

Fiji Islands

Downturns in key industries, tightened monetary and fiscal policies, and weakened business confidence following a military coup in December 2006 caused the economy to contract in 2007. Foreign reserves stabilized, but the balance of payments remained weak. Prospects depend on the interim Government's ability to meet a timetable for elections in 2009, to ensure fiscal sustainability, and to promote private sector development. Modest growth is expected in 2008 and 2009.

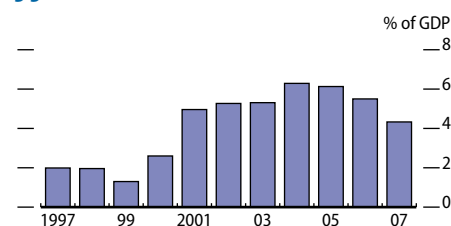
Economic performance

All major sectors of the economy weakened in 2007, after a military coup in December 2006 that led to the installation of an interim administration. Export income and business confidence fell and macroeconomic policies were tightened, resulting in an estimated 3.9% contraction in the economy. Active marketing and discounting kept the decline in tourist arrivals to 1%, but steep discounts offered on air fares and accommodation cut tourism earnings by an estimated 14%. A 20% fall in remittances (Figure 3.31.1), which have grown to be the second largest source of foreign exchange earnings, contributed to the malaise.

A weaker services sector accounted for much of the contraction in GDP (Figure 3.31.2). Activity slipped in wholesale and retail trading, hotels and restaurants, transport and communications, finance, and community services. Industrial production contracted as well, because the country's only gold mine closed in late 2006, bad weather reduced the output of sugar mills, and the clothing industry continued to decline after the loss of preferential access to some export markets. Construction activity dropped by almost 15% as major projects were completed and a loss of investor confidence and the macroeconomic tightening slowed new project development. A decline in sugarcane production led to an overall weakening in agriculture. The only area to achieve noticeable growth was the export-focused mineral water business.

The interim administration, faced with revenue shortfalls in a contracting economy and a high public debt burden, slashed outlays. It cut the civil service wage bill over the year by 9.7%, public spending on goods and services (including maintenance) by 28.2%, transfer payments by 15.9%, and capital expenditures by 44.8% (Figure 3.31.3). Total expenditures fell by 14.2% in 2007 and were 22% below the budget estimate. Even though revenues fell 15.5% short of target, the spending cuts swung the budget into surplus by an estimated 0.4% of GDP. As for public debt, the authorities consider it has reached an unsustainable level. Total public debt at end-2007 was F\$2.8 billion, or 50.3% of GDP, up from 40.8% in 2000 and well above an official target of 45%. Domestic

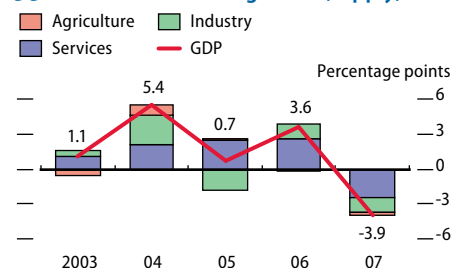
3.31.1 Private remittances



Source: Reserve Bank of Fiji.

[Click here for figure data](#)

3.31.2 Contributions to growth (supply)



Note: Official projection for 2007.

Sources: Fiji Islands Bureau of Statistics, *Key Statistics*, June 2007; Ministry of Finance, National Planning and Sugar Industry, *Economic and Fiscal Update: Supplement to the 2008 Budget Address*, November 2007.

[Click here for figure data](#)

debt accounted for 86.2% of the total and external debt for 13.8%. External debt servicing was an estimated 3% of exports last year. In addition to this debt, the Government bears sizable contingent liabilities, largely with respect to guarantees for state-owned enterprises.

The Reserve Bank of Fiji, acting to protect shrinking foreign exchange reserves in late 2006, tightened exchange controls. It also increased interest rates on its lending to commercial banks, imposed ceilings on lending to the private sector, and in March 2007 tightened capital controls. Monetary policy was eased later in the year: the Reserve Bank reduced the commercial bank reserve-deposit ratio (in May) and slightly relaxed exchange controls (from October). However, the credit ceiling remained in place, with exceptions for export businesses and some others. Growth in broad money supply (M2) slowed to 10.4% in 2007, from 19.8% in 2006. Credit to the private sector rose by just 2.3% over the 10 months to October 2007, the slowest rate in 5 years (Figure 3.31.4). The easing of monetary policy, combined with declining demand for funds, prompted a sharp drop in short-term interest rates over the year (Figure 3.31.5), while longer-term rates softened slightly.

Available balance-of-payments estimates suggest that import growth in nominal United States (US) dollar terms decelerated from 12.8% in 2006 to 1.8% in 2007 as the economy contracted, while exports fell by 0.8%, with fish, lumber, and mineral water the only exports of any importance to increase significantly. Balances on the income and current transfer accounts improved in 2007, and the current account deficit narrowed to an estimated 19.6% of GDP from 21.1% in 2006. The overall balance of payments registered a surplus of 0.7% of GDP.

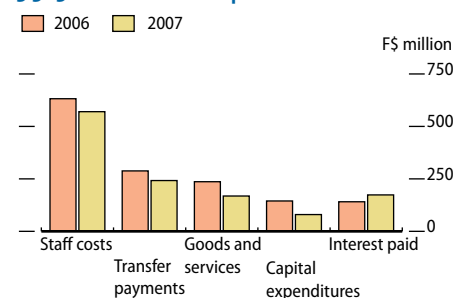
Foreign exchange reserves were rebuilt by about US\$89 million to US\$618 million (4.3 months of import cover) owing to a combination of the fiscal contraction, monetary tightening early in the year, and the weakening in private sector demand associated with the economic downturn. These effects more than offset declining exports and tourism receipts. Nominal and real effective exchange rates of the Fiji dollar appreciated by 0.2% and 2.4%, respectively, in the first 9 months of 2007, but the terms of trade continued to worsen. The central bank adhered to its policy of maintaining the exchange rate peg against a basket of currencies.

Inflation accelerated to 4.8% in 2007, nearly double the 2006 rate. Increased excise duties in early 2007 had a one-time upward impact on prices. Rising world oil prices pushed up transport and electricity costs, though a greater contribution from hydropower after good rainfall, and the continuation of oil supply contracts at pre-2007 prices, mitigated the full impact.

Economic prospects

The outlook depends heavily on the interim administration pushing ahead with proposed economic reforms and adhering to a timetable for national elections in 2009. Proposals put forward in the 2008 budget include a streamlining of investment approvals, promotion of private-public partnerships to lift infrastructure investment, deregulation to raise competition, provision of targeted incentives to businesses, and

3.31.3 Government expenditure items

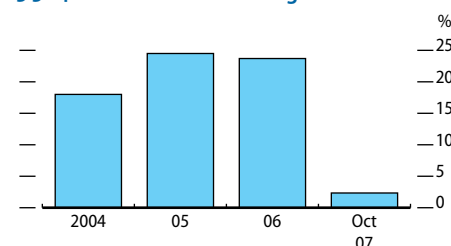


Note: Official projection for 2007.

Source: Ministry of Finance, National Planning and Sugar Industry, *Economic and Fiscal Update: Supplement to the 2008 Budget Address*, November 2007.

[Click here for figure data](#)

3.31.4 Private sector credit growth



Source: Reserve Bank of Fiji, *Monetary Policy Statement*, December 2007.

[Click here for figure data](#)

3.31.1 Selected economic indicators

	2008	2009
GDP growth	1.6	1.6
Inflation	4.6	3.7
Current account balance (% of GDP)	-21.0	-

Source: Staff estimates.

a reduction in the size of the public sector. The reforms would lay the foundation for a restoration of investor confidence, and the elections would likely lead to a normalization of relations with development partners and a removal of the adverse travel advisories issued after the coup. If this can be achieved, the balance of payments would be strengthened and room would be created for growth-promoting public expenditures, while fiscal sustainability would be enhanced through the public sector reform.

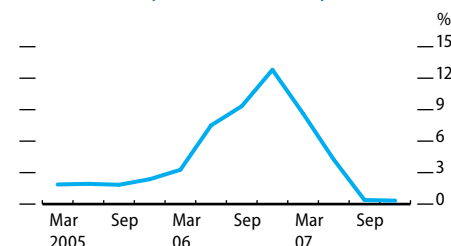
Official projections for 2008 include a pickup in sugar production and in tourism, as well as some improvement in fisheries, forestry, construction, and some parts of manufacturing. However, the sugar industry faces major hurdles. Production of both sugarcane and raw sugar fell in 2007 to one of the lowest levels in 30 years (Figure 3.31.6). Declining productivity over many years has put the cost of producing raw sugar domestically above the current world market price. The industry relies on concessional prices from the European Union (EU), which are being renegotiated, and their continuation is important to the industry's expansion. A range of initiatives, including adoption of improved farming practices, mill refurbishment, and expansion into cogeneration and ethanol production, are officially projected to return sugar output close to historical peaks by 2011. However, it is uncertain that the EU will agree to the concessions sought, or that the large productivity gains targeted are achievable. EU funding for the sugar restructuring program has been suspended, and this may contribute to delays in reform.

A cyclone in January 2008 damaged agriculture, including sugar, and hurt tourism earnings. For all of 2008, tourist arrivals and spending are officially projected to improve by 6.0% and to stimulate tourism-related services. This still might not be enough to increase occupancy rates though, given that new hotels have been built in recent years. As for gold, a new operator plans to reopen the mine, but production is not expected to return to previous levels. Remittances will continue to be a significant source of foreign exchange, but a decline in the number of security personnel in the Middle East from the Fiji Islands could further reduce these inflows.

A highly expansionary fiscal policy helped the economy recover from a coup in 2000. This time, the higher level of public debt and deterioration in the balance of payments preclude a fiscal-led recovery, although minor budgetary stimulation is planned. Taking these factors into account, a moderate economic recovery is forecast, with GDP rising by 1.6% both this year and next (Figure 3.31.7).

The 2008 budget projects an overall fiscal deficit of 2.0% of GDP. Revenues are expected to rise by 8.1%, helped by tax increases on hotels and gambling and a restructuring of customs tariffs. Current expenditures are set to rise by 8.4%, with spending on goods and services increasing by a substantial 23.8% and capital spending more than doubling, though this latter increase may prove hard to achieve because of capacity constraints. Last year's civil service pay cut will be partially reversed. As a result, the civil service wage bill will increase by 3.4% and absorb 48.7% of operating expenditures. A fiscal deficit of 1.5% is projected for 2009, which will keep public debt above the official target of 45% of GDP.

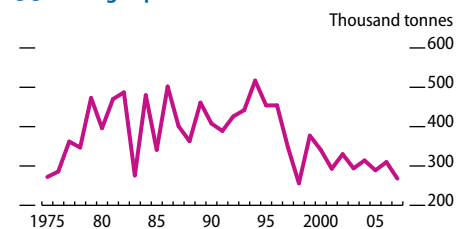
3.31.5 Treasury bill rates (91-day)



Source: Reserve Bank of Fiji, *Quarterly Review*, December 2007.

[Click here for figure data](#)

3.31.6 Sugar production

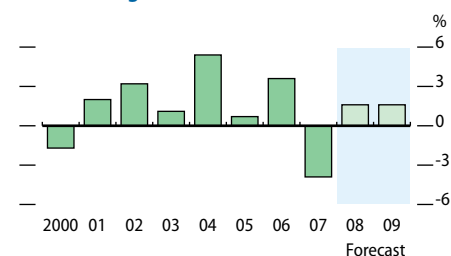


Note: Official projection for 2007.

Sources: Fiji Islands Bureau of Statistics, *Key Statistics*, June 2007; Ministry of Finance, National Planning and Sugar Industry, *Economic and Fiscal Update: Supplement to the 2008 Budget Address*, November 2007.

[Click here for figure data](#)

3.31.7 GDP growth



Note: Official projection for 2007.

Sources: Fiji Islands Bureau of Statistics, *Key Statistics*, June 2007; Ministry of Finance, National Planning and Sugar Industry, *Economic and Fiscal Update: Supplement to the 2008 Budget Address*, November 2007.

[Click here for figure data](#)

Inflation is seen staying moderately high in 2008 at 4.6%—primarily because of the flow-through of rising oil prices and disruption to food supplies from the cyclone in January—and then easing in 2009 as these effects dissipate (Figure 3.31.8). With the fuel import bill constituting about one third of total import costs, the balance of payments is vulnerable to further rises in oil prices, with the result that exchange controls may be maintained. The current account deficit is projected to remain at about 20% of GDP (Figure 3.31.9).

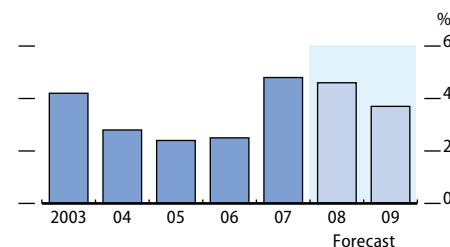
Development challenges

A deterioration in economic and development performance has been evident for some time. Per capita GDP has grown by an average of only 1.0% annually since 1995, traditional export industries have contracted without any compensating expansion in new industries, and there has been a high rate of emigration of business people and skilled labor. The 2006 coup added to the difficulties by eroding confidence in the state, and further weakened the investment outlook.

Reforms proposed in the 2008 budget signal a way forward with a program that stimulates export-oriented private sector development. The program needs to allow for greater public spending and investment, which should be offset over time by reduced spending on public sector wages. It requires broad-based support to maximize its chances of success.

The impact of four coups since May 1987 is apparent from population trends. Population growth slowed after the first coup, largely because of emigration, and preliminary results of the 2007 census point to a plateau (Figure 3.31.10). Emigration has contributed to rising remittances, but also to social dislocation and to an erosion of the skills base and the business community, undermining long-term growth prospects.

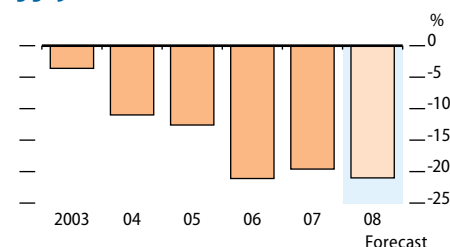
3.31.8 Inflation



Sources: Fiji Islands Bureau of Statistics, available: <http://www.spc.int/prism/>, downloaded 14 March 2008; staff estimates.

[Click here for figure data](#)

3.31.9 Current account balance

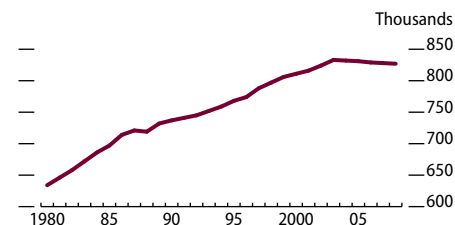


Note: Official projection for 2007 and forecast for 2008.

Sources: Reserve Bank of Fiji, *Quarterly Review*, September 2007; Ministry of Finance, *Economic and Fiscal Update*, Budget 2008 Address.

[Click here for figure data](#)

3.31.10 Population



Note: Estimates for 2004 to 2006 are extrapolated from 2003 official estimates and the 2007 preliminary census results.

Sources: Fiji Islands Bureau of Statistics, available: <http://www.spc.int/prism/>, downloaded 14 March 2008; Reserve Bank of Fiji, *Quarterly Review*, various issues; staff estimates.

[Click here for figure data](#)