Saturday, May 31 2014

The bogey of devaluation

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The bogey of devaluation was once again raised last week.

As Fiji TV 1 reported in its 6 pm news on May 24, this time the occasion was the Panel Discussion during the 2014 Annual Conference of the Fiji Institute of Accountants, held last week in Sigatoka.

Since one of the Panelists happened to be the Deputy Governor, Reserve Bank of Fiji (RBF), a question was posed to him from the floor whether there was any possibility of a devaluation of the Fiji dollar.

The answer from Deputy Governor Inia Naiyaga was "No".

Fiji’s 2009 Devaluation

As Mr. Naiyaga told the audience, economic conditions in 2014 are different from those that prevailed in 2009.

Months before April 2009, Fiji’s foreign exchange reserves began to dwindle. The reserves were enough just to cover a month’s imports. The trade deficit was at the highest, around 37 percent of GDP.

With economic sanctions imposed on Fiji and the decline in tourist arrivals since 2007, the overheated economy with fiscal and external current account deficits was tattering. The government preferred not to seek assistance from International Monetary Fund for meeting the emerging balance of payments crisis, which is accompanied by stringent conditionalities.

The only remedy open to the government was currency devaluation. The value of Fiji dollar was reduced in terms of the US dollar by 20 percent.

Fast recovery

Following the April 2009 devaluation, imports including food and fuel became more expensive and consumers had to face hardships. However, the economy began to bounce back thanks to prudent policies. Two years later, Fiji proved to the world that it is a credit worthy nation by successfully floating its second international issue of bonds for US$ 250 million. The misery that would have been imposed by IMF conditionalities was avoided.

Today, foreign reserves are at a comfortable level, sufficient to cover imports of 4.5 months.

In 2012, trade deficit was 27 per cent of GDP as against 37 percent in 2009. Trade deficits are financed by tourism earnings and remittances. Tourism earnings rose from F$1.29 billion in 2011 to F$1.32 billion in 2013, while remittances increased from F$ 280 million in 2011 to F$ 339 million in 2013. As a result, reserves are rising: in March 2014, they were F$1.72 billion. A year ago, in March, 2013, it was F$1.49 billion.

Economic development, however, depends on productive utilization of these reserves. One has to resist temptation to fritter them away on consumption.

Why then this bogey?

The word bogey means something imaginary that people needlessly worry about, similar to the abominable snowman! The fear of the unknown is natural, especially if the future is uncertain.

Trade deficits of developing economies are normal. Fiji is dependent on imports of staples such as rice and wheat, fuel and consumer goods. Imports exceed more than exports.

The trade deficits can be bridged by inflows of funds, if appropriately encouraged. They include tourism earnings and remittances and aid. The resultant balance is called current account balance.

A negative figure is known as current account deficit (CAD).

Only when annual CADs are persistent and increasing each year, they become worrisome. During 2008-12, Fiji's CAD was the least, at just 6 percent of GDP. The corresponding figures in percent are for Vanuatu (6.1); Samoa (6.9); PNG (10.8); and Solomon Islands (16.9).

The CADs are financed by capital inflows. These include foreign direct investment (FDI); portfolio inflows as seeking higher rates of return; borrowing overseas either from private sector or governments or international agencies.

In the case of Fiji, there is no scope for portfolio investment.

Borrowing results in annual debt servicing obligations and ultimate return of capital borrowed, all in foreign exchange. The healthiest financing option therefore is FDI. The funds are non-interest bearing and are not pulled out as easily as portfolio investment, known as hot moneys.

Only when all the options are exhausted and none is available, the last remedy is devaluation.

FDI inflows

Aside from FDI in tourism, Fiji is now witnessing a real estate investment surge. Rachna Lal (Fiji Sun, May 25) gave a compilation of urban property purchases by Asian investors. They are flocking into Fiji with ready cash eager to buy up built-up properties. These transactions are in hard currencies, such as US dollars.

So, there is no room for any fear of falling reserves.

The theme of the FIA 2014 Annual Congress was: “Today’s Vision Tomorrow’s Reality”.

Today’s vision is rosy on the foreign exchange reserves front.

Tomorrow’s reality depends on how prudently Fiji uses these valuable reserves.