

# Asia Pacific economic update

## The global economy and the Fiji dollar

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### Executive summary:

- The Fiji dollar is a managed currency. The Reserve Bank of Fiji (RBF) announces a rate for the FJD/USD each morning at around 8.45am Fiji time.
- The correlation of movements in the Fiji dollar and the Australian dollar is around 0.9. Day-to-day movements in the AUD/USD rate thus have a large influence over the daily setting of the FJD/USD rate by the RBF.
- ANZ expects that the Fiji economy will grow by a moderate 1.5% in 2005. With ANZ having expected the AUD/USD to reach 0.80-0.84 by mid year if not before, that would also lead to an accompanying upward drift in the FJD/USD rate to 0.65-0.66 in the same time frame. Once the AUD/USD peaks, so will the FJD/USD rate which is expected to fall to below 0.60 by 2006.

*The following summarises ANZ's outlook for the Fiji dollar in its regional and global economic context outlined in recent presentations by David de Garis, Senior Treasury Economist to ANZ clients, the business community and government officials in Nadi and Suva, Fiji.*

The Fiji dollar is a managed currency. The Reserve Bank of Fiji (RBF) announces a rate for the FJD/USD each morning at around 8.45am Fiji time having regard to the morning's levels of Fiji's major trading partner currencies. The objective of the RBF is to maintain a broadly stable effective rate for the FJ\$, that is broad stability in its trade-weighted index. While the RBF does not disclose the weights in its trade-weighted basket, the Australian dollar is understood to have a large weight. The correlation of movements in the Fiji dollar and the Australian dollar is around 0.9. Day-to-

day movements in the AUD/USD rate thus have a large influence over the daily setting of the FJD/USD rate by the RBF. Other currencies having a large bearing beside the AUD and the NZD include the Japanese yen and the Euro.

### The global setting

The global economy had a stellar year of growth in 2004. Global growth was estimated to be 5.0%, the best year of growth for the global economy since equivalent growth in 1984. A mainstay of growth has been, and still remains, the US economy that grew by 4.4% last year. The other major growth support has been China that continued on a solid path of expansion, growing by 9.5%, faster than has been expected through most of the year and despite the progressive tightening of liquidity, lending and credit conditions.

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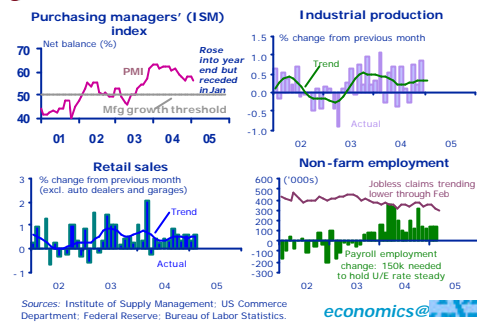
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ANZ expects that the impact of this Chinese monetary tightening will slow growth in the year ahead with expansion of 7.4% expected for 2005 of the Chinese economy. Japan is expected to record slower but still positive growth in 2005 after a very promising start to the year. Japan recorded real economic growth of just over 2.6% for 2004 and growth of 0.8% is in prospect for 2005.

**The US economy ended 2004 with reasonable growth momentum**



Underneath disappointing real GDP data in the second half of the year, Japan is making structural progress with the banking sector in recovery, companies expanding capital expenditure and employment opportunities. This recovery – though interrupted – is markedly different from the economic false starts of the past decade, being built on private sector growth and not fiscal pump-priming.

**Last year started strongly but then growth eased**

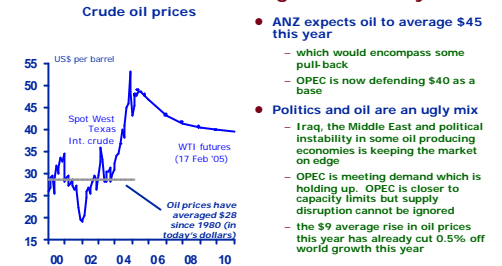


Europe continues to be the major growth laggard economic zone, recording growth of just 1.8%, with Germany expanding by just 1%. No better is expected in 2005, held back by the slow pace of structural reforms, the impact of the high Euro on exporter competitiveness and of course continuing high oil prices.

**Oil still weighing on oil-consuming economies**

ANZ expects that the price of oil will remain at very elevated levels this year, averaging \$US45 for West Texas Intermediate (WTI) crude, well above its \$US28 average over the past 25 years. While OPEC has been able to meet strong levels of demand this year, political and other uncertainties continue to plague the market which is continuing to price for some major supply disruption(s) that are yet to occur.

**Oil prices and surrounding geopolitics remains a "thorn in the side" of the global economy**



Given continuing geopolitical uncertainty, it is difficult to see that these concerns are going to dissipate anytime soon. ANZ is assuming that the price of WTI oil will average \$US45/barrel in 2005. The \$US10/barrel increase in the average price for 2004 has likely already cut world growth by 0.5% this past year; a further rise in the average price from \$US41/ barrel to \$US45/barrel on average this year stands to trim around ¼% off 2005 growth. Oil prices bear close watching; elevated prices remain a drag on the growth of the major oil-consuming economies.

**The USD: one final phase of decline?**

The US current account deficit continues to run at a very high level. At an annual rate of \$663bn pa in 2004, 5.7% of GDP, the deficit requires a significant amount of financing and the faith of international investors to invest in US\$ assets.

We continue to expect one more phase of decline in the US\$, a downtrend that has been evident for the past three years. That would bring the cumulative decline in the US\$ in real effective broad terms to 20%, in line with past major currency

adjustments in times of excessive current account deficits.

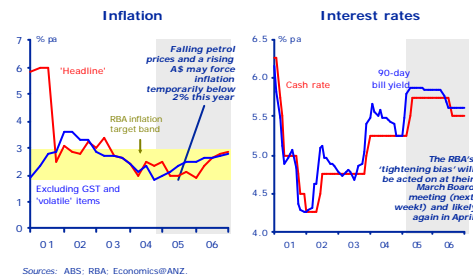
Trading has yet to confirm that this decline has emerged (the Euro for example is yet to break through its end year level of 1.364) and we would wish to see that such key levels have broken before market confirmation of this further decline arriving. We would expect that the final phase of decline would see the Euro at 1.36-1.40, by mid year if not sooner.

If this decline fails to appear soon, then higher interest rates in the US will act to support inflows into the US\$ over the next year or so. The Federal Reserve funds rate is expected to rise to 3.75% by the end of this year and to over 4% next year as the Fed lifts its rate toward a neutral rate of between 3-5%.

**Fiji trading partner growth set to struggle**

ANZ expects that the Fiji economy will grow by a moderate 1.5% in 2005. Adjustments taking place in the sugar and garment industries will restrict growth in those sectors and the economy will be even more reliant on its tourism-related growth spur. Tourism is estimated to represent around 20% of the economy and is currently enjoying buoyant conditions owing to relatively stable internal political conditions and buoyant household incomes and spending of its major source markets, Australia and New Zealand.

**The RBA has recently signalled that rates could rise over the next few months**



signalled that interest rate rises in the near term are being contemplated and ANZ expects two rate rises in the next few months, the first at the March RBA Board meeting next week.

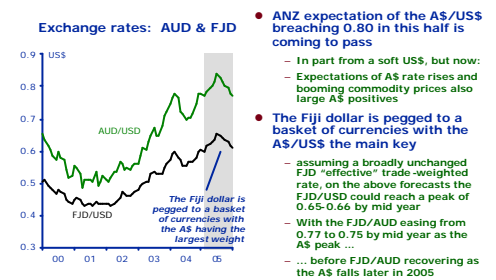
ANZ expects that the Australian economy will record growth of 3.0% in 2005 after growth of 3.6% last year, two moderate years of expansion by Australian standards. Lower growth and a flatter profile of house prices and consumer spending on the back of two rate rises will crimp demand for tourism from Australian households.

New Zealand's growth is also expected to slow from 4.8% to 4q04 to below 2.3% in 2005, dampening the growth in outbound tourism from New Zealand.

**FJD/USD to rise short term, then fall**

With ANZ having expected the AUD/USD to 0.80-0.84 by mid year if not before, that would also lead to an accompanying upward drift in the FJD/USD rate to 0.65-0.66 in the same time frame. With the AUD and the NZD outperforming, the FJD/AUD rate would be expected to move down from 0.77 to 0.75.

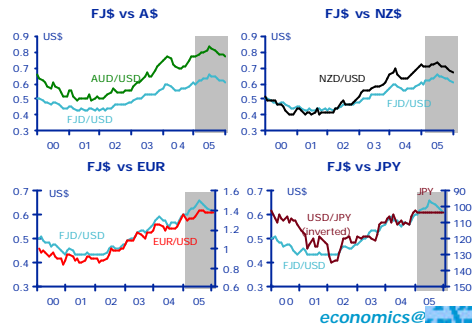
**Outlook for the Fiji dollar (FJD)**



Later in 2005, the AUD is expected to fall as factors emerge that will progressively build to become greater AUD negatives. Among these are the diminishing interest rate differential – if interrupted by the RBA final phase of tightening - and, in 2005/06, a peak in the global industrial commodity price cycle as global demand eases and as commodity producing economies overcome supply and infrastructure bottlenecks to meet demand. Under the same FJD exchange rate setting regime, such a fall in the AUD would also lead to a decline in the

FJD/USD from current levels that are beginning to approach pre-1998 devaluation levels.

**Fiji dollar cross rates**



Major key forecasts are set out in the accompanying graphic. From this Friday's Weekly, we will include forecasts for the FJD on a regular basis.

**Key FJD-related FX rates & drivers**

	Dec 2004*	Jun 2005	Dec 2005	Dec 2006
US Fed funds rate (% pa)	2.25	3.25	3.75	4.00
€ - US\$	1.36	1.40	1.37	1.26
US\$ - ¥	103	103	104	101
A\$ - US\$	0.78	0.84	0.77	0.70
RBA cash rate (% pa)	5.25	5.75	5.75	5.50
Australian 10-year bond yield (% pa)	5.33	5.50	5.30	5.10
RBNZ cash rate	6.50	6.50	6.25	6.00
FJD - US\$	0.60	0.63	0.60	0.56
FJD - A\$	0.77	0.75	0.78	0.80
FJD - NZ\$	0.84	0.85	0.89	0.94
FJD - €	0.44	0.45	0.44	0.45
FJD - ¥	61.7	65.1	62.1	55.9

\* actual

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