

Does Fiji's monetary policy need normalisation?

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Fiscal policy implications of the 2016 budget disposals currently dominate national attention. My column focuses on Fiji's monetary policy, which has already "kicked in animal spirits."

Fiji is on an expansionary path.

The recent two-week IMF Annual Staff Consultation Mission under Article IV of its Charter commended Fiji's growth for a continuous period of three years: 4.7% in 2013 and 5.3% in 2014.

The projected growth rate for 2015 will also be well above 4%.

Much of the exceptional growth momentum in Fiji is attributed to high levels of public investment, tourism earnings and remittances. A continuous period of lower oil prices and recent depreciation of the currencies of Fiji's trading partners, and the resultant falling imported prices of staples and other critical imports, have also kept domestic inflation low. While inflation in 2014 was just 0.5%, the year on year change in price level percent in September is 1.5%, still below the inflation target (3% to 4%) of Reserve Bank of Fiji (RBF).

The monetary policy of RBF in the context of a fixed exchange rate regime has twin objectives: internal (price level) stability and external (value of Fiji dollar) stability. Internal stability relates to maintenance of the domestic purchasing power of Fiji dollar, while external stability relates to maintaining the overseas value of Fiji dollar. The external stability is concerned with defending the country's fixed exchange rate within certain agreed margin. The RBF targets at maintaining level of foreign exchange reserves equivalent to the value of 5 months of imports.

The latest figures reveal Fiji's reserves are around F\$ 2 billion, sufficient to cover six months of retained imports of goods and non-factor services.

Animal spirits

It is the favourite term, coined by John Maynard Keynes, a votary for public spending as a tool to kick start the economy, when there is recession. It refers to boosting the sagging private sector confidence and improving business sentiments. The catalyst under Keynesian economics is government. By providing the much needed infrastructural support in terms of cheaper power,

transport and communications, government contributes to lowering the cost of production in private sector by creating what is known as external positive economies.

When public expenditures rise, private sector spirits get a boost. The stirring of private sector spirits is reflected in the flow of credit to private sector since 2012.

The subsequent three years saw Fiji growing at a high growth rate. From the monetary policy side, which is the responsibility of RBF, an accommodative monetary policy stance keeping the RBF's benchmark rate known as overnight policy rate (OPR) as low as 0.5% since 2010, has kept commercial bank lending rate low.

The commercial banks' average lending rate has been falling. For example, it fell from 6.13% percent in August to 5.53% in September. The latest *RBF October Economic Review* released on Tuesday reveals that new lending for investment purposes increased by an annual 94.9 % up to September. On domestic credit, private sector credit (14.2%) rose on the back of growing commercial banks' lending (14.0%) in the year to September.

Robust credit growth

There has been a rapid rise in commercial bank loans since 2010. Annual total bank credit rose from 47.8% of GDP in 2010 to 60% of GDP in December 2014. It is reported to be around 61% in June according to *RBF 2015 June Quarterly Review*. Loans to real estate sector (both building and construction and real estate property development) accounted to 20.6% of GDP.

The IMF does not hide its concerns when it says that “credit cycle should not upset the economic cycle”. It wants growth over the medium term should be on a sustainable footing since low interest environment has fuelled credit growth.

“Strong credit growth has led to growth in house prices. There is a case to tighten macro policies to ensure credit does not lead to sharp fluctuations in the economic cycle”, says IMF. It gently indicates: “On monetary side there is the case for some normalisation in the monetary policy”.

The word, “normalisation” is a euphemism for a relook at the interest rate environment by RBF.

A fortnight ago, Australian Prudential Regulation Authority (APRA) issued a regulatory policy change, requiring banks to hold more capital against mortgages to cushion for potential losses in the event of falling property prices. APRA views housing loans a riskier portfolio than others. The big four commercial banks have now raised interest rates for housing loans.

The fear of the bubble bursting giving rise to bad loans is real.

We know a central bank always strives to be prudent. It keeps a watch if the party gets wild.

It is aware when to “take away the punch bowl.”

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