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# Dilemma to raise our dollar

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As usual, there were several 2013 Budget submissions in the last few weeks.

One of the submissions was that government should raise the value of the Fiji dollar by 5 percent to 10 percent for reducing inflation.

It was argued that both businesses and consumers rely more on imported products, from manufacturing to retailing, and more expenditure is incurred by business and consumers;. The submission stated that if the value of the domestic currency is increased, the imported items would cost less.

It was also claimed that relief in terms of lower import costs would be welcomed by consumers and manufacturers alike.

***The 2009 devaluation***

A foreign exchange crisis led to devaluation in 2009. There was a rapid decline in foreign reserves by end of 2008. They were about F$ 560 million, sufficient for two months of imports.  The decision was taken on April 15, 2009 to devalue the Fiji dollar by 20 percent.

The Fijian dollar was US$ 0.57 before devaluation. After devaluation it was US$ 0.45, the drop being 12 cents.

Consequent to devaluation, rise in earnings from commodity exports and services including tourism led to growth in foreign reserves in the next three years. By end of October 2012, foreign reserve levels rose to F$1,581.6 million, which were sufficient to cover 5.0 months of imports in current prices.

No doubt landed prices of imported goods of all sorts, food, fuel and raw materials and capital goods went up as a result of devaluation, whether or not the imported materials were imported before devaluation.

In the 12 months following the April 2009 devaluation of the currency, inflation was over 10 percent.  However, it moderated to 4 percent by end of 2010.

During the 12 months ending Sept 2011, consumer price index rose only 3.7 percent.

Price controls imposed on many food products since 2009 contributed to low inflation. It is reported that 24 food items, 460 hardware items, 74 pharmaceuticals, utility rates, wholesale cement and steel, fuel and rental properties were covered under price controls.

***Purpose of devaluation***

Devaluation is an adjustment measure to correct balance of payments disequilibrium. The disequilibrium is reflected in widening trade deficits and current account imbalances.

In a country under a fixed exchange rate regime, as in Fiji, an adequate level of foreign reserves is needed to defend the fixed exchange rate. Only under a flexible exchange rate system, no there is no need to maintain reserves.

Fiji cannot afford to have a flexible exchange rate system. Fiji's exports earnings are determined by a very limited range of exports. These include sugar, tropical fruits and vegetables, tourism and remittances. Further, the export earnings are seasonal and are not steady throughout the year. On the other hand, imports of Fiji are not only steady but they exceed exports in certain times of the year.

In such circumstances, a floating regime would play havoc: High volatility in exchange rate would affect investment decisions.

A fixed exchange rate regime has served the country well. A steady exchange rate requires adequate level of reserves.

The devaluation of April 2009 was resorted to correct the fundamental disequilibrium. High trade deficit (31 percent of national output) and current account deficit (18 percent) necessitated a drastic remedy.

If the country had borrowed funds for structural adjustment to improve balance of payments from IMF, austerity measures would have to be implemented as part of conditionalities.

**Uncertain world economy**

Presently the US economy is in doldrums ever since 2008. The euro crisis is continuing. Only mineral exporting economies including Australia have done well. Bilateral exchange rates react in a predictable fashion. The Fiji dollar declined against Aussie dollar; and appreciated against US dollar.

In the uncertain circumstances, the competiveness of Fiji's exports is of paramount concern.

One measure is real exchange rate (RER), which is the product of nominal exchange rate and ratio of the domestic price level to world price level. Given the nominal rate, a rise in domestic price level relative to the world price level, would result in an increase in RER. Increase in RER would hurt the competitiveness of exports and tourism.

Fiji needs to protect the level of resources in an uncertain world.

A recent IMF study shows that Fiji dollar is broadly in line with fundamentals with no deviation of any significant concern.

With a benign world inflation outlook, there is no need to effect any change in nominal exchange rate.