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Fear of falling foreign reserves

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Last week, Samoa decided to impose exchange controls to protect its dwindling foreign exchange reserves from further fall.

Various exchange control measures became effective from Monday, March 3.

The situation is not alarming. Foreign reserves are sufficient to cover 5 months of imports.

The exchange controls imposed are more on the precautionary side,

Recovery by Samoa's economy

After negative economic growth for two consecutive quarters, the September 2013 quarter growth, according to the latest *ANZ Bank Pacific Quarterly Report*, is positive

This was mainly due to impressive performance by agriculture sector. This is the first time after six consecutive quarters of negative growth in agricultural output and exports after the effects of cyclones of 2012 and 2013. Besides the 17 percent growth in agriculture, Samoa's other sectors are also doing well: construction growth at 4.6 percent, electricity and water: 3.7 percent, and commerce: 4 percent.

Growth means rise in import requirements: not just for consumption but also for investment purposes.

Total imports rose sharply in late 2013, as the latest trade figures (November 2013) show.

Though exports rose, it was not at the same rate. Imports increased on annual basis by a huge, 46 percent, exports registered only 7 percent increase. The result was a big deterioration in trade deficit: a close 59 percent of gross domestic product (GDP).

Low growth in tourism (visitor arrivals declining in December 2013 by 11 percent on a year to basis) and fall in remittances in December were not happy signs.

It is feared Samoa's external debt is likely to go up to 64 percent of GDP in fiscal year 2014 from 54 percent.

Viewed against this background, exchange controls effective from Monday March 3 make sense.

All payments in foreign exchange relating to dividends, land sale income, insurance payments, management fees and airline ticket payments over $1 million tala will have to be approved by the Central Bank of Samoa (CBS).

Funds for investments overseas, proceeds from sale of property, overseas borrowings and overseas loan repayments will also have to be cleared by monetary authorities.

A brief statement by central bank says these measures have been taken with due regard to "liquidity conditions in the domestic economy".

Domestic credit

Samoa has a fixed exchange rate regime. Money supply under such as an exchange rate regime is determined by availability of net foreign assets, besides domestic credit. If net foreign assets decline, money supply also declines, given the domestic credit.

In the face of declining reserves, any rise in domestic credit is risky: excessive credit growth spills over into demand for foreign goods and services, leading to a bigger disaster: foreign exchange crisis and the dreaded devaluation of tala.

The recent available figures show that commercial bank credit was at its highest ever level: 722 million tala, as compared to 488 million tala.

The fears of falling reserves are justified.

The message is clear.

There is only one way which works: control spending by public sector and raise interest rate to check private sector credit growth.

Experiences of emerging countries will be useful.

Recent monetary tightening measures by Reserve Bank of India, which were disliked by the ruling coalition government facing the May 2014 elections, are proving correct.

Fiji's situation

The latest economic review for February 2014 published by Reserve Bank says improvements in business sentiments, which are reflected in rising construction work has led to an 8 percent increase in imports of capital goods during January-November 2013.

Since exports declined by 5 percent due to decrease in exports of gold and fish, trade deficit widened during the corresponding period by 24 percent. However, inflows of remittances and rise in tourism earnings provided the much needed support for financing the trade deficit.

As of February 28, Fiji's foreign reserves are F$ 1,696 million as against F$1,756 million as of 31 January 2014. The current level of reserves will cover 4.5 months of imports.

The liquidity position, which was high in January at F$ 636 million has now declined in February to F$ 556 million.

In terms of ratio of liquidity assets margin to deposits, the liquidity is declining from the November figure of 11.2 percent to 9.5 percent in December 2013 and 9.4 percent in January 2014.

The monetary authorities will be watching the liquidity position in the next few months for any change in monetary policy action.

Net domestic credit went up by 13 percent. Private sector credit, which rose by 10 percent, propelled the rise in domestic credit. Much of the speculative activities in land and housing are on the rise and they are influenced by bank credit.