

# Country Update: Fiji

## Fiji economy to slow but diversification of economy will help to lift long-term growth prospects

- Real GDP growth for 2005 and 2006 poised to slow to 1-1.5% due to falling exports following expiry of US quota access under the Multifibre agreement and proposed EU sugar reform.
- However, there is tremendous potential for the tourism sector to be an increasingly important contributor to economic performance.
- Inflation is expected to remain contained, providing scope for accommodative fiscal and monetary policies.
- We expect the Fiji dollar to ease against the US dollar from FJD/USD0.59 currently to FJD/USD0.54 by end-2005 and FJD/USD0.52 by end-2006. The Fiji dollar is forecast to strengthen against the Australian dollar to around FJD/AUD0.81 at end-2005 from FJD/AUD0.78 currently due to AUD weakness and remain steady at around this level in 2006.

Since the recession in 2000, the Fijian economy has enjoyed a period of relatively strong and sustained economic expansion, growing at an average rate of 3.5% per annum between 2001 and 2004. The economy has been assisted by favourable global growth, accommodative fiscal and monetary policies and a period of domestic political stability.

The outlook for 2005 and 2006, however, is for growth to slow to around 1-1.5%. This largely reflects the decline in the garment industry following the expiry of quota access to the US market from January 2005 and the adverse impact of the proposed EU reform on the sugar industry. Garment exports accounted for around 22% of total exports in 2004. Fiji and many other garment producers now face an even more challenging environment from competitors like China, India and Vietnam. While the industry also relies heavily on duty-free access to the Australian and New Zealand markets under the South Pacific and Regional Trade Agreement scheme, which has been extended to 2011, the expected production declines due to the expiry of the US trade quota arrangement are likely to force producers to review their operations.

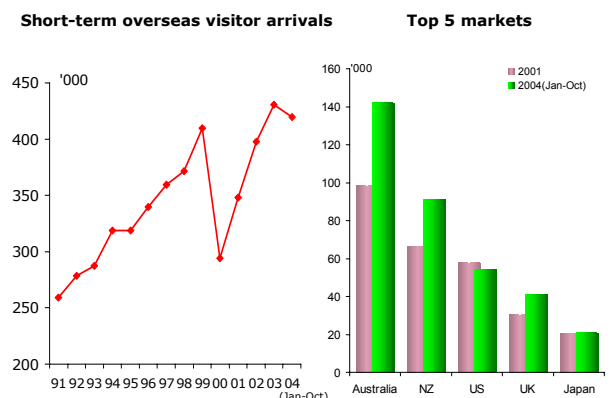
Uncertainty about the future of the EU's sugar protocol with the sugar exporting ACP (African, Caribbean, Pacific) countries is a major concern for the sugar industry. Sugar exports accounted for 15% of Fiji's total exports in 2004 and the EU absorbs more than half of Fiji's annual sugar production of around 300,000 tonnes. The EU has proposed a cut in sugar prices starting with a

5.1% reduction in 2006 and moving to a 39% cut within 4 years. The government is taking steps to reform the sugar industry to improve efficiency, lift production levels and better cope with EU sugar reform but the transition will be difficult.

The tourism sector is, however, expected to continue to fare well and is likely to play an increasingly important role in supporting economic activity over the medium term. Construction is also expected to stay strong but skilled labour shortages are likely to limit its pace of expansion.

The chart below illustrates the strength of the tourism sector. Tourist arrivals have grown at a rate of 14% per year between 2001 and 2003. For the first 10 months of 2004, visitor arrivals rose by 17.5% compared with the same period in 2003. The average stay remained fairly steady over 2001-04 at around 9 days. This year is turning out to be another strong year for tourism. New Zealand statistics showed that visitors from New Zealand grew by around 14% during the first half of the year compared with January-June 2004 and Australian data showed an increase in the number of Australians visiting Fiji of the order of 18% for the same period.

### Strong recovery in tourist arrivals



Source: Fiji Islands Bureau of Statistics

The outlook for tourist arrivals is bright, underpinned by the relatively strong growth picture in its main tourist-generating markets. The favourable prospects for tourism will be enhanced by further infrastructure development. Tourism in Fiji will also benefit from being considered one of the "safer" tourist destinations given concerns over terrorist attacks elsewhere. From an operational perspective, however, the main challenge for this sector is to address the shortage in tourist accommodation.

### Economic outlook for main tourist-generating markets

Real GDP growth	2004	2005f	2006f
Australia	3.2	2.1	3.3
New Zealand	4.8	2.3	2.0
US	4.2	3.7	3.3
UK	3.2	2.0	2.3
Japan	2.6	2.0	1.8

Source: ANZ Bank

Inflation has been relatively steady despite surging oil prices over the past year. This is partly explained by spare capacity in some sectors of the economy. Annual inflation averaged 2.6% during the first half of 2005, slightly higher than the same period in 2004 (2.5%). Annual inflation is officially forecast to end the year at 4.5% but we expect the average for the year to be around 2.8%, largely unchanged from 2004. Price pressures are likely to moderate over 2006 due in part to a softer oil price outlook.

The budget deficit in 2004 came in at a smaller 3.3% of GDP compared with the official forecast of 4.8% of GDP. The government has forecast a deficit of 4.3% of GDP for 2005 but data for the first half of 2005 has been more favourable than forecast, suggesting that the shortfall will be lower than projected. The government is committed to improve the fiscal position over the medium term and aims to reduce the deficit to less than 2% of GDP by 2007. It will be difficult, however, to tighten fiscal policy amid an economic slowdown. Nevertheless, the government's commitment to lift investment spending bodes well for medium term growth sustainability. The ratio of gross investment to GDP reached a 17-year high of 17% in 2004 although it was below the government's target of 25%.

The Reserve Bank of Fiji has kept the policy indicate rate (91-day RBF notes) unchanged at 1.75% since May 2004 when it lifted the rate by 50 basis points. In reviewing the balance of risks, interest rates are likely to be kept on hold, but with an accommodative bias, given the sharp slowing in economic growth against a fairly well-contained inflation outlook.

Fiji's trade performance is likely to deteriorate over 2005 and 2006 due largely to an expected decline in exports of garments and sugar. While demand for imported consumer goods may ease as the economy slows, imports of investment goods are likely to remain steady as infrastructure development proceeds. An increase in tourism receipts and remittances from Fijians working abroad will help to partly offset the weakness in

the merchandise trade account but poor export prospects over 2005 and 2006 are likely to lead to a deterioration in the current account. Data for the first half of 2004 showed that the current account reverted to a deficit of 2.1% of GDP after registering surpluses in recent years, putting pressure on foreign reserves.

The Fiji dollar has depreciated by around 2.5% against the US dollar since the start of the year (FJD/USD0.59 on 17 August). It is forecast to continue to weaken against the US dollar to FJD/USD0.54 by end-2005 and FJD/USD0.52 by end-2006 mainly reflecting US dollar strength. A further easing of the Fiji dollar will help support exports without posing a threat to inflation. Against the Australian dollar, the Fijian currency has been fairly stable this year but it is forecast to appreciate against the AUD to FJD/AUD0.81 by end-2005 (FJD/AUD0.78 on 17 August) as the Australian dollar weakens. We are forecasting the Australian dollar to ease to sub-AUD/USD0.70 by end-2005 and AUD/USD0.65 by end-2006. This largely reflects falling premium for Australia with rates on hold in Australia against further hikes in the Fed Funds rate expected over the next six months, and a softening in commodity prices. The Fiji dollar is likely to remain steady at around FJD/AUD0.80 by end-2006.

On the political front, there has been a period of relative political stability since the coup in 2000. However, tensions remain between the government of Prime Ministry Laisenia Qarase, which draws its main support from indigenous Fijians, and the opposition Fiji Labour Party, led by Mr Mahendra Chaudhry, that draws support primarily from the ethnic Indian community. General elections are due in September 2006 and uncertainty in the run-up to elections could weigh on investor sentiment.

#### Forecast table

	2004	2005f	2006f
Real GDP growth (%)	4.1	1.2	1.0
Inflation (yr av, %)	2.8	2.8	2.3
Exchange rate (eop)			
USD per FJD	0.608	0.54	0.52
AUD per FJD	0.778	0.81	0.80

Sources: Reserve Bank of Fiji, ANZ Bank

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<http://www.anz.com/go/economics>

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