Fiji

The country continues with weak economic growth, held back by policy uncertainty and structural constraints, which have contributed to low levels of private investment. Tourism is performing well, but other leading sectors, such as sugar and textiles, are struggling to compete internationally. Economic prospects are further clouded by weak global markets. Public expenditure is limited by high levels of debt and, longer term, structural reforms are essential for the economy to achieve its growth potential.

Economic performance

In 2011, the economy grew by 2.1% after 2 years of contraction. The improvement reflects recovery in agriculture, which had been affected by cyclone damage in 2010. It also reflects an increase in tourist arrivals of 6.8% (Figure 3.32.1). Offsetting these gains, gold output fell by 22% as capital works reduced output from the key Vatukoula mine. Electricity production was also down more than 4%, because consumption was constrained by higher electricity prices.

Exports (through higher earnings from reexports, sugar, gold, molasses, and timber) rose by 26.5% in 2011, while merchandise imports (largely machinery and transport equipment, food, and mineral fuels) climbed by 16.3%.

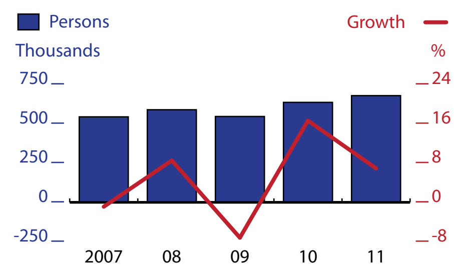
Inflation reached double digits in midyear but averaged 8.7% for the year, up from 7.8% in 2010 (Figure 3.32.2). This reflected higher fuel and food prices, an increase in value-added tax, and steeper electricity prices.

The budget deficit was equivalent to 3.5% of GDP in 2011, up from 2.1% of GDP in 2010. Tax revenue exceeded budget estimates with growth in collections from value-added, hotel turnover, and water resource taxes. Total revenue fell below budget estimates, however, on delays in selling government assets. Expenditure was slightly lower than expected because of underspending on the operating and capital budgets.

Government expenditure in 2011 was dominated by current spending, which accounted for 86% of budget outlays. The wage bill remained at around 40% of total public spending, or nearly half current outlays. In recent years the government has increased spending on infrastructure. Capital investment has risen from 9% of total public spending (3.5% of GDP) in 2007 to an average of 14% of total public spending (5.2% of GDP) in 2008–2011.

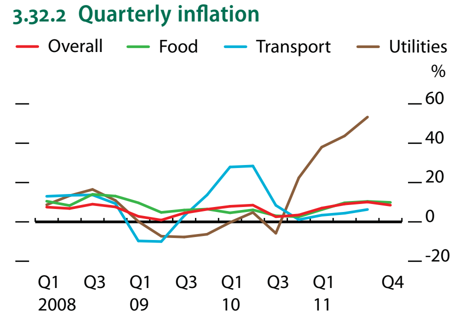
Monetary growth was 16.5% in 2011. This reflected a $250 million foreign bond issue by the government in March 2011 and resulting influx of foreign exchange, as well as higher foreign exchange earnings and weak import growth.

3.32.1 Visitor arrivals



Sources: Reserve Bank of Fiji; ADB estimates.

3.32.2 Quarterly inflation



Source: Reserve Bank of Fiji.

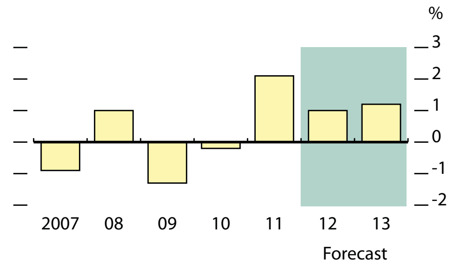
This chapter was written by Laisiasa Tora of the South Pacific Subregional Office, ADB, Suva.

Since 2008, Fiji's financial markets have had excess liquidity but, despite monetary-policy easing, domestic credit growth has continued to slow, rising by just 10% in the 4 years to end-2011. After holding steady for 6 months, the Reserve Bank of Fiji (RBF) cut its policy rate in October 2011 by 100 basis points, to 0.5%. Although lending to the private sector subsequently rose, the RBF is concerned that small and medium-sized enterprises are being excluded. It has, therefore, introduced a loan guarantee scheme, among other measures, to encourage such lending.

Fiji's index for the real effective exchange rate rose on an annual basis by 5.2% in 2011 due to comparatively high domestic prices. This indicates a loss in international competitiveness against major trading partners, as well as an erosion of the benefits from devaluation in 2009.

The current account deficit widened marginally to 11.2% of GDP in 2011, from 11.0% the previous year. The surplus in the capital and financial accounts declined following repayment of a $150 million global bond, issued in 2006, using part of its March 2011 bond issue. As of end-2011, official foreign exchange reserves reached $856 million, equivalent to around 5 months of imports.

3.32.3 GDP growth



Sources: Fiji Ministry of Finance. *Economic and Fiscal Update: Supplement to the 2012 Budget Address*; ADB estimates.

Economic prospects

The Asian Development Bank projects GDP growth of 1.0% in 2012 and 1.2% in 2013 (Figure 3.32.3)—lower than government expectations—reflecting its assessment of likely weak global demand, slow growth in bank lending, low levels of private investment, and the effects of the floods in early 2012.

Construction and investments in mining could support modest growth. For example, investment to date for the Namosi copper mine has been about 2.2% of GDP, or $86.2 million. The impact of further investment on growth is likely to be muted, however, as equipment will be imported.

The government foresees a budget deficit of 1.9% of GDP for 2012, based largely on expectations of improvements in the economy (Figure 3.32.4). Revenue is forecast at $1.1 billion, 12.7% higher than in 2011. Corporate and personal income tax cuts are expected to boost spending and investment. Tax revenue will be supplemented by the conversion of the 5% hotel turnover tax to a service turnover tax applying to most tourism-related services. This is expected to generate $32.6 million in revenue in 2012. Other measures include increases in the airport departure tax, higher excise taxes, and new levies, including voice call charges and credit card fees.

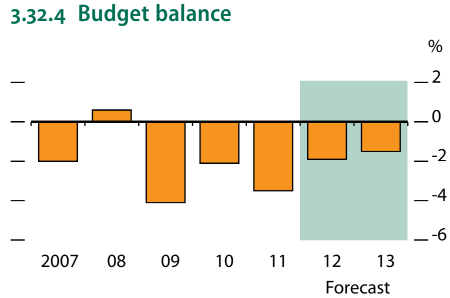
Government expenditure is estimated at $1.2 billion in 2012, up by 5.9% from 2011. Operating spending, which makes up 70% of the total (around $840 million) is projected to be 5% higher. Capital expenditure (around $320 million) is projected to rise by 7.1%. Key features of the 2012 spending program include a 3% salary increase for civil servants and an increase of $36.6 million (or 7.0%) in the infrastructure development budget allocation, to be financed largely by the export-import banks of the People's Republic of China and of Malaysia. The government projects a reduction in the debt-to-GDP ratio, from 51% in 2012 to around 49% by

3.32.1 Selected economic indicators (%)

	2012	2013
GDP growth	1.0	1.2
Inflation	5.1	3.0
Current account balance (share of GDP)	-9.6	-11.6

Source: ADB estimates.

3.32.4 Budget balance



Source: Fiji Ministry of Finance. *Economic and Fiscal Update: Supplement to the 2012 Budget Address.*

2014, if its economic and revenue growth targets are met. However, this will still exceed the government's target of 40%.

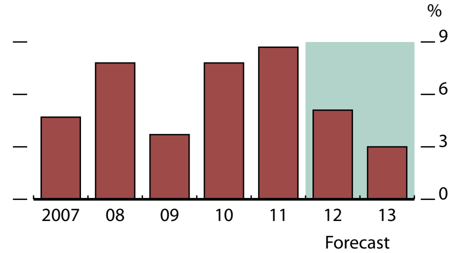
Crucially, if these targets are not achieved, the fiscal position could deteriorate. This would affect the provision of essential public services and increase public debt. There would be little scope for further fiscal expansion.

At end-March, the RBF left its policy rate at 0.5% in light of continuing uncertainty in the eurozone and the need to support domestic investment activity. In February, it required commercial banks to set aside 4% and 2% of their deposits for loans for the agriculture and renewable energy sectors, respectively. It is important that this measure is closely monitored to prevent a rise in nonperforming loans.

Average annual inflation is projected to decline to 5.1% in 2012 (Figure 3.32.5). This forecast stems from the weak growth outlook, projected declines in international food prices, and dissipation of one-time price adjustments from last year.

The current account deficit is projected to narrow to 9.6% of GDP in 2012 (Figure 3.32.6), despite lower sugar production, primarily because of lower prices of imported commodities. Foreign reserves are expected to remain above the targeted 3–4 months of imports in 2012.

3.32.5 Inflation



Source: Reserve Bank of Fiji; ADB estimates.

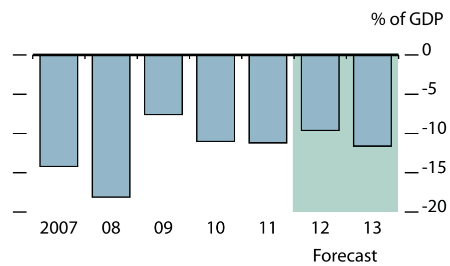
Policy challenge highlights

Fiji has experienced low economic growth, rising emigration, and high poverty over the past decade, mainly because of low domestic investment. Private investment is low, there has been little new domestic lending, and public investment has been constrained by poor implementation. Since 2005, gross domestic investment has averaged 13.1% of GDP a year, well below the government's target of 25%. The ratio of private investment to GDP declined from an average of 11.3% in 2000–2005 to 7.5% in 2006–2010; in 2011 it was around 2%.

The government recognizes that the economy operates below its growth potential because of an array of difficult macroeconomic, structural, and sector policy constraints. State-owned enterprise reform is progressing, and the government is seeking to divest its holdings in several enterprises. Yet the pace of reform is constrained by fiscal limits, a lack of technical capacity, limited stakeholder buy-in and consultation, and inconsistencies in the way reform principles are applied. The medium-term macroeconomic outlook is weak and foreshadows greater poverty challenges—unless structural reforms are carried out in a coherent and coordinated manner.

Business confidence is unlikely to be restored until progress is made on political reform. The drafting of a new constitution this year and the holding of national elections in 2014 will be crucial in this respect.

3.32.6 Current account balance



Source: Fiji Ministry of Finance. *Economic and Fiscal Update: Supplement to the 2012 Budget Address.*