

# Fiji Islands

## Economic Assessment

The economy is projected to grow at 4.1% in 2004, compared with an original *ADO 2004* forecast of 3.9%. This upward revision reflects an unexpectedly strong stimulus from tourism in the first two quarters of the year (Figure 2.18). The midyear introduction of new air services from Australia and New Zealand is expected to underpin continued expansion in tourism in the latter half of 2004 and thereby further stimulate the trade, restaurants and hotels, and transport and communications subsectors. A relatively strong performance is also anticipated in the community, social, and personal services subsector, with the services sector as a whole projected to contribute 2.4 percentage points to the aggregate growth rate for 2004.

In contrast, figures for the primary sector have been revised downward. Sugarcane production is likely to fall, while noncane agricultural production was damaged by flash flooding in major growing areas in April. Fisheries production is expected to stay subdued, with a new Fisheries Management Bill intended to monitor and control catches. The small forestry subsector is forecast to grow at a historically high rate, though from a small base. Mining production in 2004 is being ramped up as a result of the expansion program at the Emperor Gold Mine, with maximum production to be achieved in 2005. The primary sector is projected to contribute 0.4 percentage points to aggregate growth in 2004.

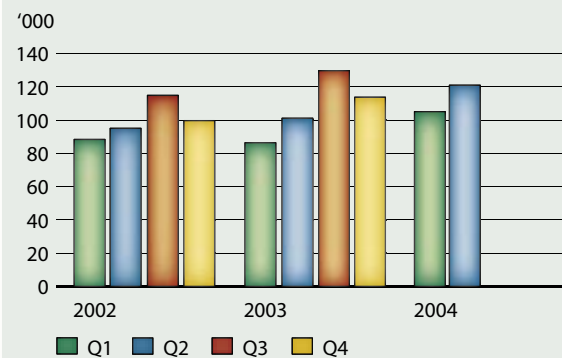
Growth in the secondary sector, i.e., manufacturing, construction, electricity, and water, has also been revised downward, and is expected to contribute 1.3 percentage points to the aggregate GDP figure. This revision primarily reflects midyear sugar mill breakdowns that have hampered crushing. Production in the clothing and footwear subsector was virtually stagnant in the first 5 months of 2004, but is likely to increase

and register some positive year-on-year growth. As envisaged, construction has expanded significantly, with a range of private and public sector investment projects completed or initiated. Private business will drive much of the activity in this subsector during the second half of 2004. The electricity and water subsector is growing modestly.

Labor market conditions have improved somewhat. In the year to end-June 2004, the number of new registered taxpayers rose by 6% from the year-earlier period, with the vast majority of new jobs generated in the services sector. Employment surveys have also shown a higher volume of job advertisements, and employers are expected to create more jobs while wage increases remain moderate and are limited to a few sectors, including pay increases of 1% for civil servants in February and 5% for transport workers in March. However, the demand for skilled labor is unlikely to be met in full by domestic supply, as emigration continued in the first 5 months of 2004, albeit at a slower rate than previously.

On the demand side, stronger employment has benefited private consumption as evidenced by a substantial rise in VAT revenue and bank

Figure 2.18 Quarterly Visitor Arrivals, Fiji Islands, 2002–2004



Source: Reserve Bank of Fiji, *Quarterly Review*, June 2004.

**Table 2.20 Selected Economic Indicators, Fiji Islands, 2004–2005, %**

Item	2004		2005	
	ADO 2004 Update	ADO 2004 Update	ADO 2004 Update	ADO 2004 Update
GDP growth	3.9	4.1	3.0	3.2
Inflation (CPI)	3.0	3.0	3.0	3.0
Current account/GDP	-6.6	-6.0	-9.6	-8.8

Source: Staff estimates.

lending to individuals during the January–May period. Investment spending has also been relatively buoyant, mainly due to revived construction activity. Overall business confidence seems to have improved, but it remains to be seen if the long-term decline in the investment-to-GDP ratio has bottomed out.

The 2004 budget targeted an overall deficit of 3.9% of GDP (before asset sales), to be financed by domestic borrowing. Preliminary data show a budget surplus equivalent to 0.2% of GDP in the first 4 months of 2004, suggesting that the Government is on track to achieve or possibly exceed its target. Capital expenditure has been well below the budgeted level, but is forecast to pick up. Operating expenditure has been broadly in line with budget forecasts, largely because the public sector wage bill has remained under control. At the same time, revenue collection has exceeded expectations, partly because of improved coordination between the tax and customs authorities. At end-June, the Government's domestic debt stood at 42.6% of GDP, down from 44.7% at end-2003.

Annual inflation in the year to June 2004 was 2.7%, in line with the *ADO 2004* forecast of 3.0% for the calendar year. Some upward pressure on prices has been exerted by food shortages following the April floods, and there may be further pressure if oil prices stay high. The nominal and real effective exchange rate indexes of the Fiji dollar have both risen marginally in 2004, leading to a slight deterioration in the country's international competitiveness. In the first 7 months of the year, the local currency appreciated by about 2% against the US dollar.

Broad money declined during the first 5 months of 2004 because of a drop in net foreign assets. Domestic credit growth was dominated by

increased private sector credit, with commercial banks lending quite heavily to individuals seeking housing finance. The trade, construction, business services, and public sectors have also borrowed more, whereas lending to agriculture and utilities has fallen. The commercial banks' weighted average lending rate fell to 7.17% by May 2004, while rates on savings fell to 0.36% and rates on time deposits rose to 1.72% at that time. Consequently, the interest rate spread narrowed slightly, while real interest rates on deposits remained substantially negative.

The export performance of the first 5 months of 2004 was disappointing vis-à-vis the year-earlier period. Reexports and exports of sugar, garments, mineral water, and fish all declined. Imports slid even further as a result of reduced imports of intermediate and investment goods. The resultant narrowing of the trade deficit, though somewhat offset by higher inflows on the services account due to tourism, helped reduce the current account deficit. By end-June 2004, foreign reserves covered the equivalent of 3.2 months of imports of goods and nonfactor services.

### Policy Developments

The key macroeconomic policy development in 2004 has been a tightening of monetary policy, introduced at end-May. The official interest rate (the rate on 91-day Reserve Bank notes) was raised from 1.25% to 1.75% to restrain burgeoning consumer spending which, in the monetary authority's assessment, was threatening to create unsustainable pressure on the balance of payments. The Reserve Bank has emphasized the need for an improved export performance if recent economic growth is to be sustained, but has not indicated any intention to review the exchange rate policy. (As anticipated, measures to relax exchange controls were introduced from January.) In a midyear economic symposium, the Government, too, underlined the need for faster private sector-led export expansion, and reiterated its commitment to the development objectives and policies enunciated in the current strategic development plan, and to the 2001–2020 plan aimed at enhancing the participation of Fijians in the economy.

With regard to the key issue of investment promotion and achievement of an investment-to-

GDP ratio of 1:4, the Government has amended foreign investment legislation and formulated accompanying regulations intended to streamline the approval process for foreign investment. The business community is awaiting the outcome of an associated review of the list of potential investment areas restricted or reserved for nationals.

In general, rather than exchange rate adjustments, factors such as infrastructure quality, reliability and price of utilities, availability of skilled labor, and efficiency of public administration are the major determinants of the country's competitiveness.

The early months of 2004 have seen progress on another key issue—restructuring the sugar industry. A new board has been appointed to reform the Fiji Sugar Corporation. The Indian Government is providing technical assistance and a concessionary loan to expand sugarcane cultivation and to improve the transport and milling systems. The aim is to make the industry internationally competitive after the renegotiation of the European Union Sugar Protocol in 2007, which will lead to a significant reduction in prices for sugar from the Fiji Islands. In the matter of fundamental land issues, a bipartisan committee of politicians is due to report in September 2004, while the Government is reviewing the legislation governing landowner-tenant relations in the hope of resolving long-standing tensions in this area.

### Outlook for 2004–2005

The services sector is expected to drive the economy in its fourth year of brisk economic expansion since the 2000 coup, with the construction sector playing a crucial auxiliary role. In 2005 and broadly in line with the *ADO 2004* projections, growth is forecast to slow to 3.2%, with the services sector contributing 2.2 percentage points to this outcome. The secondary sector is projected to contribute a lower 0.6 percentage points as construction activity decelerates with the completion of several large projects. Garment producers will struggle to adjust to greater international competition when the MFA quota in the crucial US market expires at end-2004, though a more severe adjustment scenario has been avoided with the recent 7-year extension of duty-free access to the Australian

market. Sugar production is expected to pick up slowly as transport and milling problems are gradually solved, while mineral water production is likely to show the benefits of the 2004 investment program. The growth projection for the secondary sector may turn out to be conservative if garment producers secure new markets and sugar restructuring is accelerated.

The primary sector is projected to contribute 0.4 percentage points to growth in 2005. Little improvement is foreseen in the agriculture and fisheries subsectors, though the forestry subsector could expand significantly if the country's mature mahogany forestry resources are commercially exploited. Output from gold mining is expected to grow relatively fast.

Economic expansion in the 3–4% range will generate essential growth in formal sector employment of about 2% a year, but this is insufficient to fully absorb the annual net increase in the labor force. Many job seekers will be forced to enter the informal sector or become openly unemployed. Additionally, former tenants of sugarcane land are likely to join the labor market, and the garment industry may resort to redundancies. Clearly, such events would strain the Government's capacity to address poverty. Already, about 10% of the population live in squatter settlements in the Suva-Nausori corridor, and fiscal constraints have limited the scope of poverty reduction programs.

Macroeconomic stability is expected to be maintained through 2005 as the Government continues to rein in the budget deficit and adheres to a cautious monetary policy stance. However, the official projection of a budget deficit of 0.8% of GDP in 2005 appears overoptimistic, since it relies on a fall in nominal operating expenditure that will be difficult to achieve. Inflation is projected to remain at around 3%, while the nominal effective exchange rate is likely to appreciate marginally. There is considerable uncertainty surrounding balance-of-payments projections, given the lack of timely and reliable data, and the difficulties facing the sugar and garment industries.

Growth in gold, mineral water, and timber exports, combined with tourism expansion, will boost foreign exchange earnings, though the current account deficit is likely to widen as imports pick up from their 2004 level.