for General Insurance Companies



The majority of the assets continued to be tied up in investments, comprising 67.5 percent of the general industry assets (\$221.5m). Bank deposits accounted for the largest percentage of investments at \$114 million (76.2% of total investments) compared to \$139.4 million in 2006.

The other major assets include outstanding premiums, amounts due from reinsurers, government securities, shares in related persons and cash on hand.

All insurers satisfactorily complied with the **reinsurance** requirements indicating that their reinsurance arrangements are in place and assessed to be adequate.

The insurance industry recorded a growth of 1.0 percent in combined life and general insurer **liabilities** (excluding shareholders funds) to reach \$625.5 million. This was underpinned by the growth in the life insurers' balance of revenue account which continues to form the bulk of insurance industry liabilities at \$456.6 million (3.0 % of total liabilities).

After providing for tax of \$1.9 million, the industry reported an overall **after tax profit** of \$11.0 million in the 2007 March quarter, a significant improvement on the 2006 performance. The overall net profit emanated primarily from the positive underwriting performance by the life insurance industry as well as favorable investment returns.

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

Insurance Brokers

The insurance broking industry's total earnings for the first quarter of 2007 stood at \$2.7 million, a marginal drop compared to the same period in 2006.

Brokerage earned as commission continued to be the major revenue for the broking industry. Commissions increased from \$2.56 million in the March quarter 2006 to \$2.59 million in the comparable quarter in 2007.

Total expenses rose by 15.0 percent to \$1.9 million. The composition of total expenses remained almost consistent with 'other expenses' and salaries and wages accounted for 46.0 percent and 41.0 percent of total expenses, respectively.

This resulted in the reduction of the industry's overall after tax profit by 28.0 percent to \$0.7 million. However, it increased by 58.0 percent over the December 2006 quarter.

The aggregate amount outstanding in the insurance broking account amounted to \$5.5 million, up by 41.0 percent from \$3.9 million in 2006. The growth was due to the rise in total monies received coupled with the reduction in total monies withdrawn.

The Reserve Bank of Fiji processed 142 offshore applications amounting to \$6.6 million compared to 116 offshore

approval amounting \$8.9 million in the corresponding quarter of 2006.

Outlook

With the contraction in the Fiji economy this year, insurers have become more vigilant with regard to the types of businesses they underwrite, by increasing their risk analyses and maintaining adequate reinsurance arrangements. Insurance companies are expected to continue improving and/or developing their risk and asset-liability management frameworks to ensure they maintain stability and remain profitable and solvent.

For the Record**RESERVE BANK OF FIJI 2006 INSURANCE ANNUAL REPORT**

Statement by the Governor of the Reserve Bank of Fiji, 25 July 2007

The Minister for Finance, National Planning and Sugar Industry, Mr. Mahendra Chaudhry tabled the 2006 Insurance Annual Report in Cabinet on 24 July 2007.

The report includes a review of the performance of the Fiji Insurance Industry for the year ended 31 December 2006. The report also highlights the developments in the international insurance market.

The Governor of the Reserve Bank, Mr. Savenaca Narube, in highlighting the developments in the international insurance market said that 2006 was a year free of major disasters, compared to 2005, in which the global insurance market was hit by a number of major natural disasters which impacted the cyclone and flood insurance market, where premium rates rose. The international insurance and reinsurance companies recorded good performances resulting in the growth in their balance sheet and capital base in 2006.

Mr. Narube said the domestic insurance market also performed well in 2006, where the gross premium pool grew to

\$194 million. The domestic market continued to grow on the back of a soft international market with premium rates held at affordable levels. However, despite the overall good performance, the market faced some challenges. The introduction of the new international financial reporting standards had a significant impact on asset revaluation of life insurance companies which were required to produce fair values of their long-term investment holdings. This saw a fall in asset values that resulted in a reduced solvency surplus. At the same time, the performance of the general insurance market was mixed, with a number of insurers performing exceptionally well, whilst others were affected by changes in the level of technical provisioning and adjustments to assets.

Governor Narube further stated that the Reserve Bank continued to hold consultations in 2006 with the insurers and brokers to ensure they comply with the legislative and policy requirements. Looking ahead, the Reserve Bank intends to continue developing the policy environment and move towards enhancing its supervision based on sound risk assessments.

For the Record

REVISED ECONOMIC PROJECTIONS

Statement by the Governor of the Reserve Bank of Fiji, 27 July 2007

The Chairman of the Macroeconomic Policy Committee and Governor of the Reserve Bank of Fiji, Mr Savenaca Narube, today announced that, “The economy is now projected to contract by 3.1 percent this year, compared to the 2.5 percent economic decline expected earlier. All sectors, except manufacturing and mining, are now envisaged to record lower-than-expected performances, which have resulted in the relatively larger economic contraction.”

Elaborating on the projected economic contraction, the Chairman highlighted that “Lower spending for the community, social & personal services sector which is measured by the Government operating expenditure and the stalling of certain major projects are the major contributors to this year’s economic decline. Additionally, the fall in visitor arrivals so far this year and the on-going discounts provided by hoteliers will have a flow-on effect in the wholesale & retail trade and hotels & restaurants and transport & communication sectors. Moreover, the mining & quarrying sector is not expected to register any output in 2007, following the closure of the Vatukoula gold mine late last year.”

The Chairman added that, “On a positive note though, the finance, insurance, real estate & business services; manufacturing; agriculture, forestry,

fishing & subsistence and electricity & water sectors are anticipated to contribute positively to growth in 2007, although at a level lower than previously estimated. The agriculture sector’s growth has been affected somewhat by the flash floods and a cyclone in the earlier part of this year.”

According to Mr Narube, “Growth projections for 2008 to 2009 have also been revised. The economy is now projected to grow by 1.9 percent in 2008, largely on the back of an expected recovery in the tourism industry next year. Economic growth in 2009 is expected at 2.8 percent with the finance, insurance, real estate & business services sector expected to lead growth. Notably, the benefits of the sugar industry restructure are factored in 2009, contributing to the projected strong performance of the agriculture, forestry, fishing & subsistence sector in that year. As for 2010, the economy is anticipated to expand by 2.9 percent.”

On trade projections, Mr Narube highlighted that, “Imports (excluding aircraft) are now projected to decline by 2.1 percent this year, following a growth of 13.8 percent in 2006. This is a reflection of a combination of factors – the economic downturn this year and the tighter fiscal and monetary policies. Nevertheless, the country’s export performance remains weak with exports

(excluding aircraft) projected to contract by 2.6 percent in 2007. ”

equivalent to around 3.5 months of imports of goods”.

Mr Narube stated that, “Official foreign reserves at the end of June were at adequate levels of \$859.9 million,

The Macroeconomic Committee will revisit these projections for announcement in the 2008 National Budget.

For the Record

RESERVE BANK ANNOUNCES CHANGES TO EXCHANGE CONTROL POLICY

Statement by the Governor of the Reserve Bank of Fiji, 04 September 2007

The Reserve Bank has made changes to the exchange control policy it announced in March with regards to local borrowing by non-resident companies and individuals.

These changes were the result of consultations with commercial banks, the private sector and other stakeholders.

The amended policy which comes into effect from 1 January 2008 is as follows:

1. Foreign owned companies will now be allowed to borrow locally up to a certain percentage of their total borrowings based on their shareholding structure under the debt to equity ratio guideline of 3:1. The following will apply to all new borrowings by non resident companies:

- 51% - 70% non-resident ownership - upto 75% local financing

- 71% - 90% non-resident ownership - upto 65% local financing
- 91% - 100% non-resident ownership - upto 50% local financing

2. Non-resident individuals will be required to fully finance from offshore purchase of properties except those in approved tourism related projects.

The Governor of the Reserve Bank Mr Savenaca Narube said “The earlier intention of requiring 100 percent non-resident owned companies to refinance half of their existing local borrowing from abroad has been relaxed. I believe that these changes go a long way to address the concerns that we have received but at the same time continue to support the Reserve Bank’s monetary policy aimed at safeguarding our foreign reserves position.”

Details of these measures are available from the Reserve Bank and commercial banks.

**ECONOMICS ASSOCIATION OF FIJI PRESENTATION:
THE FUTURE OF ECONOMIC PARTNERSHIP AGREEMENTS WITH THE
EUROPEAN UNION. WILL THEY BE GENUINELY
DEVELOPMENTALLY POSITIVE?**

The Economics Association of Fiji held its first Forum on 22 August 2007 at the Reserve Bank of Fiji Building. The guest speaker for the first meeting of this year was Dr Roman Grynberg, the Director for Economic Governance at the Pacific Islands Forum Secretariat, Suva. An abridged version of Dr Grynberg's speech is provided below.

The Economic Partnership Agreement (EPA) as envisioned by our Island ministers will help facilitate the very substantial changes and adjustments that the Pacific Islands need to make in order to fully integrate in the changing globalised world we live in. It was always expected that the EPA we are currently negotiating would be important instruments that would facilitate the change and foster our sustainable development and the eradication of poverty.

It is important to note that the EPA is a negotiation and hence it is a mechanism whereby differences between two parties are expected to be resolved. Often the process appears adversarial even when it is between two partners that have such a long historic relationship as the European Union (EU) and the Pacific Islands. In the end, despite differences it is our firm hope that compromise will be reached but this can only be assured if both parties approach the process with an open mind and in a spirit of compromise and flexibility.

The Pacific began the EPA negotiations in 2000 after seriously addressing the question of what the region felt was needed to make a trade agreement that suits our unique situation. That unique situation stems from fundamentals that have to be understood by our partners. Only some five years ago, the Pacific Island countries embarked on the very first steps of their own economic integration through Pacific Island Countries Trade Agreement (PICTA). It is an integration that is at best fragile and highly vulnerable and could easily be undermined by an ill-conceived trade agreement.

The EU has said, and we largely accept this at face value, that the EPA is primarily to help regional integration, and ostensibly not about EU commercial interests. In the eyes of the EU, regional integration creates a bigger market and is good for their exporters and, in our opinion is also good for the Pacific. Yet an EPA which focuses only on trade in goods, for example would be of no interest to Niue or Tuvalu which largely do not trade in goods. An agreement that just gives labour market access will be of no interest to the Federated States of Micronesia (FSM), Marshall Islands, Palau, Cooks and Niue for that matter. Fisheries is of minor interest to those Pacific and Pacific African Caribbean Pacific (PACP) countries outside the tropical convergence zone but of great interest to Papua New Guinea (PNG) with its huge export potential for canned tuna

and for all the Parties to the Nauru Agreement countries. An EPA would be of great benefit to FSM, for example, because it would be the only country in the region that has relatively abundant fresh water and tuna and would have simultaneously duty free access to the United States and EU tuna markets. Thus, what appears from Europe or from the perspective of other trading partners as a Pacific EPA which is 'hopelessly ambitious' is quite the opposite; it is in fact the bare minimum that is needed to keep the region's interest in these negotiations. Pull elements of the EPA out and the balance of benefits falls apart and the EPA will only be of benefit to a limited number of countries. It is easy to divide the Pacific, we have vastly different cultures and economic interests, it is much harder to craft an agreement that strengthens our regionalism. Thus, what the Pacific has demanded is an EPA that will strengthen and support our integration and allow genuinely sustainable development.

We have five key negotiating objectives;

1. Improved market access for goods
 - a) Rules of origin
 - b) Duty and Quota free access
2. Market access for Pacific ACP service suppliers - our current areas of interest include:
 - a) Seafarers
 - b) Careers and health sector service providers
 - c) Hotel and Tourism service providers
 - d) Construction service suppliers
3. An agreement on Investment that helps the development of Small & Micro Enterprises
4. A multilateral fisheries agreement that includes access
5. An EPA Adjustment Facility

It should not be forgotten that this is a trade negotiation and what we will be giving the EU is duty free access to our markets for substantially all exports. Even though this may be of no commercial value to large EU firms it is major challenge for the PACP. Under the Cotonou Agreement, virtually all of our exports enter the EU duty free already, so what the EPA provides is the existing duty free access for all Pacific exports to the EU.

At the beginning of our negotiations with Europe what we tried to impress on the European Community (EC) is the fact that many of our countries would be unwilling to sign an EPA in goods because they do not trade in goods and therefore do not stand to benefit. The EU accepted this position and the related position that all Pacific countries trade in services, and hence services would be the basis of the EPA negotiations. As a result, the one area where there has been substantial progress is in the so-called architecture of the agreement. Those countries wishing to sign a goods agreement or even a services agreement can do so. Those not wishing to do so are free to opt out.

Unfortunately, in the other substantive areas, the Pacific has not experienced a similar spirit of compromise and flexibility from the EU as we have found on the issue of architecture. The Pacific ACP trade officials and the staff at the Forum Secretariat have worked very hard to develop a positive agenda with specific positions on virtually every issue in the negotiations. We have developed a draft EPA text of which we are quite rightly proud and which we gave to the EU many months ago. We are virtually ready with both goods and services offers. We have also prepared a draft services request.

Thus, almost all the technical work is complete for us to sign an EPA by the 31st December 2007.

The EC has said that it is willing or has already addressed all of these issues. This is correct, but the devil is very much in the detail. The rules of origin will be simplified (likely to a system based on value addition that will never allow us to export), we will get duty free quota free access for all of our exports except a few sensitive products (e.g. sugar, where Fiji and PNG could benefit). The EC is willing, at this point, to make offers on temporary movement (for Information and Communication Technologies but for six months, and certainly not as yet for our construction sector suppliers for 3 years). The EC is happy to address investment by which is meant that we would make market opening commitments but there would be no reform of dysfunctional and antiquated Cotonou private sector instruments such as the European Investment Bank. The EC is willing to discuss fish, i.e. management and rules of origin, but not access for which 'there is no mandate'. And lastly, the EC has said that all adjustment costs and aid to the

ACP for the EPA must be covered by the existing instruments under Cotonou, except for sugar of course where there is more money (and fish where the EC has a commercial interest and there is more money).

Nothing has changed in the stance in the Pacific towards the EPA - we are completely committed to concluding the EPA by 31st December 2007. Whether this is in fact achievable rests almost completely with the EU. We have done our technical work, we know what we want and we are prepared to negotiate. If the EU begins to negotiate on core issues of concern to the region, then meeting the deadline for an EPA is still possible. But as yet the EU has not even completed its own internal consultations on vital market access issues and we are supposedly far from completing negotiations. As yet the Commission had no firm internal position on rules of origin and there is no internal agreement on temporary movement of people. It is time for the EU to accelerate its internal consultations and show greater commitment and flexibility in negotiations otherwise we will not be able to close on time and it will not be the Pacific's fault.

**ECONOMICS ASSOCIATION OF FIJI PRESENTATION:
DIAGNOSING CONSTRAINTS TO ECONOMIC GROWTH FOR
FIJI AND ITS POLICY IMPLICATIONS SINCE POLITICAL
INDEPENDENCE: 1970-2003**

The second Economics Association of Fiji Forum was held on 11 September 2007. The guest speaker at this session was Mr George Niumataivalu, the Director for Kontiki Capital Limited and Kontiki Growth Fund. A summary of Mr Niumataivalu's presentation is provided below.

My presentation¹ tonight is based on Harvard's Professors Rodrik and Hausmann heterodox method² of diagnosing constraints to economic growth using decision tree analysis. In their paper, they developed a framework used to analyse and formulate growth strategies following a careful diagnosis of constraints to economic growth. The ultimate aim of the framework rests upon identifying factors that constrain countries from achieving higher economic activity. Hence, policy making resources are better positioned in alleviating binding constraints to achieve the most cost-effective outcome for achieving sustainable economic growth. According to the World Development Report titled *Economic growth in the 1990s – learning from a decade of reforms*, “Sustained growth depends less on whether policies conform to some ideal than on whether they identify binding constraints accurately and address them effectively” (page 80). The report goes on to prescribe that “Key functions to be fulfilled in

sustained growth are the accumulation of capital, allocative efficiency, technological progress and the sharing of the benefits of growth” (page 83).

Progressing from the Keynesian and Malthusian models for growth, this new insight focuses mainly on what are the most binding constraints to economic growth rather than actively trying to push the production possibilities frontier outward and its accompanying problems of capital versus labour constraints that normally result in unemployment or misguided spending.

First, it is recognised that higher growth rates are essential (although not sufficient) for achieving improvements in social and human indicators. Reform strategies should then be focused on ensuring sustainable growth rates, since it is through this basic precept that an economy ensures adequate returns to economic activity, social development and an improvement in the welfare of its citizens. Secondly, it is almost impossible to come up with identical growth strategies for all countries. While some general abstract principles are desirable in all countries (property rights, rule of law, market-oriented activities etc), blending them together to attain desirable growth objectives requires considerable understanding of local specificities.

¹ The full paper can be obtained by contacting the author on e-mail at grln888@gmail.com.

² Hausmann, R., Rodrik, D. and Velasco, A (2005), “Growth Diagnostics”, Harvard University.

Thirdly, a laundry list method of reforming an economy that was based on the so-called Washington Consensus³, has not resulted in sustainable economic growth for countries that embarked on it; most notably the Latin American Countries. Parts of this laundry list approach were also applied to Fiji in the 1980s and 1990s, as this was the reform structure that was promoted by the World Bank and the International Monetary Fund during this period.

The conceptual framework involves the use of decision tree analysis to ask a progressive line of questioning of an economy's performance over time to then derive a profile of an economy based on deductive reasoning and a process of elimination – that will finally identify the most binding constraints to economic growth. Questions such as: What keeps growth low? According to Professors Rodrik and Hausmann, the decision tree redirects the matter into a wide variety of propositions such as;

“Is it inadequate returns to investment, inadequate private appropriability of the returns, or inadequate returns to finance? If it is a case of low returns, is that due to insufficient investment in complimentary factors of production (such as human

capital or infrastructure)? Or is it due to poor access to imported technologies? If it is a case of poor appropriability, is it due to high taxation, poor property rights and contract enforcement, labour-capital conflicts, or learning and coordination externalities? If it is a case of poor finance, are the problems with domestic financial markets or external ones? And so on.”

Now we turn to our local economy and observe our growth path. It is clear that the trend is far from steady growth and convergence with benchmark countries (such as Jamaica, Vietnam, Thailand, Botswana, Dominican Republic) has not been occurring. Note that these countries were carefully chosen as an important stage in the diagnosis process to ensure that reasonable comparative analysis can be made between Fiji and these countries. The question then we ask is; What is constraining Fiji's economic growth?

In using the decision tree analysis, we identify a variety of factors that may restrain a country from attaining growth in economic activity.

Is it poor infrastructure? We can all agree that the state of ports and roads could be better. Transport costs are high. Energy, Water and Telecommunications industries are highly monopolised and regulated. Is it a binding constraint? Yes, since it is well recognised that appropriate infrastructure is critical in a growing economy as evidenced from capital expenditure as a percentage of GDP for growing economies.

Is it low human capital? Country comparisons on Human Development Index and average secondary school enrolment revealed no major differences from the benchmarked countries.

³ Washington Consensus was coined in the 1980s to describe what had become the US Administration's laundry list of fixes in reforming especially Latin American Countries which required the International Monetary Fund/World Bank funding to fix their economies. This laundry list of reforms included: tax reforms, structural reforms, institutional strengthening, trade liberalisation, privatisation, fiscal discipline, legal security for property rights, disciplined monetary policies and other measures – some of which were also implemented in Fiji during this period and thereafter. Refer to internet reference for a more detailed explanation at http://en.wikipedia.org/wiki/Washington_Consensus cited 30/10/2007.

Comparisons based on years of education for population of those above 25 years old ranked Fiji higher among those countries. Is it a binding constraint? No, yet this is nonetheless alarming since it infers that returns to education for Fiji are very low in relation to returns to economic activity in general. Policy questions that may arise include: are we providing the appropriate kind of education and training that is targeted to growing our economy in the future? Is this leading to self-discovery as a key element of sustained economic growth?

Is it low domestic savings? Country comparisons revealed a lower real interest rate and its spread for the year 2003. Mauritius and Jamaica for instance had higher interest rates and spread than Fiji. Yet our investment ratio for the period 1993-2003 was the lowest amongst all other countries compared. Is it a binding constraint? Yes, since investment (external and domestic) are key factors in higher returns to financial returns and economic activity.

Is it poor intermediation? Our financial sector is competitive. International Banks are operating domestically ever since for quite sometime. However, capital markets are developing but at a slow rate. Is it a binding constraint? Yes. Again questions such as: is there sufficient capital mobility and liquidity within the economy to trigger the risk/return criteria that drives economic activity? Is capital being mobilised to its most optimum location? Is the financial sector an effective allocator of capital, that also includes Fiji's developing capital markets?

Is it poor international finance? There has been barely any access to international capital markets to finance current account deficit. This could have been due to

difficulty in obtaining international finance considering Fiji's credit risk classification. At the same time, capital flows is controlled by the central bank. Is it a binding constraint? Yes.

Is it a lack of self discovery? There is little research and development on new products. This is perhaps due to inadequate protection framework in place such as patents in the country to ensure the inventors receive desired benefits of their work. There is also lack of dynamism in our already underperforming non-traditional exports. Is it a binding constraint? Yes.

Is it too much corruption? Country comparisons on the rule of law indicator and corruption perception index showed that Fiji is rated similar to most benchmark countries albeit significantly lower than Australia, the United States, Mauritius and Botswana. Is it a binding constraint? Yes.

Is it too much taxes? Fiji's average tax income as percentage of GDP is higher than other benchmark countries, while at the same time, our interest rates and investment ratio are low comparatively. Various modelling often show that reduction in tax rates is often associated with great responses to growth. Is it a binding constraint? Yes.

In conclusion, Fiji's economic growth is constrained mainly by the lack of investment (Foreign Direct Investment and domestic) which is essential for capital formation, accumulation and mobility. This diagnosis has shown that Fiji exhibits the characteristics of an "under-investing" state. Policy makers hence should ensure more investment incentives are attractive enough to start the process of capital mobility and

accumulation. In addition, policies must also be geared towards improvement in financial sector and capital market efficiency as allocators of capital. Our human capital must be mobilised to ensure that we self-discover, that we improve our productivity, and that we increase our returns to education and to productive capacity. These are important steps in defining a new paradigm, and political will is a critical ingredient for ensuring that these changes occur. In a globalised world, where there is a looming energy crises on the horizon, Fiji has to act now to be able to ensure a semblance of control in what international relations defines as a “anarchic world”. Fiji can focus on key areas such as improving its manufacturing base; incentivising small businesses as key components of any modern economic growth strategy; improving liquidity and even running a deficit to reduce unemployment but improve consumption since globalised economies are now

concentrating more on urban centers as the basis for economic growth. It is from urban centers that any sustainable long term economy recovery and growth will emanate since this is where consumption will be located as typical of an economy that is integrated to the globalised economy.

In concluding, past focus on a “laundry list” of remedies for economic recovery and growth have been found to be a waste of valuable scarce resources for developing countries. The failure of the Washington Consensus, especially in a more globalised economy, means that a new paradigm for economic growth must be defined. It is thanks to Professors Rodrik and Hausmann of Harvard University, that a methodology has emerged that offers a critical path to sustained economic growth rather than one of “hit and miss”. Fiji will do well to not re-invent the wheel in this regard.