Fiji

Stronger consumption and investment demand underpinned higher growth in 2012, despite the adverse impacts of three natural disasters and continuing weak global demand. Near-term growth is expected to be driven by tourism and public infrastructure investments. Longer-term economic prospects are likely to be influenced by political as well as economic developments.

Economic performance

According to the latest official estimate included in the 2013 budget, GDP growth rose to 2.5% in 2012 from 1.9% in the previous year as consumption demand strengthened (Figure 3.32.1). The Reserve Bank of Fiji, the central bank, reported that new consumption lending increased by 25.4% last year. Net value-added tax collection increased by 4.9% in real terms, reflecting higher consumption expenditure prompted by lower tax and interest rates. Lending for investment also increased, by 28.1%, according to the central bank. Increased loans to borrowers in real estate, tourism, and building and construction fueled the rise. Imports of capital goods showed an increase of 8.8% in the first 11 months of 2012. Sales of cement also trended upward over the year on the back of higher government capital spending.

However, the performance of some key sectors deteriorated during the year. Some agricultural output in 2012 was lost to flooding in January and March. Production of sugar, the country's primary agricultural export, fell by 7.1% during the year (Figure 3.32.2). Cyclone Evan caused damage estimated at $42 million, equal to 1% of GDP. Just under half of this loss was to agriculture outside of sugar. Despite the start of bauxite production in Naiwalevu, mining remained weak and the production of gold, Fiji's primary mineral resource, fell by 8%. Tourist arrivals declined by 2.1% relative to 2011, at least in part because of successive floods early in the year, with arrivals from Australia being down modestly (Figure 3.32.3). In December, flight cancellations caused by the cyclone drove down departures to Fiji that month from Australia and New Zealand—the two main markets—by 11% and 16%, respectively, year on year. Given these late developments, the official 2012 GDP growth estimate is likely to be revised downward, particularly when flow-through effects on other sectors are fully taken into account.

In 2012, inflation ran at 4.3%—less than half of the rate in 2011 (Figure 3.32.4). Floods in January and March disrupted the supply of locally produced fruits and vegetables, fueling higher inflation early in the year. Inflation then fell gradually as commodity prices stabilized.

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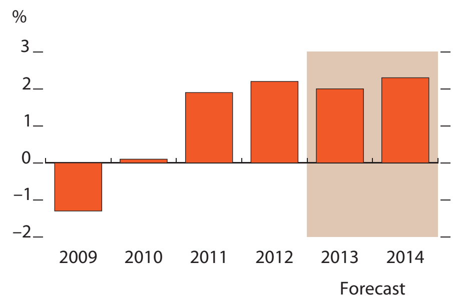
3.32.1 GDP growth



Sources: Fiji Bureau of Statistics; ADB estimates.
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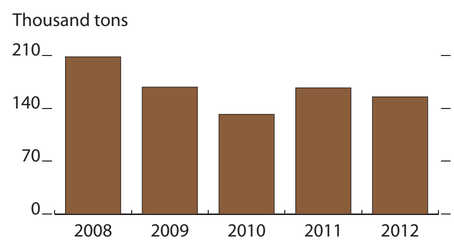
3.32.2 Sugar production



Source: Fiji Ministry of Finance. *Economic and Fiscal Update: Supplement to the 2013 Budget Address.*
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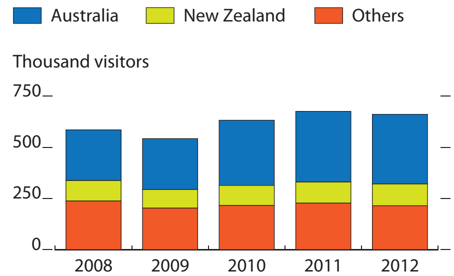
3.32.3 Visitor arrivals



Sources: Reserve Bank of Fiji; ADB estimates.
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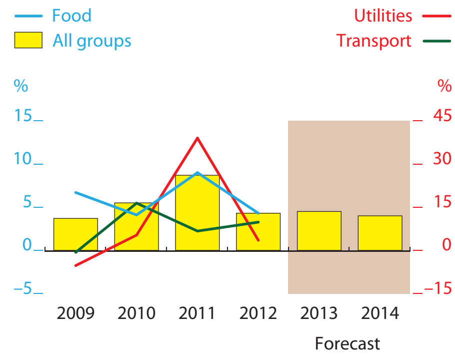
Fiji's net budget deficit in 2012, excluding principal repayments on loans, was estimated to be equivalent to 1.6% of GDP. This was larger than the 1.4% of GDP recorded in the previous year, but on-target expenditure and unexpectedly high revenue collections—particularly corporate taxes following the adoption of an advance tax payment system for companies—brought the deficit down to below the target of 1.9% of GDP.

The central bank maintained an expansionary monetary policy, keeping its overnight policy rate at 0.5%, which it has maintained since October 2011. This contributed to low interest rates on loans and time deposits at commercial banks and kept liquidity high. In 2012, commercial banks' outstanding loans increased by 7.6% year on year. The central bank also loosened exchange rate controls in response to rising foreign reserves. Nonetheless, at the end of 2012, foreign reserves totaled $922 million, sufficient to cover 5.2 months of imports, up from 5.0 months in December 2011.

The 2013 budget reports Fiji's current account deficit as narrowing to 6.1% of GDP in 2012 from 7.0% in 2011. However, the actual current account deficit may widen because of a higher trade deficit late in the year reflecting lower sugar and gold export earnings, as well as lower tourism receipts. Merchandise exports, including re-exports, grew by only 5.1%, far short of the forecast 12.3%. Import growth estimates for 2012 have been revised upward to 5.4% from 4.7%.

3.32.4 Inflation



Sources: Fiji Bureau of Statistics; ADB estimates.
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Economic prospects

Fiji's economy is forecast to grow by 2.0% in 2013, driven mainly by tourism and higher public capital expenditure. The increased public capital expenditure will focus on constructing new transport infrastructure, valued at more than $225 million, and infrastructure rehabilitation.

Consumption expenditure is expected to strengthen further in 2013, propelled by improved household disposable income from lower personal income tax rates, and the implementation of a 10% wage increase for public employees earning below F$10,000 per annum. Rising investment is expected to tighten the labor market and spur higher consumption. Investment is expected to reach 25% of GDP in 2013, up from 18% in 2012. The size of the investment expansion will raise fiscal risks and further stretch public fiscal resources.

Higher consumption, combined with public infrastructure work, election-related expenditure, and continued expansion in tourism in line with an improving global economy, support a prediction of growth rising to 2.3% in 2014.

Supply disruptions caused by Cyclone Evan are expected to accelerate inflation in 2013, particularly early in the year. Full-year average inflation is projected at 4.5%, as planned increases in capital spending push up prices, slowing to 4% in 2014 in line with declining international food and fuel prices.

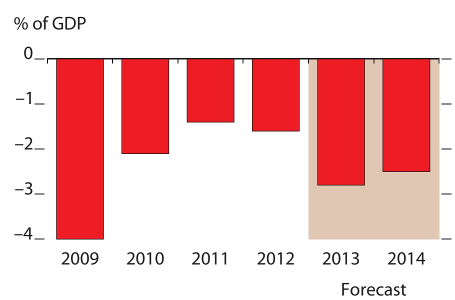
Fiji's 2013 budget projects a net deficit equivalent to 2.8% of GDP, wider than the 1.6% recorded in 2012 (Figure 3.32.5). The government plans expansionary fiscal policy this year, with capital expenditure increasing to 32% of total spending, up from 29% in the previous year, to improve roads, water supply and sanitation, and information and communication

3.32.1 Selected economic indicators (%)

	2013	2014
GDP growth	2.0	2.3
Inflation	4.5	4.0
Current account balance (share of GDP)	–22.5	–7.0

Source: ADB estimates.

3.32.5 Net budget deficit



Source: Fiji Ministry of Finance. *Economic and Fiscal Update: Supplement to the 2013 Budget Address.*
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technology infrastructure. This will entail deficit spending financed with domestic borrowing and loans from the export–import banks of the People's Republic of China and Malaysia. It will further tax the government's capacity to implement multiple projects.

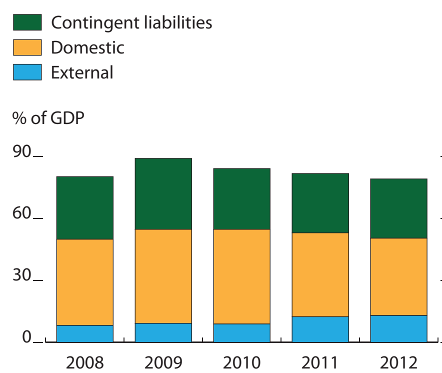
The central bank plans to keep interest rates low to support domestic economic growth. The current account deficit is projected to widen to 22.5% of GDP in 2013 on the back of worsening terms of trade. Imports are expected to increase substantially as the national airline buys three new Airbus A330 aircraft this year, hoping to improve fuel efficiency, cargo capacity, and ultimately profitability. These developments are likely to put pressure on the country's foreign reserves.

Policy challenge—reinvigorating private sector growth

The current business regulatory environment and political uncertainty continue to weigh on Fiji's growth prospects. Barriers to higher growth include limited fiscal flexibility under current debt levels, challenging business and political environments, and a longstanding need for structural reform, particularly in the sugar sector.

The budget deficit could be larger than expected if economic growth below the government assumption of 2.7% reduces government revenues. Planned sales of government real estate to the Fiji National Provident Fund (FNPF) help finance the government's projected deficit. A larger deficit could prompt the expanded use of FNPF resources to finance it, which could raise concerns about the fund's long-term sustainability. Public debt is relatively high at 50.4% of GDP, about three-quarters of it in the form of government bond purchases by the FNPF (Figure 3.32.6).

3.32.6 Public debt



Source: Fiji Ministry of Finance. *Economic and Fiscal Update: Supplement to the 2013 Budget Address.*
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Despite significant investment in recent years, the outlook for Fiji's sugar industry remains uncertain. The government's planned purchase of equipment to mechanize production and improve its efficiency may be insufficient to overcome the challenges the industry faces trying to compete internationally. Sugar production and its supply chain need deeper structural adjustment, the list of needs headlined by land tenure reform and an improved business environment. Such reforms would help revive the sugar industry and stimulate broader private sector development.

While new investments and signs of greater interest from investors are encouraging, the political situation will affect how much new foreign investment is realized. The process leading up to national elections scheduled in 2014 and the credibility of election results will be important determinants of Fiji's future economic performance. If a new democratically elected government is installed in a process that is acceptable domestically and internationally, renewed business confidence and development partner reengagement should follow. This would help harness the country's rich resource base and its natural position as a regional hub for the Pacific, shifting Fiji onto a higher growth path.