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Monetary Policy and Development in Fiji

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Fiji has a relatively developed financial system, compared to other countries of similar size and level of economic development. The relative sophistication of the financial system can be judged from the diversity in the types of financial institutions operating in the country and the volume of financial assets compared to local economic activity.

Instruments of monetary policy

The Reserve Bank of Fiji was established in 1984 after its predecessor, the Central Monetary Authority, had been in operation for approximately 10 years.

The main instruments used for controlling the monetary aggregates are:

1. Statutory Reserve Deposits held by the commercial banks with the monetary authorities (currently at 6 per cent of all deposits).

2. Unimpaired Liquid Assets Ratio requirement (in the form of public sector securities) intended not only as an allocative and prudential instrument, but also to have the effect of decreasing the probability that a credit-squeezed public sector would resort to borrowing from the Reserve Bank.

3. Control of short-term capital import by individuals and commercial banks alike.

4. Operations in the primary and secondary securities market, not only as government agent, but also in order to promote monetary policy targets.

5. Fixing of the interest rate structure on the overdraft facility that the banks have with the Reserve Bank.

6. A recently introduced, short-term instrument of 'special deposits' by commercial banks with the Reserve Bank during periods of seasonal, or short-term, excessive increase in liquidity.

7. Direct lending, and accepting deposits, from a few main public sector entities.

(See the changes in the uses of these instruments in 1985 described in the first issue of this Bulletin and more recent changes outlined in the introductory article in this issue.)

The financial sector and degree of monetization

The commercial banking system is composed of five banks, with a network of forty-five branches, approximately fifty banking agencies located within the premises of other businesses and approximately 290 other agencies. Four of these banks are branches of Australian, New Zealand and Indian banks with wide international presences and connections, and the fifth is wholly owned by the Fiji Government. A sixth bank (with strong international linkages) is now in the process of establishment.

The dominant organization comprising the non-banking financial institutions is the Fiji National Provident Fund, which accumulates the long-term savings of about 80,000 employees. The other main organizations in this group are the Fiji Development Bank, Housing Authority and Home Finance Company which specialize in long-term finance for investment in housing, agriculture and manufacturing. The fifth organization is the tiny Unit Trust of Fiji. Four insurance companies and a number of small sectoral credit unions close the list of existing financial institutions doing business with the public. Recently a new type of institution, a merchant bank, opened an office in Fiji and it is expected that it will increase the diversity of investment finance sources and instruments available in the country.

The total value of financial intermediation through the financial institutions (excluding the Reserve Bank) at the end of 1985 was F$1550 million, approximately the same as the estimated gross domestic product for that year (see Table 1).

Besides the financial institutions sector, there is a continuing attempt to develop a security market. At present, that market is very small in terms of funds raised, number of participants, and in its contribution to increased savings and efficiency of capital allocation.

Table 1 Total liabilities of financial institutions, Fiji, December 1985

	Liabilities Fiji $ million	Number of institutions
Reserve Bank of Fiji	220	1
Commercial banks	590	5
Non-banking financial institutions	640	5
Credit Unions	5	b
Insurance companies	95	4
Merchant bank	a	1
Total	1550	

a Began operations only in September 1986.
b Between 5 and 150, depending on definition of independent, separate organization being used.

Looking to the longer term, it seems that the process of monetization of economic activity in Fiji has reached a certain degree of saturation (at least at the present structure of social and economic activity) and the accumulation of financial wealth at a higher degree of sophistication is taking place. The ratios between different aggregates of 'money' and economic activity, measured by the gross domestic product, have been remarkably stable. Only the all-embracing M3 (including liquid components like currency, checking accounts and demand deposits in the form of savings deposits, together with the less liquid and sometimes long-term time deposits) is showing a tendency to grow faster than gross domestic product.

Scope for monetary policy in a Fijian-type economy

Monetary policy strives to create the conditions for full utilization of the productive capabilities of the economy, while maintaining price stability and a manageable balance of payments position. It tries to manage the relevant monetary aggregates so that the consumption and investment sectors will have enough liquidity to generate the amount of demand the economy can sustain, and so that the productive sectors have enough liquidity to be able to make maximum use of their production capabilities. However, monetary policy has to guide the economy towards a balanced situation; too much liquidity may be as harmful as too little. In the case of relatively closed economies (for this purpose defined as big and diversified economies with a resulting low import content in consumption and investment demand) the 'pendulum' moves mainly between unemployment of labour and capital (when a too restrictive monetary policy prevails) and inflation (when excessive monetary growth prevails). In the case of relatively open economies like Fiji (with an import ratio of approximately 50 per cent between imports and GDP), the pendulum moves between unemployment, as in the relatively closed economies, and a combination of inflation, loss of foreign reserves and growth of external debt; the more open the economy, the more will an expansionist monetary policy result in the depletion of foreign reserves and growing external indebtedness.

The effectiveness of monetary policy guiding the economy depends on a few structural characteristics and supportive policy actions. One of the most important structural characteristics is the 'transmission mechanism'. This is the chain of events that is triggered by the change in monetary policy, through the different sectors of the economy and ultimately resulting in a change in aggregate demand in the desired direction. The bigger the number of sectors affected and the stronger the impact, the more effective monetary policy is. In Fiji there are a few factors that tend to limit the effectiveness of monetary policy. Two of these are:

1. The existence of a substantial part of the economy (the sugar and tourism sectors) whose activity - demand for its final product and the availability of working capital - is only slightly affected by local monetary developments.

2. The existence of a relatively big non-bank financial sector which is affected only in a minor way by monetary policy but which has an important role, similar to that of the commercial banks. Total credit to private business, individuals and business-oriented statutory bodies by the non-banking financial institutions is almost as big as that granted by the commercial banks and its share in financing the public sector is higher again. Indeed, the commercial bank credit is biased, at least partly, towards short-term working capital while the non-banking financial institutions use mainly long-term financing instruments. However, there is still a high degree of substitution between the two.

Monetary developments

During the last few years, most indicators of financial stability in Fiji showed a marked improvement, with the inflation rate and balance of payments leading the way. These achievements were certainly the result of the overall economic policy. Monetary policy made a marked contribution, certainly in the latter part of this period, towards bringing

Table 2 Selected monetary and economic indicators

	Per cent change, end of year over end of previous year				
	1981	1982	1983	1984	1985
Consumer price index	9.7	6.3	6.0	4.6	2.9
Money supply (M2)	12.6	5.0	10.0	1.5	3.6
Money supply (M3)	6.3	8.5	12.2	10.4	2.6
Domestic credit	20.7	19.4	14.3	8.2	7.1
Net foreign assets	-10.4	-11.5	1.5	9.2	11.1
Real rate of interest on bank credit (%)	2.5	7.0	7.1	8.7	10.5
Credit account balance (F$ million)	-145.0	-86.0	-64.0	-27.0	-8.0
Government finance overall balance					
- F$ million	-60.0	-88.0	-66.0	-67.0	-60.0
- as % GDP	5.7	7.9	5.8	5.3	4.5

down the inflation rate from 10 per cent in 1981 to 3 per cent in 1985, and approximately 1 per cent in 1986, and the current account of balance of payments to almost full balance (Table 2).

During the same period, gross domestic product grew by 2 per cent annually. While not representing an impressive rate of economic growth, this figure still sustains the claim that the improved financial stability had not been achieved at the expense of a marked fall in the degree of utilization of the production capability of the economy. But if 2 per cent average annual growth is regarded as not satisfactory for a country like Fiji, recourse will have to be made to overall economic policy and priorities (see comments on Fiji's development plan in the introductory article in this issue). Within a different overall economic policy which is more growth-oriented, monetary policy may be accommodating and may avoid developments like the marked increase in the real rates of interest.