

ASIA PACIFIC ECONOMICS PACIFIC QUARTERLY

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NO REST FOR CURRENCY WATCHERS

Volatility in currency markets took another step higher over the past three months with the underlying theme being a strong USD. Global currencies that are pegged to the USD have come under increasing pressure to revalue their currencies. Last week alone the Chinese yuan, Vietnamese dong, and the Kazakh tenge were devalued.

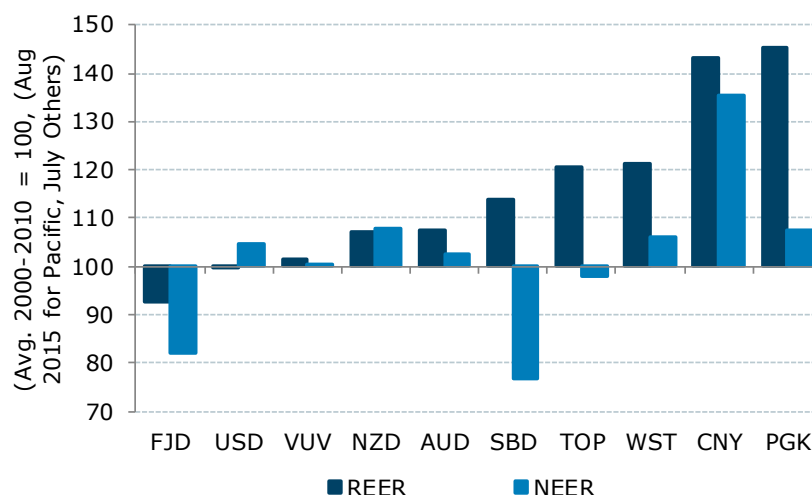
In this quarterly feature note we take a closer look at Pacific currency valuations on a trade partner basis. We hope that our examination of currency valuations across the Pacific is useful, although it does not necessarily reflect ANZ policy recommendations on any Pacific currency. Examining currencies on a NEER and REER basis is a recognised metric to understand currency valuation and we aim to encourage a broader examination of the appropriate level of currencies across the Pacific by presenting valuation metrics that are not merely reflective of the bilateral USD exchange rate. Our analysis highlights:

- **The PGK valuation looks high.** The Real Effective Exchange Rate (REER) of the PGK is currently up 45% compared to the 2000-10 average.
- **The SBD appears modestly high** although the currency has been correcting downwards over the past couple of months.
- **The TOP and WST look more fairly valued.** Both currencies have fallen recently, but are still up compared to their 2000-10 average.
- **The FJD and VUV appear fairly valued.** On a REER basis, both currencies have moved in tandem with global moves.

CHART OF THE QUARTER

The 'REER' and 'NEER' are important tools to determine the value of currencies compared to that of their trading partners. Our snapshot of the current valuations of Pacific Island currencies highlights the PGK valuation seems high with REER on par with China's. Elsewhere in the Pacific, currency valuations look more fair.

PACIFIC CURRENCY VALUATIONS COMPARED TO 2000-2010 AVG



Source: IMF, Haver, Bloomberg, ANZ Research

FEATURE NOTE

WHY FOCUS ON CURRENCY VALUATIONS IN THE PACIFIC?

The global foreign exchange market is becoming increasingly dominated by a strong USD upswing which is forcing many currencies that are either fixed or managed against the USD to become overvalued. Devaluations are becoming more frequent, as seen in recent foreign exchange realignments by Vietnam and China. In this note, we examine the performance of the Pacific Island currencies against the backdrop of wide fluctuations in currency markets over the past 12 months. We believe that too much focus has been given to bilateral exchange rates, usually the USD cross rate, and not enough attention is paid to multi-lateral trade partner rates.

While the bilateral USD exchange rate is important in determining the competitiveness of Pacific Island trade with the US, it does not provide enough information about the competitiveness of each Pacific Island with its major trading partners – such as Australia, New Zealand, China and other Pacific Island counterparts. Thus, rather than merely focussing on the bilateral USD exchange rate, we need to have an 'effective exchange rate' measure by constructing a 'basket' measure of currencies to know whether currencies are misaligned relative to those of their trading partners.

In this note we have constructed two such baskets: the Nominal and Real Effective Exchange Rate (NEER and REER) indices for six Pacific Island currencies: the PGK, FJD, SBD, TOP, VUV and WST. The advantage of analysing NEER and REER is that they take into account a larger share of trading partners and allow estimations on currency valuation and levels of competitiveness.

We hope that our examination of currency valuations across the Pacific is useful, although it does not necessarily reflect ANZ policy recommendations on any Pacific currency. Examining currencies on a NEER and REER basis is a recognised metric to understand currency valuation and we aim to encourage a broader examination of the appropriate level of currencies across the Pacific by presenting valuation metrics that are not merely reflective of the bilateral USD exchange rate. Our analysis suggests:

- **The PGK valuation looks high.** On a REER basis, the PGK is currently up around 45% compared to the average rate over 2000-2010.
- **The SBD appears modestly high.** Although the currency has been correcting downwards over the past couple of months, its REER is still almost 15% above levels in 2000-2010.
- **The TOP and WST look more fairly valued.** Both currencies have fallen with global trends; however, from 2000 to 2010, there was a sharp appreciation of their REERs.
- **The FJD and VUV appear fairly valued.** On a REER basis, both currencies have fallen over the past couple of quarters. The FJD's current valuation is lower than it was in 2010.

THE GLOBAL AND REGIONAL FX BACKDROP**SLEEPY CURRENCY MARKETS AWAKE FROM THEIR SLUMBER**

Following the Global Financial Crisis (GFC) in 2008-09, key central banks around the world embarked on aggressive monetary policy easing to arrest the slowdown in domestic growth, thereby giving rise to 'the carry trade'. The US Federal Reserve led the pack in monetary policy easing, lowering interest rates to near zero and purchasing government assets via 'quantitative easing.' With weak corporate earnings and depressed US bond yields this process began a global hunt for yield, or the 'carry trade.' In principle, a carry trade entails borrowing money at a lower interest rate, converting it into another currency which yields a higher interest rate, holding the foreign currency to profit from the interest differential, then converting it back into the original currency to repay the loan. At the end of the trade, one will receive the difference between the interest rate borrowed at and the interest rate paid, together with any change in currency valuations. The carry trade dominated markets for nearly five years following the GFC because the US was keeping interest rates low, and prospects for USD appreciation were weak as the economy struggled to gain traction. A lot of money thus cascaded into emerging markets and higher-yield developed markets. The AUD and NZD were certainly recipients of this flow.

However, volatility and market expectations have killed the carry trade. As the US economy moves closer to starting policy normalisation, it brought a new bout of currency volatility and a re-assessment of the USD's valuation. This global transition in expectations over the past 12 months has sent the USD on a strong appreciation path, with emerging market currencies and higher-yield developed market currencies left in its dust. Sharp declines in commodity prices (-40% y/y), slowing ex-US global growth (led by China) and the sentiment shift on the USD has certainly caused an increase in volatility.

FEATURE NOTE

Over the past year, a trade-weighted broad USD index has climbed around 20% y/y (Figure 1), representing USD performance against partners: EUR (32% weight), JPY (19% weight), CAD (12% weight), AUD (6% weight), CNH (3% weight), and others (28% weight); the NZD is not included. Figure 2 shows USD performance against three partners of the Pacific Island economies (Australia, New Zealand, and China) over the past year. Against the AUD and NZD, the USD appreciated 23% and 25% respectively, while the recent regime change¹ in China's foreign currency policy has resulted in the USD rising 5% against the CNY, with the bulk of gains made during the past week.

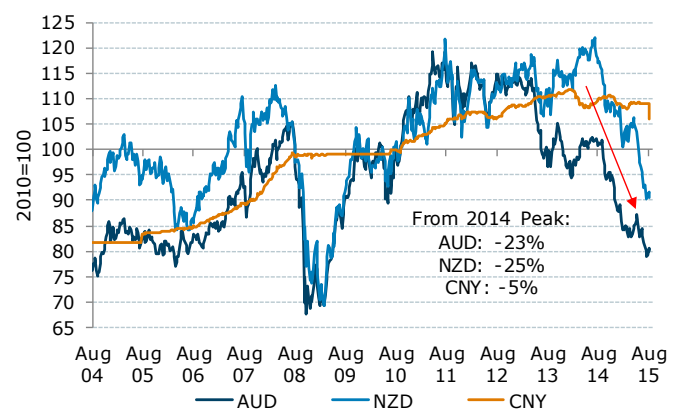
CHART PACK: KEY CURRENCIES AT A GLANCE

FIGURE 1. USD HAS BEEN ON A STRONG APPRECIATION PATH



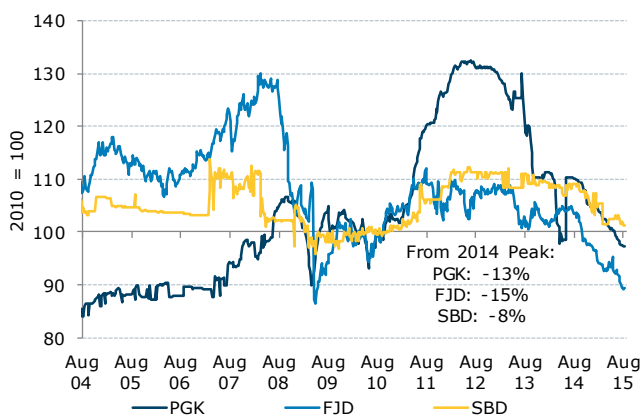
Source: Bloomberg, ANZ Research

FIGURE 2. PERFORMANCE OF AUD, NZD AND CNY AGAINST USD (QUOTED AS LOCAL/USD)



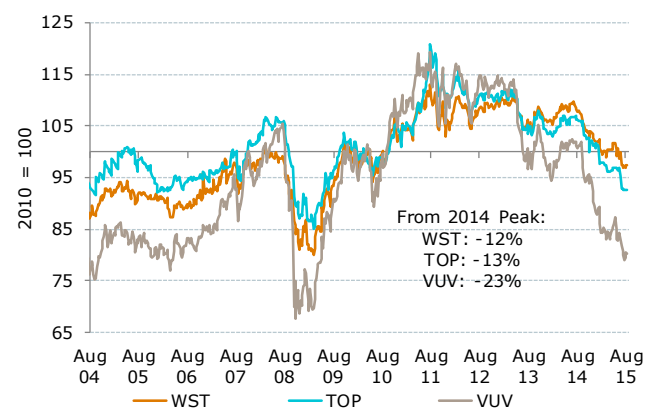
Source: Bloomberg, ANZ Research

FIGURE 3. PERFORMANCE OF PGK, FJD AND SBD AGAINST THE USD (QUOTED AS LOCAL/USD)



Source: Bloomberg, ANZ Research

FIGURE 4. PERFORMANCE OF WST, TOP AND VUV AGAINST THE USD (QUOTED AS LOCAL/USD)



Source: Bloomberg, ANZ Research

A look at the Pacific currencies showed that all have also depreciated against the USD in the past year. In Figure 3, we focus on Papua New Guinea, Fiji and Solomon Islands, the three largest economies with a local currency. From their peaks in 2014, the PGK is down 13%, the FJD has fallen 15% and the SBD has skidded 8% against the USD. In Figure 4, we look at the currencies of some of the smaller Pacific Islands, whose movements against the USD have also been quite significant, led by Vanuatu's VUV decline of 23%, Samoa's WST fall of 12% and Tonga's TOP drop of 13%. Nonetheless, most Pacific Island currencies have not depreciated as much as the AUD or NZD. Historically, Australia and New Zealand have been key trading partners of the Pacific Island economies. Thus, given the relative sharp falls in the AUD and NZD, we want to determine whether the Pacific Island currencies are currently over-valued, or if their declines are in line with historical rates.

¹ ANZ Insight: China's New Exchange Rate Regime: A Step Towards a More Flexible System

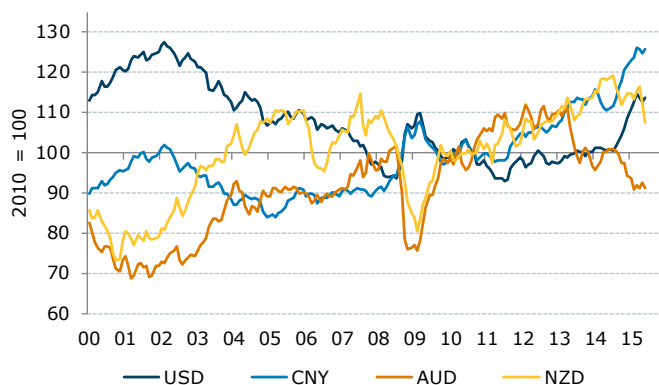
FEATURE NOTE

TECHNICAL NOTE: THE 'NEER' AND 'REER'

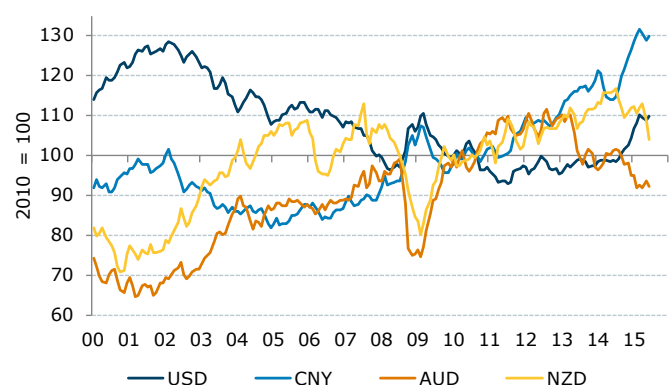
From a macroeconomic perspective, it is important to consider exchange rate valuations beyond the movements of any single currency pair. As economies grow in size and complexity, the number of trading partners also increases. Therefore, over-concentrating on any one currency pair will mask the impact of the inter-related moves of other currencies. Hence, economists and policy makers frequently look beyond bilateral exchange rates, such as the AUD/USD or NZD/USD, to a basket of currencies.

The Nominal Effective Exchange Rate (NEER) and Real Effective Exchange Rate (REER) are tools to examine currencies on a multi-lateral trade partner basis. The NEER measures the weighted average value of a country's currency relative to that of its trading partners, while the REER adjusts the NEER for differences in inflation between the home country and its trading partners. "The REER is used for a wide variety of purposes, such as assessing the equilibrium value of a currency, the change in price or cost competitiveness, the drivers of trade flows, or incentives for reallocation of production between tradable and non-tradable sectors."² In view of the importance of the REER and NEER in formulating economic policy, a number of organisations (World Bank, Eurostat, BIS, OECD and many central banks) produce these data series for global currencies. However, because of the geographic segmentation of the Pacific Island region and lack of comprehensive trade data, their economies are often excluded from such analyses. **Thus in the following section, we attempt to construct the NEER and REER series for the Pacific Island economies.** For the equations used to calculate the data, please refer to the Appendix.

First, it is worth analysing how major currencies NEER and REER have performed. The NEER performance of four global currencies (USD, CNY, AUD and NZD) is shown in Figure 5. A number above 100 signals that a currency has appreciated relative to its valuation in 2010, whereas a number below 100 suggests it has depreciated. 2010 is used as an arbitrary base year, but it also serves as an anchor for the post-GFC currency trend. Among the four currencies, the USD began the 2000s at a higher valuation, peaked in 2002 and gradually depreciated over the next seven years. The GFC (2008-09) saw the USD appreciate for a brief period before it reversed gains and traded in a horizontal fashion from 2010-14. At the end of 2014 and into 2015, the USD rose sharply, in an almost vertically upward fashion. On the other hand, the AUD and NZD have been more volatile in the past 15 years. Both were generally appreciating until sharp declines during the GFC. This was followed by a period of recovery, until a divergence in 2013 when the AUD slid but the NZD continued its appreciation path, and subsequently both currencies declined from 2014. On the other hand, the CNY NEER has been on a steady appreciation path over the past 15 years. **In Figure 6, we compare REER performance takes inflation into account and shows the same general pattern.**

FIGURE 5. MAJOR CURRENCY NEER PERFORMANCE

Source: BIS, Haver, ANZ Research

FIGURE 6. MAJOR CURRENCY REER PERFORMANCE

Source: BIS, Haver, ANZ Research

We then constructed the NEER and REER series for all Pacific Island economies over the past 15 years, using 11 trade partner countries for each economy that account for 60-90% of individual trade baskets. The trade weights are adjusted on a 12-month rolling basis (For a table of the most recent weights, please refer to the Appendix). We will go through a more detailed analysis of each individual currency in the next section, but at first glance, a few broad trends are apparent:

Figure 7 shows the Pacific NEER series. The PGK, SBD and FJD have been much more volatile over the past 15 years compared to the other Pacific currencies. The PGK and SBD began the 2000s at much higher levels before declining in the 2000-2005 period. The strength of the FJD is notable until its devaluation in 2009. The VUV, TOP and WST have been trading closer to their 2010 value over most of the sample period.

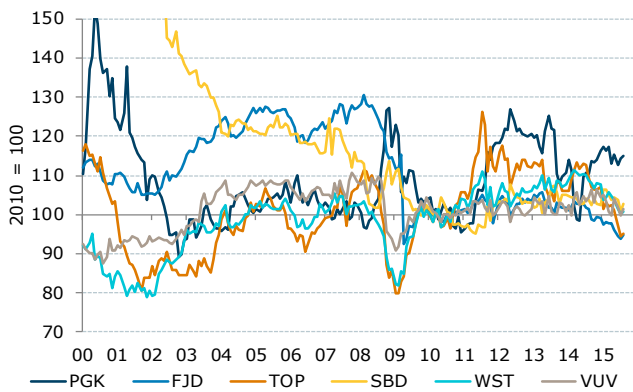
² Bruegel European Think Tank

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Finally, during the most recent eight to 12 months, the majority of the Pacific Island currencies have experienced a decline in NEER, except for the PGK whose NEER has remained sticky to the high side.

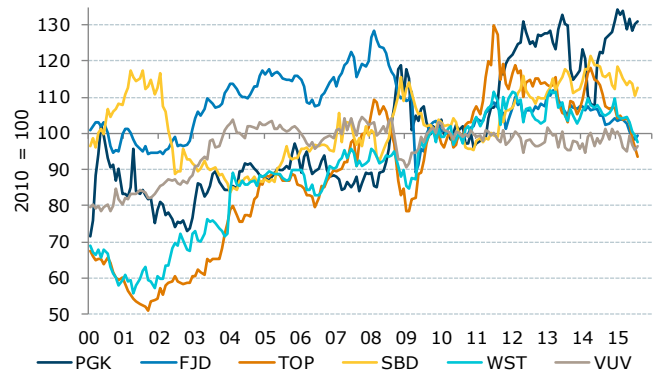
In Figure 8, the Pacific REER series (controlling for inflation). Generally, most Pacific currencies had a gradual uptrend in REER over the past 15 years, which implies that they have either become increasingly expensive compared to their trading partners, or there is a loss of competitiveness. Notable, the PGK REER has been on a clear appreciation path over the past 15 years, and is currently 30% greater than the 2010 value. However, over the past couple of months, most Pacific REERs have declined.

FIGURE 7. PACIFIC CURRENCY ANZ NEER PERFORMANCE



Source: Haver, CEIC, Bloomberg, ANZ Research

FIGURE 8. PACIFIC CURRENCY ANZ REER PERFORMANCE

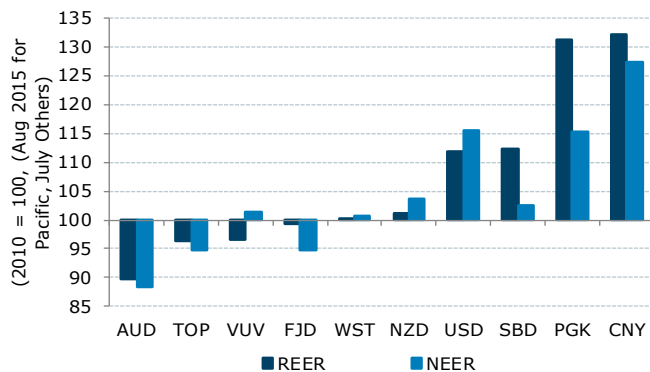


Source: Haver, CEIC, Bloomberg, ANZ Research

HOW DO CURRENT VALUATIONS COMPARE TO HISTORIC RATES?

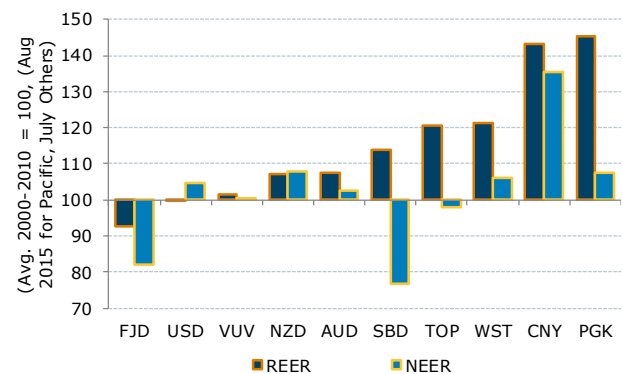
In Figure 9 we map out the current NEER and REER values. On the left of the chart are currencies that have depreciated relative to their trade partners, and on the right, currencies that have appreciated. From a policy setting perspective, the REER is more important than the NEER as currency values can change because of price differences onshore. However when we normalise for this (REER), we are able to gain an indication of competitive gains (or losses). The AUD, TOP, VUV and FJD have become more competitive compared to 2010 (depreciation), but not by a large amount, with AUD only falling around 10%. On the other hand, PGK and CNY have appreciated a significant amount since 2010, with both up about 30% on a REER basis. The SBD and USD have also appreciated over the same period.

FIGURE 9. CURRENT NEER AND REER VALUATIONS COMPARED TO ONLY 2010 (2010=100)



Source: Haver, CEIC, Bloomberg, ANZ Research

FIGURE 10. CURRENT NEER AND REER VALUATIONS COMPARED TO 2000-2010 AVERAGE (2000-2010=100)



Source: Haver, CEIC, Bloomberg, ANZ Research

There could be base effect concerns in the Figure 9. We used '2010=100' in our calculations, but what if currency valuations were an anomaly that year? In Figure 10 we attempt to control for this by averaging 2000-2010 = 100 to help mitigate base effects and to include a couple of economic cycles. The results change for some Pacific currencies: FJD's current valuation is below its 2000-2010 average, while the USD and VUV are relatively consistent with their valuations. NZD and AUD are slightly stronger than their longer term average, but less than 10% on a REER basis. SBD, TOP and WST are a fair bit stronger on a REER basis, up 15-20%. CNY and PGK appreciate strongly. On a REER basis, PGK is up 45% compared to its 2000-2010 average and CNY is up 43%. The strong gains in REER could represent upgrades in economic productivity, or they could represent over-valuation which could bring risks of a subsequent corrective fall in the currency.

FEATURE NOTE

COUNTRY SUMMARIES

THE PAPUA NEW GUINEA KINA HAS APPRECIATED STRONGLY OVER PAST 15 YEARS

Depreciation would be a helpful dynamic to support growth

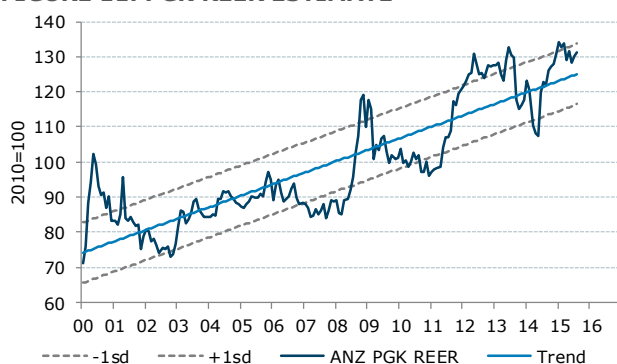
The PGK REER has been on a strong appreciation path over the past 15 years. We note three key events which drove the PGK REER to its current level. First, strong commodity price gains from 2000 to 2009, and to a smaller extent, elevated commodity prices from 2010 to Q3 2014; second, the construction phase of the LNG project brought significant FDI onshore 2010-2013; and third, the 2014 implementation of a band around PGK trading. The first two events were macroeconomic in nature while the third was a policy choice.

Commodity price gains in the period 2000-2009 saw increases of over 160%, and PNG as a commodity exporter undoubtedly benefited. From 2010 to 2013, commodity prices were fairly high compared to long-term historical standards although it was not the main driver of PNG's REER appreciation over that period. Rather, the construction of PNG LNG brought substantial capital onshore and likely raised potential growth. These two factors were likely the main drivers behind the uptrend in REER from 2000 to 2013.

However, as commodity prices fell (by roughly 40%) and construction of the LNG project ended, the REER began to slide sharply. From a structural standpoint, an argument could be made that the uptrend in REER should flatten, if not decline from 2013. However, the implementation of the trading band in 2014 quickly reversed the fall. Over the past eight months, the PGK REER has remained relatively stable and is currently hovering around levels similar to those at the peak of the LNG construction in 2011-2012. Currently, the REER is trading at more than one standard deviation from the trend, and 30% above its 2010 valuation, and 45% above the 2000-10 valuation. With commodity prices falling and future FDI projects still a number of quarters (or years) away, this trend slope is likely too sharp. **At these levels, the REER may be too high. The currency would need to depreciate to be more aligned with economic conditions, in our view.**

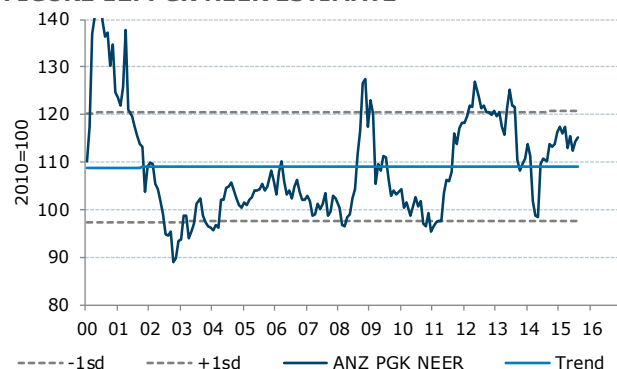
The PGK NEER has not exhibited the same upward trend, highlighting the masking effects prices (inflation) can have. Indeed, inflation in PNG has strongly outpaced the rest of the world, driving up the REER. Typically, if an economy is running high levels of inflation its nominal exchange rate would depreciate to offset this decline and the REER would be maintained for international competitiveness. Currently the NEER is about 15% the 2010 level in the upper half of the first standard deviation.

FIGURE 11. PGK REER ESTIMATE



Source: Haver, CEIC, Bloomberg, ANZ Research

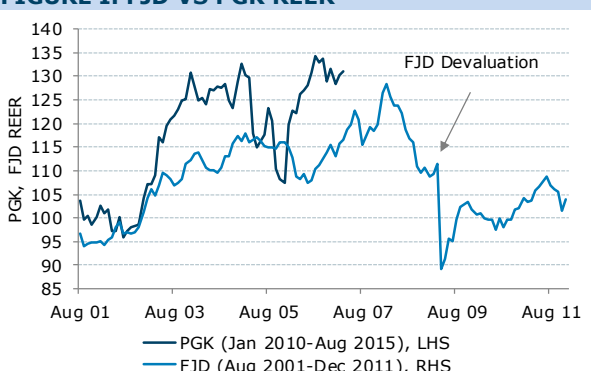
FIGURE 12. PGK NEER ESTIMATE



Source: Haver, CEIC, Bloomberg, ANZ Research

BOX 1 – THE EXPERIENCE OF FJD MISALIGNMENT AND REVALUATION

FIGURE I. FJD VS PGK REER



Source: IMF, Haver, Bloomberg, ANZ Research

Given our assessment on the PGK, it is useful to look at other examples of currency misalignment in the Pacific. We are reminded of the significant misalignment of the Fijian currency that arose from 2001 to 2009, which was eventually remedied by a 20% devaluation. In 2009, Mr. Sada Reddy, Governor of the RBF, noted they were “[monitoring our currency closely for a number of years and our balance of payments.](#)” The FJD had appreciated 35% from 2002 to 2009. By comparison, the appreciation of the PGK since 2010 suggests a larger misalignment has occurred over a shorter time frame.

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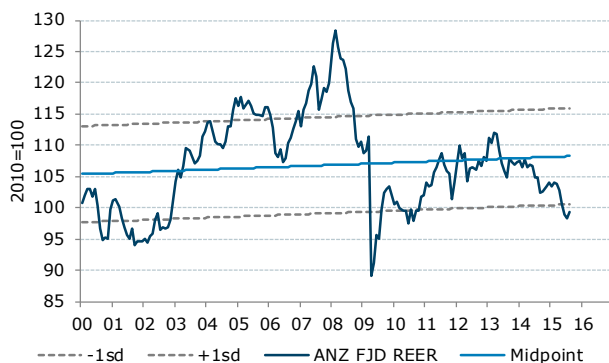
THE FIJIAN CURRENCY APPEARS FAIRLY VALUED

No significant misalignment appears to be in place

The FJD REER is currently trading one standard deviation below the relatively flat trend. From 2002 to the start of 2009, the FJD REER was on a strong appreciation path, climbing around 35%. The sharp rise in the REER eventually led to an overnight 20% devaluation in the FJD in 2009. Following this decline, the REER has been moving in a more controlled and relatively horizontal direction. Meanwhile, compared to 2010, Fiji has improved their competitiveness, with REER trading 8% lower than 2010. The current account appears to be reacting positively to the currency valuation at the present time, with a deficit that is roughly half the amount (% of GDP) compared to that during the 2009 devaluation. **At present, the FJD REER appears fairly valued and we do not see any significant misalignment.**

The FJD NEER has been on a declining trend over the past 15 years. Much like the REER, after the FJD devaluation, the NEER has climbed sharply from 2002-2009 levels. Hitherto, the FJD has been maintaining international valuations within a thin range.

FIGURE 13. FJD REER ESTIMATE



Source: Haver, CEIC, Bloomberg, ANZ Research

FIGURE 14. FJD NEER ESTIMATE



Source: Haver, CEIC, Bloomberg, ANZ Research

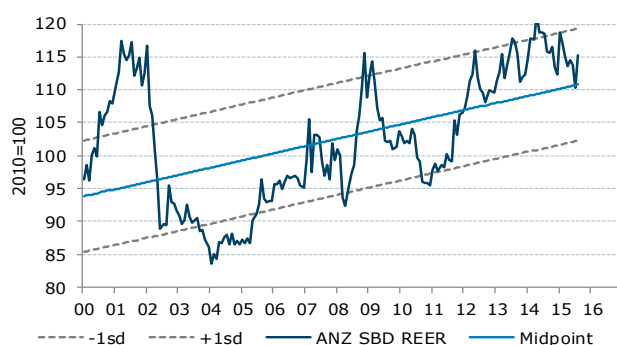
THE SOLOMON ISLANDS DOLLAR LOOKS SOMEWHAT EXPENSIVE

A modest depreciation could be useful

The SBD REER has been on a gradual appreciation path over the past 15 years, especially over the past four, the REER has been sticky to the high side. The SBD regime is a currency basket; if large shifts in the basket components are not followed by corresponding moves in the SBD, then there will be risks of misalignment in the currency valuation. However, for Solomon, the currency basket is different from the REER trade basket because of the importance of China to trade. In 2015, China accounted for 54% of Solomon's trade, even though the CNY is not currently in the SBD basket. The REER is currently 15% higher than the 2010 valuation. **We thus see the currency as modestly overvalued on a REER basis, so a modest depreciation of the currency would be appropriate.**

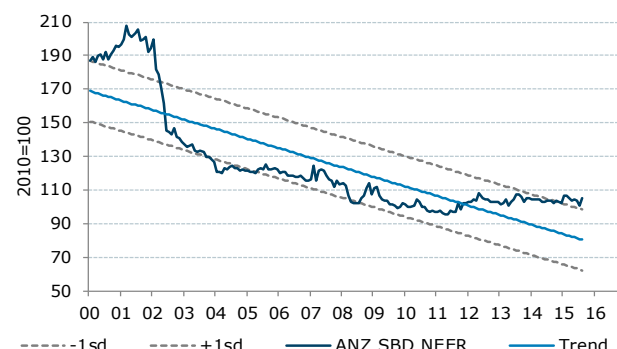
The SBD NEER has been on a downtrend over the past 15 years, but recently it has been trading horizontally and is one standard deviation above trend. Though we view the REER as a better gauge for policy, the NEER can help highlight the presence of direct market pressure for valuation changes.

FIGURE 15. SBD REER ESTIMATE



Source: Haver, CEIC, Bloomberg, ANZ Research

FIGURE 16. SBD NEER ESTIMATE



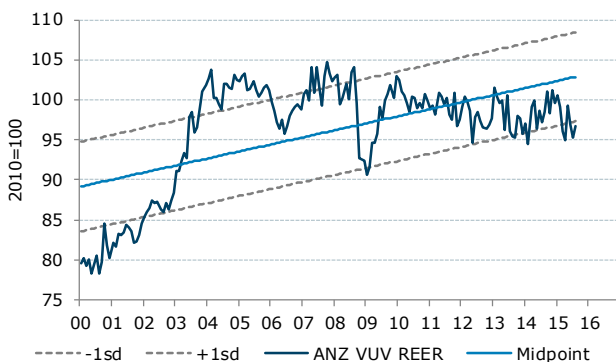
Source: Haver, CEIC, Bloomberg, ANZ Research

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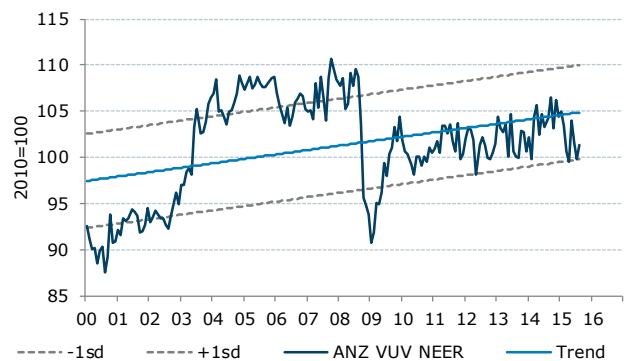
THE VANUATU VATU IS APPROPRIATELY VALUED**There does not seem to be any significant currency misalignment**

The VUV REER has been on an uptrend over the past 15 years. However, for the past 10 it has been trading in a horizontal channel. More recently, the VUV REER has fallen to one standard deviation below the trend value due to the currency's underperformance in the Pacific complex as a whole and its general move with major trading partners. **In conclusion, we see the VUV as fairly valued and no significant misalignment is identified.**

The VUV NEER has also been trending in the lower half of the trend band, hovering around the 100 level over the past five years after the currency fell sharply in the wake of the global financial crisis.

FIGURE 17. VUV REER ESTIMATE

Source: Haver, CEIC, Bloomberg, ANZ Research

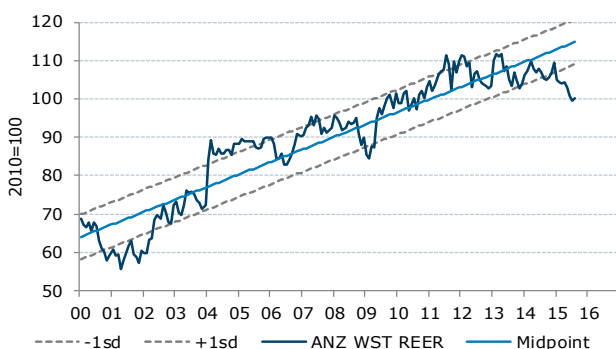
FIGURE 18. VUV NEER ESTIMATE

Source: Haver, CEIC, Bloomberg, ANZ Research

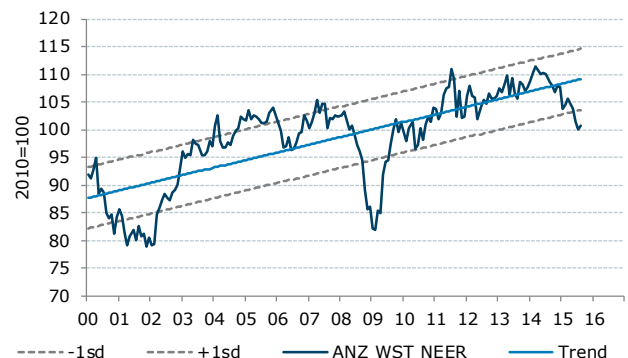
THE WEST SAMOAN TALA LOOKS WELL PRICED**The currency is becoming more competitively positioned**

The WST REER has been on a firm appreciation trend over the past 15 years, although over the past five years a sideways correction or even downward move is emerging. The REER is now trading below one standard deviation from the trend line, which we view as a healthy move for the currency, given its exhibited strength over the 2000-2010 period. The REER is now on par with its 2010 level and appears to be in a downtrend. With global trading partners also depreciating, we view the correction in WST as a stabilising move. However, as noted above, when we calculate the average of the 2000-2010 period for the WST REER and compare it to today's valuation, the REER is still high. **This suggests there may be a technical continuation of the downward move, but in our view the WST looks reasonably priced.**

The WST NEER has been on a relatively gradual uptrend over the sample period. Recently, the currency has fallen below one standard deviation of the trend value, but this natural currency adjustment seems appropriate.

FIGURE 19. WST REER ESTIMATE

Source: Haver, CEIC, Bloomberg, ANZ Research

FIGURE 20. WST NEER ESTIMATE

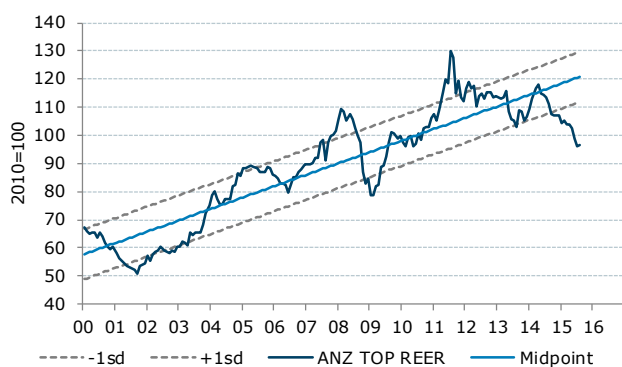
Source: Haver, CEIC, Bloomberg, ANZ Research

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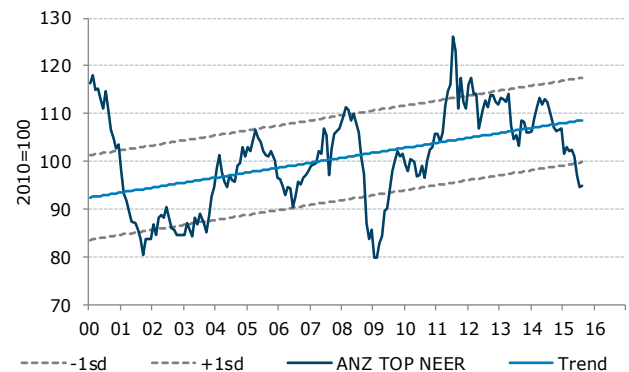
THE TONGAN PA'ANGA LOOKS WELL PRICED**The currency is competitively positioned**

The TOP REER is also now trading more than one standard deviation below the long term trend. Since 2011, the TOP has actually experienced a downward trend, falling over 30%, and increasing the economy's competitive position on a global scale. The REER is now at 2009-10 levels. However, like the WST, the TOP REER valuation is still high when compared to the 2000-2010 average. **As such, the downtrend could be maintained so the currency can perhaps be more competitively priced.**

The TOP NEER has also fallen below one standard deviation of the trend band. The currency has fallen sharply over the past 18 months on a nominal basis compared to the economy's trading partners, and is down roughly 30% from 2011 levels. The NEER is now trading below the 2010 watermark of 100.

FIGURE 21. TOP REER ESTIMATE

Source: Haver, CEIC, Bloomberg, ANZ Research

FIGURE 22. TOP NEER ESTIMATE

Source: Haver, CEIC, Bloomberg, ANZ Research

CONCLUSION

Global currency misalignments are increasingly becoming the focus of policy makers in economies large and small. Over the month of August, both China and Vietnam have responded to significant currency misalignments by revaluing their currencies. As in other markets, misalignments and mispricings occur occasionally in the foreign exchange market. However, when a misaligned currency poses a threat to the medium term sustainability of economic growth, it becomes appropriate for governments and policy makers to respond to such misalignments with engineered revaluations. In the recent history of the Pacific, the events in Fiji of 2009 are a useful illustration.

We hope that our examination of currency valuations across the Pacific is useful, although it does not necessarily reflect ANZ policy recommendations on any Pacific currency. Examining currencies on a NEER and REER basis is a recognised metric to understand currency valuation and we aim to encourage a broader examination of the appropriate level of currencies across the Pacific by presenting valuation metrics that are not merely reflective of the bilateral USD exchange rate.

Where we have identified currency misalignments, we also present a simple conclusion on what would be a useful development on the currency front for the next 12-18 months. Indeed, we note that where currency misalignments have developed, they have usually developed over a period of years, not merely months.

- We feel currency depreciation would be useful in both Papua New Guinea and the Solomon Islands, given the large declines in global commodity prices, softer growth outlook, and elevated REER levels.
- We believe Tonga and Samoa have appropriately valued currencies, but they perhaps need to monitor if the level of the currency is starting to restrain growth or inflation.
- Fiji and Vanuatu have competitively priced currencies and should be alert to the fact that these may become stimulatory over time.

Daniel Wilson, Glenn Maguire, Eugin Lee

FEATURE NOTE

APPENDIX

FIGURE A. NEER AND REER EQUATION

$$NEER_t = 100 \times \prod_{i=1}^{11} (S_{it}^*)^{w_i}$$

$\prod (S_{it}^*)^{w_i}$ = product of the shares of the exchange rates of the individual trading partners (exchange rate in the period under review / exchange rate in the base period) raised to the power of their weights in the base period

$$REER = NEER * \left(\frac{\text{Domestic Inflation}}{\text{Foreign Inflation}} \right)$$

FIGURE B. EXAMPLES OF COUNTRY WEIGHTS FOR NEER AND REER CALCULATION

Country weights - December 2010												
% of total	AUD	CNY	EUR	JPY	KRW	MYR	SGD	THB	USD	GBP	NZD	Trade captured by model
PNG	50.7	9.8	8.0	10.1	2.5	4.6	7.3	2.1	2.2	1.3	1.5	67%
Fiji	22.5	7.1	1.4	5.1	1.8	2.1	28.8	3.5	10.4	2.5	14.8	70%
Samoa	18.3	12.6	1.1	5.0	1.8	0.9	17.9	2.1	7.7	0.8	31.9	59%
Solomon	19.8	40.0	6.6	3.0	2.0	4.4	15.7	3.5	0.9	0.2	4.0	81%
Tonga	7.3	8.4	1.0	20.2	0.9	1.8	2.0	2.3	15.2	0.4	40.5	59%
Vanuatu	7.2	2.6	1.4	9.4	53.2	0.5	8.8	12.7	0.6	0.2	3.3	90%

Country weights - August 2015 (current)												
% of total	AUD	CNY	EUR	JPY	KRW	MYR	SGD	THB	USD	GBP	NZD	Trade captured by model
PNG	35.9	17.3	5.8	21.0	3.0	4.1	6.5	1.9	1.9	1.5	1.3	63%
Fiji	17.1	14.6	3.4	4.6	14.4	2.8	13.5	2.9	9.5	3.5	13.7	70%
Samoa	15.2	17.3	1.9	4.5	12.8	2.7	5.8	3.4	9.2	0.3	26.9	59%
Solomon	15.4	53.8	5.8	2.3	2.1	4.3	6.2	2.8	1.5	2.6	3.2	80%
Tonga	7.3	18.9	5.4	9.5	1.2	1.8	3.1	1.7	16.8	0.3	34.1	58%
Vanuatu	11.5	29.8	2.0	20.3	2.6	1.3	15.8	8.6	2.1	0.5	5.3	81%

Source: IMF Direction of Trade database, Haver, ANZ Research

FEATURE NOTE

ANZ INSIGHT SERIES, ISSUE 6: POWERING PNG INTO THE ASIAN CENTURY

Papua New Guinea's development goals require a tripling of electricity supply by 2030, which the existing delivery system will be hard-pressed to deliver. The challenge suggests new directions for electricity, including both on-grid and off-grid solutions in remote areas – diesel should play little, if any role and grid extension should be judicious.

PNG's development ambitions cannot be achieved without energy supply improvements, which must be delivered at an unprecedented pace and scale. Supply must increase by 225%, or 7.2% per year to meet PNG's stated development goals, with the fastest growth in rural areas where current electricity outcomes and capabilities are the weakest. Such a change will mark a sharp departure from the historic performance of PNG's electricity system. But if the current system cannot meet PNG's needs, what should replace it?

New energy technologies – such as solar PV, micro-hydro and biomass – are prime candidates. The emergence and increasing viability of new energy generation and storage technologies provide a new electrification pathway. Recent improvements in their cost, price and capabilities have unlocked new ways to vastly improve energy access, often by freeing electricity supply from grid infrastructure.

Four key points are apparent in the report:

- 1) **Move beyond an assumption 'the grid is the answer'.** As off-grid solutions improve in cost and reliability, the area for which grid extensions make sense is shrinking.
- 2) **For on-grid generation, utilisation effects can challenge traditional approaches.** The practical and commercial advantages of gas-fired generation may suggest gas is superior to hydro generation projects.
- 3) **New technologies are a superb match for off-grid needs.** In areas beyond the reach of the current electricity grid, the use of emerging energy technologies could immediately make real improvements in cost and reliability, even when compared with currently installed capacity.
- 4) **Better integration of landmark resource and agricultural developments can support nationwide network development.** In an earlier insight report [Bold Thinking](#), we identified the need to integrate infrastructure development with key agricultural and minerals projects.

Together, these points invite a move away from diesel. Achieving PNG's electricity goals by embracing new generation and storage approaches could reduce required expenditure to USD10bn from around USD15bn, with savings of around USD5bn over the next 15 years.

This report describes a possible end-state for PNG's electricity sector. However, the proposed reforms would represent rapid change for all involved and much remains to be defined. The many programs currently under way – including the drafting of PNG's new energy policy and NEROP – will ensure real resources are dedicated to establishing a secure energy future for PNG.

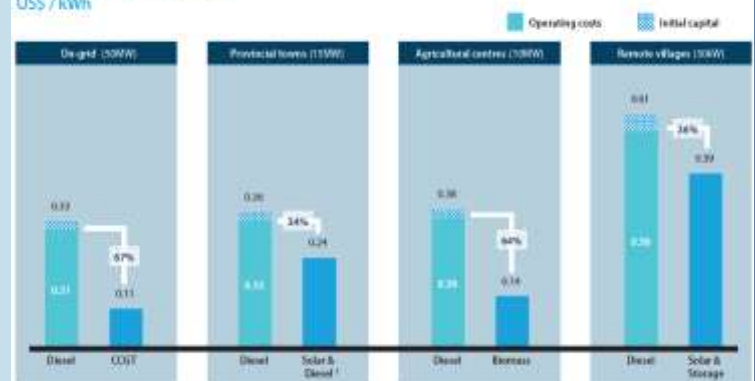
A conversation about the best response to these challenges is needed and should address the following:

- What is the best way forward for PPL and off-grid electricity provision?
- How can an appropriate and stable environment for electricity provision stakeholders be established?
- How should electricity reform align with other government initiatives and with PNG's social reality?

The possible impact of successful electricity planning and implementation in PNG includes not only the USD5bn savings mentioned above but more importantly, a foundation for PNG's future. Achieving the kind of growth across agriculture and natural resources outlined in [Bold Thinking](#) will be impossible if electricity access hinders development. Stakeholders must continue to push for an immediate and focused evaluation of PNG's electricity approach to set a course for decades to come. ([Click here for the full report](#))

DIESEL VS ALTERNATIVE ELECTRICITY GENERATION TECHNOLOGIES BY SCENARIO

Levelised cost of electricity
US\$ / kWh



Source: PJPL analysis, Insight 6

MACRO FORECASTS

REAL GDP GROWTH (%)

	2013	2014F	2015F	2016F
Fiji	4.6	4.5	4.0	3.0
PNG	5.5	8.5	10	3.0
Samoa**	0.0	1.9	2.4	2.5
Solomon Is.	3.2	1.0	3.3	3.0
Timor-Leste*	9.5	7.0	6.2	6.0
Tonga	-3.0	1.9	2.5	2.8
Vanuatu	3.2	3.6	-0.5	4.0

INFLATION (%)

	2013	2014F	2015F	2016F
Fiji	2.9	0.5	3.0	3.0
PNG	3.6	6.6	6.5	5.0
Samoa**	-0.2	-1.2#	2.0	2.3
Solomon Is.	5.8	4.8	1.8	3.0
Timor-Leste	9.7	1.5	3.1	3.3
Tonga	1.0	1.5	1.9	2.5
Vanuatu	1.4	1.0	3.0	3.0

CURRENT ACCOUNT BALANCE (% OF GDP)

	2013E	2014F	2015F	2016F
Fiji	-20.7	-10.0	-8.7	-8.9
PNG	-22.4	17.4	12.0	11.0
Samoa**	-2.0	-5.4	-5.2	-5.0
Solomon Is.	-4.0	-6.0	-5.1	-7.5
Timor-Leste*	45	22	12	12
Tonga	-6.0	-4.8	-4.8	-5.0
Vanuatu	-6.2	-6.0	-7.0	-7.0

NOMINAL GDP (USDbn)

	2013E	2014F	2015F	2016F
Fiji	3.4	3.7	3.9	4.1
PNG	16.1	18.5	21.5	23.2
Samoa**	0.8	0.8	0.8	0.9
Solomon Is.	1.1	1.2	1.3	1.4
Timor-Leste*	1.4	1.5	1.7	1.8
Tonga	0.5	0.5	0.5	0.5
Vanuatu	0.8	0.9	0.9	0.9

FISCAL BALANCE (% OF GDP)

	2013E	2014F	2015F	2016F
Fiji	-2.8	-2.1	-2.7	-1.7
PNG (under review)	-7.8	-6.9	-4.5	-2.6
Samoa**	-6.1	-4.8	-4.2	-3.9
Solomon Is.	2.3	-1.3	-3.5	3.0
Timor-Leste	39.7	21.0	22.5	19.0
Tonga	-1.1	-0.2	-0.1	-0.2
Vanuatu	0.7	-2.1	-3.0	-3.0

FOREIGN EXCHANGE RESERVES (USDm)

	2013E	2014F	2015F	2016F
Fiji	755	750	764	780
PNG	2,750	2,296	1,950	2,750
Samoa	137	155#	156	160
Solomon Is.	515	530	550	550
Timor-Leste	15.0bn	16.5bn	18.2bn	19.0bn
Tonga	140	138	140	140
Vanuatu	189	212	228	228

Source:

Fiji: Reserve Bank of Fiji, ADB, IMF, ANZ Research

PNG: Department of Treasury, Central Bank of PNG, ANZ Research

Samoa: Samoa Bureau of Statistics, IMF, ADB, ANZ Research

Solomon Islands: Central Bank of Solomon Islands, IMF, ANZ Research

Timor-Leste: IMF, ANZ Research

Vanuatu: Reserve Bank of Vanuatu, IMF, ANZ Research

* Real and nominal GDP pertain to non-oil GDP; current account balance as % of non-oil GDP.

** Samoa's fiscal year runs from July – June. Note that the Fiscal Balance is based on data from the Samoa Bureau of Statistics. Current Account Balance figures from the IMF.

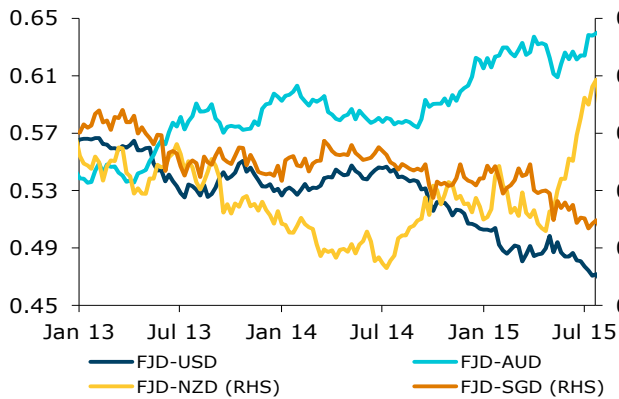
Denotes actual.

FX REVIEW

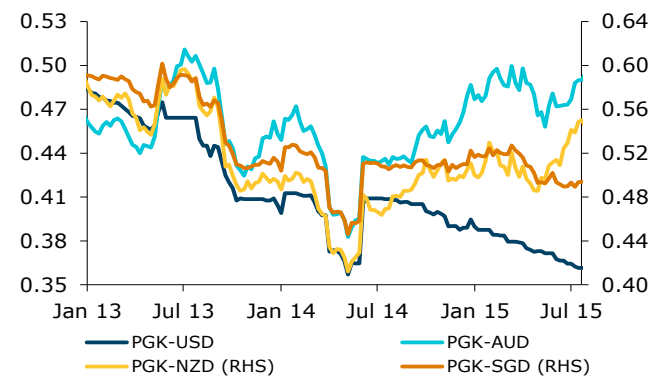
CURRENCIES

The recent draft of low commodity prices continue to weigh on commodity currencies (AUD, NZD) with the resulting income shock/ trade recession for commodity producers creating upward pressure on most Pacific currency crosses. However, the backdrop of USD strength should still remain robust although growing speculation toward the timing of the Fed rate hike and the China economy/currency could introduce more volatility to the regional Pacific currencies. Indeed, with China being the Pacific's second largest trade partner, currency movements could have profound implications for the Pacific's NEER and REER and the ensuing fair value in the near term. Generally, we see the Pacific currencies movements in July to be closely correlated to major macro risk events and we expect this trend to persist.

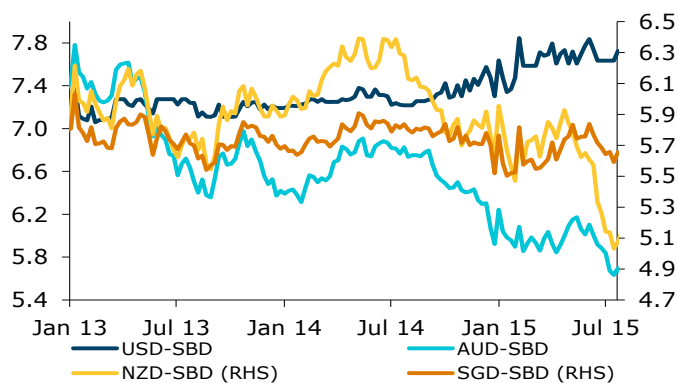
FJD – EXCHANGE RATE



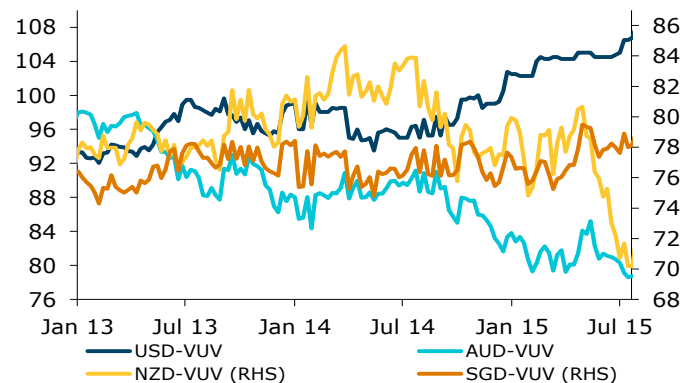
PGK – EXCHANGE RATE



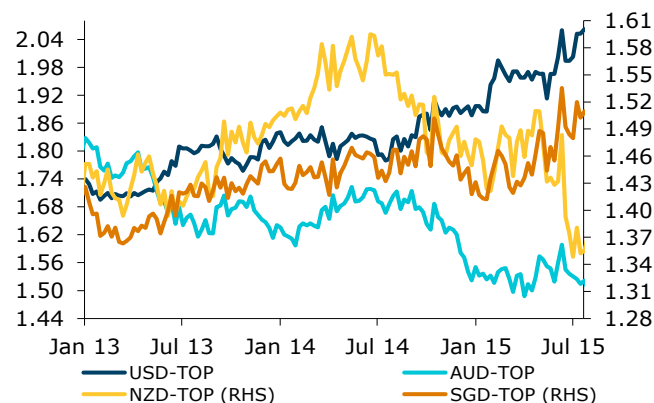
SBD – EXCHANGE RATE



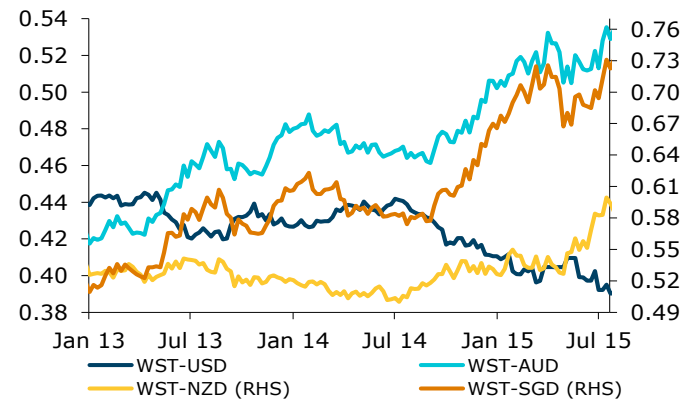
VUV – EXCHANGE RATE



TOP – EXCHANGE RATE



WST – EXCHANGE RATE



As of 19 August 2015

Source: Bloomberg, ANZ Research

FX AND POLICY RATE FORECASTS

		CURRENT	Sep 15	Dec 15	Mar 16	Jun 16	Sep 16	Dec 16	Mar 17
Global FX Forecasts									
Europe	EUR/USD	1.148	1.050	0.990	1.020	1.070	1.120	1.120	1.130
Japan	USD/JPY	120.26	125.00	125.00	125.00	125.00	125.00	125.00	120.00
Switzerland	USD/CHF	0.942	1.000	1.051	1.039	1.009	0.982	0.982	0.910
Australia	AUD/USD	0.723	0.730	0.720	0.710	0.700	0.700	0.700	0.700
New Zealand	NZD/USD	0.654	0.630	0.610	0.590	0.590	0.590	0.590	0.640
United Kingdom	GBP/USD	1.579	1.520	1.500	1.510	1.550	1.550	1.550	1.550
China**	USD/CNY	6.413	6.440	6.550	6.600	6.650	6.700	6.750	6.180
Pacific FX Forecasts									
		Current	Sep 15	Dec 15	Mar 16	Jun 16	Sep 16	Dec 16	Mar 17
Fiji	FJD/USD	0.465	0.462	0.459	0.456	0.455	0.457	0.457	0.457
	FJD/EUR	0.405	0.440	0.464	0.447	0.426	0.408	0.408	0.363
	FJD/AUD	0.643	0.633	0.637	0.642	0.650	0.653	0.653	0.653
	FJD/NZD	0.712	0.733	0.752	0.773	0.772	0.775	0.775	0.775
	FJD/GBP	0.294	0.304	0.306	0.302	0.294	0.295	0.295	0.295
	FJD/CNY	2.983	2.974	3.006	3.010	3.028	3.062	3.085	2.825
	FJD/JPY	55.933	57.728	57.371	57.002	56.916	57.135	57.135	54.850
	Policy Rate*	0.50	0.50	0.50	0.75	1.00	1.00	1.00	1.00
Papua New Guinea	PGK/USD**	0.3595	0.3565	0.3465	0.3395	0.3397	0.3402	0.3407	0.3412
	PGK/EUR	0.3132	0.3395	0.3500	0.3328	0.3175	0.3038	0.3042	0.2708
	PGK/AUD	0.4972	0.4884	0.4813	0.4782	0.4853	0.4860	0.4867	0.4874
	PGK/NZD	0.5500	0.5659	0.5680	0.5754	0.5758	0.5766	0.5775	0.5783
	PGK/GBP	0.2276	0.2345	0.2310	0.2248	0.2192	0.2195	0.2198	0.2201
	Policy Rate***	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25
Samoa	WST/USD	0.379	0.377	0.375	0.374	0.373	0.372	0.371	0.370
	WST/EUR	0.330	0.359	0.379	0.366	0.348	0.332	0.331	0.293
	WST/AUD	0.524	0.516	0.521	0.526	0.532	0.531	0.529	0.528
	WST/NZD	0.579	0.598	0.615	0.633	0.632	0.630	0.628	0.626
	WST/GBP	0.24	0.25	0.25	0.25	0.24	0.24	0.24	0.24
Solomon Islands	USD/SBD	8.013	8.120	8.176	8.222	8.307	8.327	8.347	8.347
	EUR/SBD	9.199	8.526	8.094	8.386	8.888	9.326	9.348	10.517
	AUD/SBD	5.793	5.927	5.887	5.837	5.815	5.829	5.843	5.843
	NZD/SBD	5.237	5.115	4.987	4.851	4.901	4.913	4.924	4.924
	GBP/SBD	12.65	12.34	12.26	12.41	12.88	12.91	12.94	12.94
Tonga	USD/TOP	2.189	2.202	2.205	2.207	2.210	2.212	2.215	2.217
	EUR/TOP	2.513	2.312	2.183	2.251	2.364	2.478	2.480	2.794
	AUD/TOP	1.583	1.608	1.587	1.567	1.547	1.548	1.550	1.552
	NZD/TOP	1.431	1.387	1.345	1.302	1.304	1.305	1.307	1.308
	GBP/TOP	3.46	3.35	3.31	3.33	3.42	3.43	3.43	3.44
Vanuatu	USD/VUV	110.35	111.10	111.85	112.10	112.35	112.60	112.85	113.10
	EUR/VUV	126.68	116.66	110.73	114.34	120.21	126.11	126.39	142.51
	AUD/VUV	79.78	81.10	80.53	79.59	78.65	78.82	79.00	79.17
	NZD/VUV	72.12	69.99	68.23	66.14	66.29	66.43	66.58	66.73
	GBP/VUV	174.28	168.87	167.78	169.27	174.14	174.53	174.92	175.31
	Policy Rate^	5.25	5.25	5.25	5.25	5.25	5.50	5.50	5.50

Note: The source of FX data is Bloomberg and the respective central banks in the Pacific. As the currencies are illiquid with wide bid/offer spreads, the rates published are only indicative.

For more in-depth currency forecasts on the majors, please contact research@anz.com, attn. Pacific Team.

* Overnight policy rate.

** The "Current" rate is the most recent rate posted on the BPNG website.

*** Kina Facility Rate.

^ Discount rate.

Updated as of 25 August 2015.

COMMODITY MARKETS DEVELOPMENTS

FIGURE 1. COMMODITY PRICE INDICES

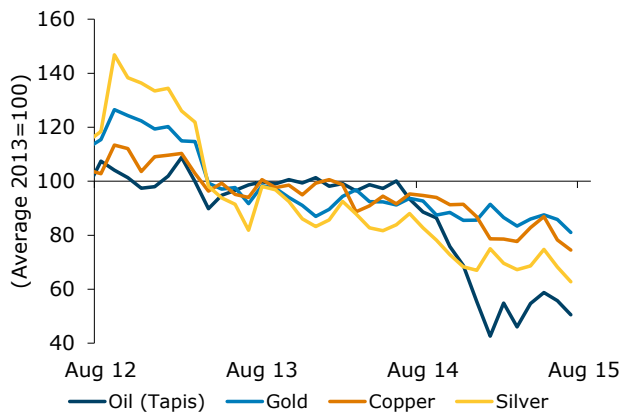


FIGURE 2. COMMODITY PRICE INDICES

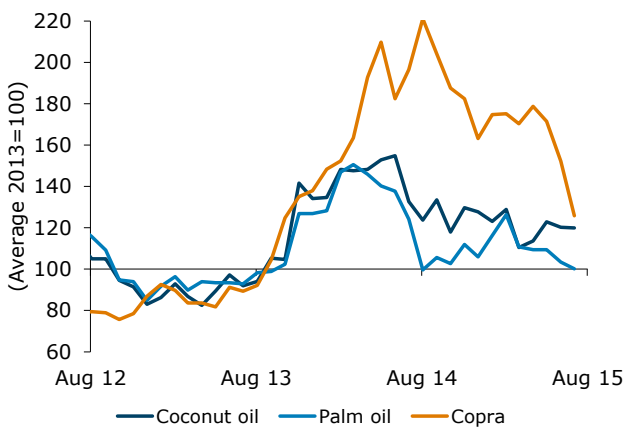
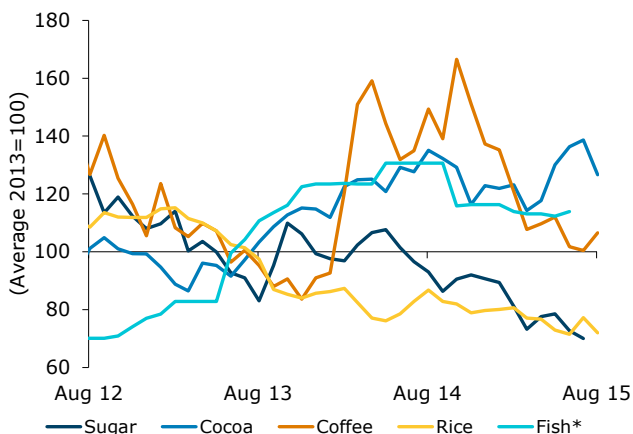


FIGURE 3. COMMODITY PRICE INDICES



*Fish prices are a proxy derived from shrimp prices.
Source: Bloomberg, World Bank, Haver, ANZ Research

Oil prices continue to weaken and the market is speculating about prices in the USD30s; focus will continue to be on US production and stock levels. Palm oil hits fresh lows and sizeable oilseed crops in Q4 suggest markets may face further pressure.

- Oil prices are at risk of testing fresh lows in the coming months as the strong summer demand period comes to an end. US crude oil inventories are on the rise once again and back in focus for the market. China's real activity indicators continue to show signs of slowing, and if equity market volatility continues, this could have a negative impact on energy demand from the country that consumes 10% of the world's oil. Iran has also been a key factor for oil markets; the country's oil minister recently stated intentions to regain lost market share, suggesting exports could more than double from 1.2mb/d to pre-sanction levels of 2.6mb/d, in the months following the lifting of sanctions.
- Market sentiment in gold still seems skewed to the downside, despite some USD-driven recovery in recent weeks. A significant shift in the gold market recently has been the move in speculative positioning in Comex, where non-commercial traders are holding the largest gross short positions in at least nine years. Within such an environment, demand for physical gold seems to have risen, but in the key consumer nations of China and India, soft onshore physical premiums suggest there is no shortage of supply either. We therefore do not expect that physical demand, despite being solid, will provide much of an offsetting lift to combat lower gold prices.
- Palm oil prices reached a six-year low of USD490/mt on the Bursa Malaysia exchange in recent days, tracking the declines in the crude oil market. Supply-side conditions also suggest an amply-supplied market as Malaysia reported July production of 1.82m tonnes, up 9% y/y. Meanwhile, Malaysian stocks rose to 2.3m tonnes, the highest in eight months. The August USDA report was also bearish for oilseeds, forecasting an above-expected 2015-16 US soybean crop of 107m tonnes.
- Arabica coffee prices remain soft, but well supported above US\$130/lb. Prices recovered as speculators cut bearish positions amid news that coffee bean harvests in Brazil are smaller than usual, which may reduce market estimates for crop sizes this year.

Price changes*	Oil (tapis)	Gold	Silver	Copper	Coc. oil	Palm oil	Sugar	Coffee	Cocoa	Rice	Copra	Fish
M/M	-9.3%	-5.6%	-8.0%	-4.8%	-0.2%	-3.2%	-3.7%	-1.3%	1.7%	8.1%	-17.4%	1.4%
3M/3M	-7.6%	-5.8%	-8.5%	-10.0%	5.6%	-8.5%	-9.8%	-8.4%	17.8%	0.7%	-29.7%	0.7%
Y/Y	-45.9%	-13.5%	-28.7%	-21.9%	-9.6%	-19.3%	-27.5%	-25.6%	8.6%	-6.8%	-36.0%	-12.8%

* Updated as of 18 August 2015.
Source: Bloomberg, ANZ Research

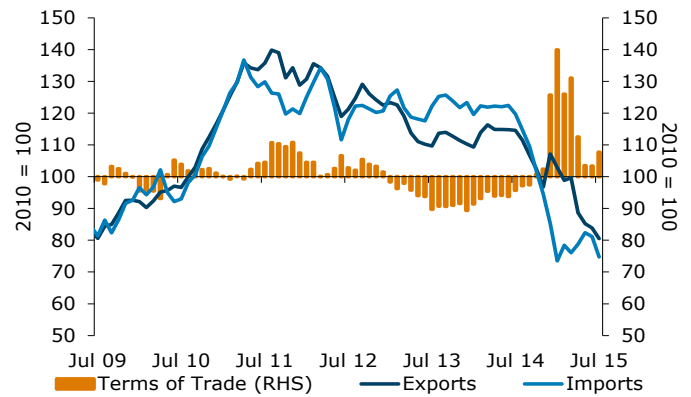
COMMODITY MARKETS DEVELOPMENTS

ANZ PACIFIC COMMODITY PRICE INDEX (PCPI)

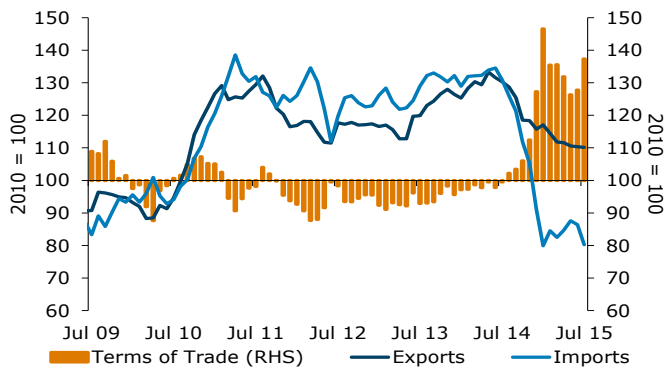
Food and energy prices continue to lead the drop in both import and export PCP indexes. The terms of trade widened during the month as import prices fell faster than export prices. On a sequential basis, our import price indexes fell 5% on average, thanks to lower petrol and wheat prices. For exports, PCPI declines are more gradual (except for Timor and PNG), supported by recovering fish and general food proxy prices. Looking ahead, the [World Bank](#) has forewarned that commodity price moderation could persist through 2015 on excess supplies.

ANZ Pacific Commodity Price Index (ANZ PCPI) Jul 2015							
	PNG	Fiji	Timor	Samoa	Sol.	Tonga	Van.
Export, y/y	-29.8	-15.5	-47.7	-15.2	-16.6	-14.9	-10.4
Export, m/m	-4.0	-0.2	-10.6	-1.0	-0.9	0.0	-0.1
Import, y/y	-37.6	-38.7	-24.8	-33.8	-37.4	-18.1	-30.8
Import, m/m	-7.9	-7.2	-3.1	-5.7	-7.3	-2.0	-4.5

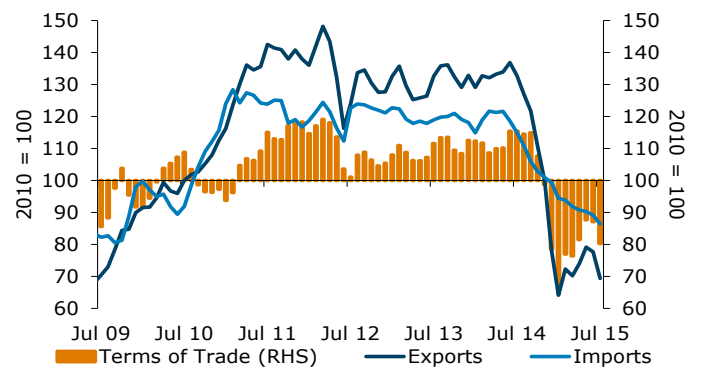
PAPUA NEW GUINEA – COMMODITY PRICE INDICES



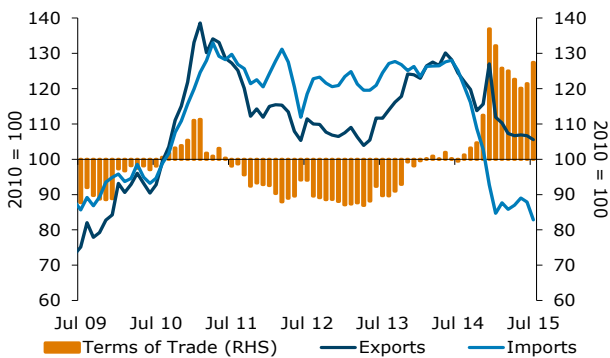
FIJI – COMMODITY PRICE INDICES



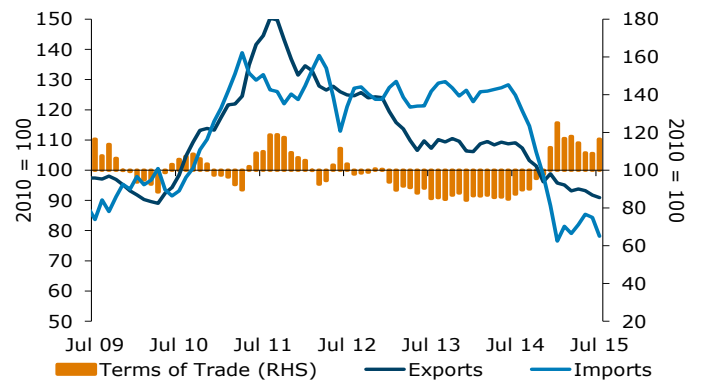
TIMOR-LESTE – COMMODITY PRICE INDICES



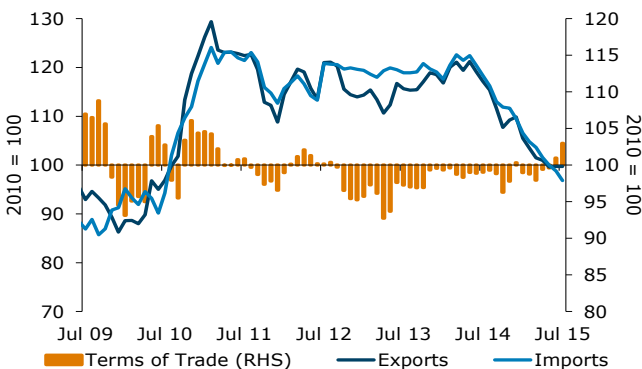
SAMOA – COMMODITY PRICE INDICES



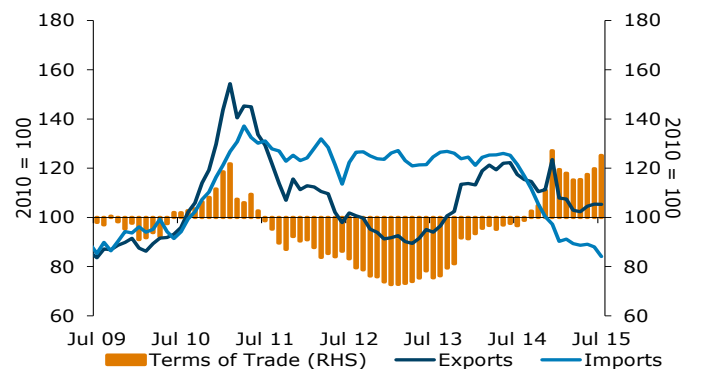
SOLOMON ISLANDS – COMMODITY PRICE INDICES



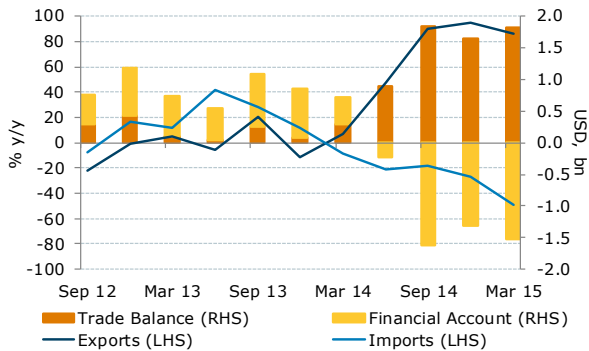
TONGA – COMMODITY PRICE INDICES



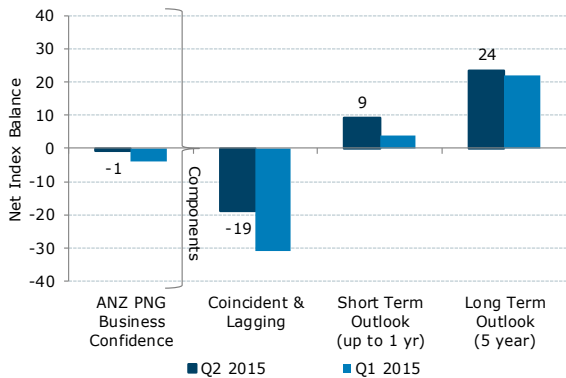
VANUATU – COMMODITY PRICE INDICES



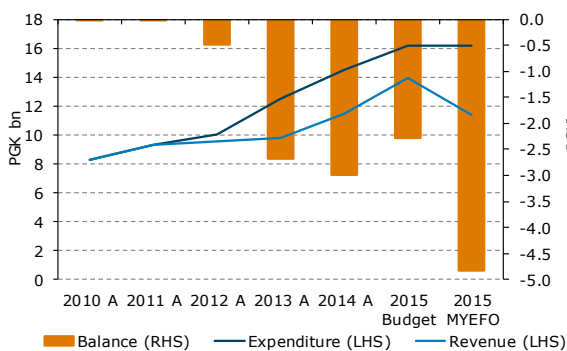
COUNTRY UPDATES

FIGURE 1. IMPROVEMENT IN TRADE BALANCE OFFSET BY FINANCIAL ACCOUNT OUTFLOWS

Source: Ministry of Finance, BPNG, ANZ Research

FIGURE 2. ANZ Q2 QUARTERLY BUSINESS SURVEY SHOWS SIGNS OF IMPROVEMENT

Source: Ministry of Finance, BPNG, ANZ Research

FIGURE 3. PNG'S MID YEAR ECONOMIC AND FISCAL UPDATE HIGHLIGHTS A REVISION TO REVENUE, BUT NO CHANGE TO EXPENDITURE

Source: Ministry of Finance, BPNG, ANZ Research

PAPUA NEW GUINEA

Papua New Guinea received a temporary boost in Q2 from hosting the Pacific Games. However, collapsing commodity prices, moderating regional growth and financial market volatility could see growth moderate further. We revise down our GDP estimate to 10% y/y in 2015, from 12% previously.

- Inflation in Q1 2015 moderated to 6.1% y/y, from 6.6% previously. Healthcare and household equipment rose by double digits, offsetting a decline in transport and miscellaneous inflation. However, the higher frequency retail price index has fallen more drastically in Q2 to 4.2%, from 8.9% previously.
- Employment over Q1 fell 2.8% y/y, down for the second consecutive quarter. All sectors showed negative employment growth. Mineral employment growth was -6.8%, wholesale -6.4%, transportation -7.5% and manufacturing -4.3%.
- Private sector credit growth has moderated to 5.1% y/y in May, from 7.2% the previous month.
- Broad money fell to 2.5% y/y in May, from 7.9%.
- The Mid Year Economic and Fiscal Outlook report, issued earlier in August, showed that the government has revised revenue estimates by a significant PGK2.5bn. However, expenditure estimates were kept unchanged. If realised, the budget deficit could expand to 9.4% of GDP in 2015 – but this is not our base case. Through the first six months of the year the deficit was at 1.8% of GDP and we believe it is unlikely that PNG will be able to spend the budgeted amount in H2. We aim to publish a fiscal update in the coming weeks.
- Export growth over the last three quarters has been over 85% y/y, while imports continue to contract by a significant amount, down 50% y/y in Q1. The trade balance ballooned to a surplus of USD1.8bn in Q1. However, against the large trade surplus, financial related outflows have picked up, likely reflecting the foreign ownership of the export revenue.
- The ANZ Quarterly Business survey released in July showed a small improvement in all segments: lagging, coincident, short term and long term outlook.
- Economic growth is coming under pressure with commodity prices collapsing and regional economic growth moderating. Inflation remains elevated and government revenues have declined. A firm government stimulus is unlikely to occur until at least Q4 2015, but a pick-up in 2016 is more likely.

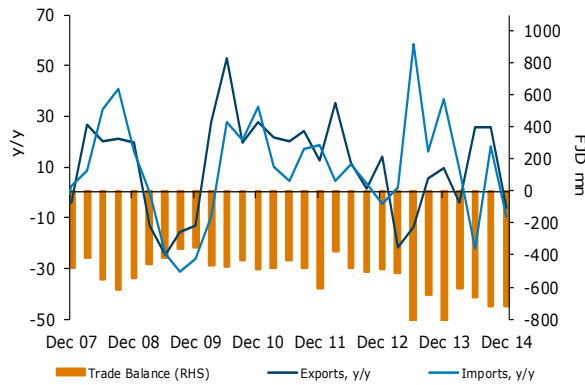
Daniel Wilson

QUARTERLY ECONOMIC DATA	SEP-13	DEC-13	MAR-14	JUN-14	SEP-14	DEC-14	MAR-15	JUN-15
Employment Index y/y (%)	-1.1	2.5	0.5	1.1	3.3	-3.4	-2.8	NA
Consumer Price Index y/y (%)	3.5	2.0	3.7	5.2	5.3	6.6	6.1	NA
Retail Price Index y/y (%) 3m avg.	2.2	1.8	1.6	5.0	4.9	7.7	8.9	4.2
Exports y/y (%)	20.5	-11.0	6.6	47.2	90.5	95.0	85.9	NA
Imports y/y (%)	28.2	11.9	-8.4	-21.1	-18.0	-27.1	-49.2	NA
Trade Balance (USDm)	250	84	300	896	1832	1646	1827	NA
Foreign Exchange Reserves (USDm)	3,037	2,855	2,781	2,593	2,496	2,347	2,168	2,060
Total Import Cover (months)	9.2	8.4	7.2	6.8	4.6	7.2	7.4	7.4

Source: Bank of Papua New Guinea, National Statistics Office, ANZ Research

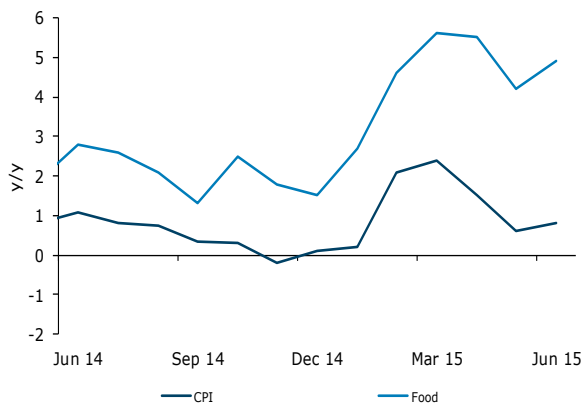
COUNTRY UPDATES

FIGURE 1. ECONOMIC GROWTH



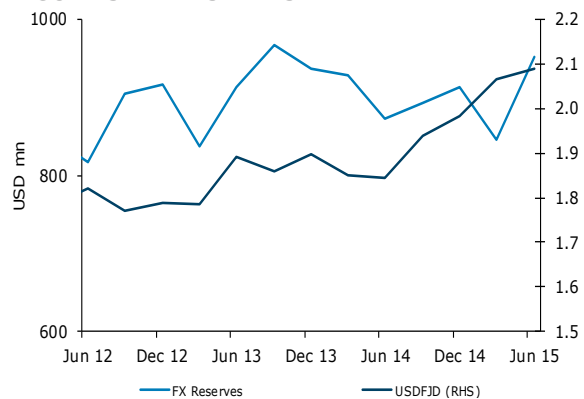
Source: Reserve Bank of Fiji, National Statistics Office, ANZ Research

FIGURE 2. INFLATION



Source: Reserve Bank of Fiji, National Statistics Office, ANZ Research

FIGURE 3. FX RESERVES AND FX RATE



Source: Reserve Bank of Fiji, National Statistics Office, ANZ Research

FIJI

Fiji's growth is confronted with headwinds arising from low commodity prices, a slowdown in China and probable weak tourist arrivals outturn due to a weak AUD. With the economy now tracking above-trend growth, tighter monetary policy and a return to fiscal prudence might be apt. With tighter fiscal space, the government has embarked on reforms to prioritise spending. Fiji's monetary policy flexibility, contrast, will be constrained by its currency basket arrangement and its under-developed financial system which limits the effectiveness of the monetary policy transmission.

- For Fiji, the risk is that domestic tailwinds might be insufficient to mitigate external headwinds to growth. Specifically, healthy domestic demand reflected in robust performance across all sectors (primary and services) continue to underpin growth. Domestic cement sales – a proxy for local construction activity – continued to expand, registering 42% growth cumulative to June. Consumption activity is projected to be robust, supported by improved labour market conditions reflected in higher hiring intentions according to the RBF's Job Advertisement survey.
- However, Fiji's external balances will be strained by rotation towards investment-driven growth and the ongoing regional 'trade recession'. Still, firm inward remittances will help mitigate pressures on the current account.
- Inflation inched up marginally to 0.8% in June, from 0.6% in the previous month, as higher food prices more than offset lower domestic fuel prices.
- A return to fiscal prudence is preferred after an expansionary 2014 budget to place the budget on a more sustainable basis. Encouragingly, the government has pro-actively embarked on a wide-ranging reform program to prioritise and consolidate fiscal spending over the next few years.
- Tighter monetary policy might be necessary to moderate credit growth. Monetary policy rates have remained near the zero lower-bound at 0.5% since October 2011. We feel the Reserve Bank of Fiji should act pre-emptively and tighten policy in a measured manner to moderate demand pressures, particularly credit growth. International reserves might face headwinds on strong import growth, but retained import cover has remained close to five months.

Weiwen Ng

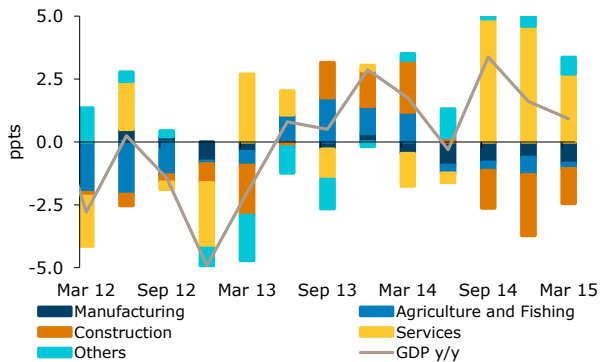
QUARTERLY ECONOMIC DATA	SEP-13	DEC-13	MAR-14	JUN-14	SEP-14	DEC-14	MAR-15	JUN-15
Consumer Price Index y/y (%)	3.1	3.4	-0.2	1.1	0.3	0.1	2.4	0.8
Domestic Credit y/y (%)	12.6	14.3	14.8	17.0	18.2	18.9	10.4	13.2
Exports y/y (%)	1.7	5.7	3.6	20.2	23.2	-6.2	N/A	N/A
Imports y/y (%)	16.4	36.9	-1.3	-8.5	18.2	-9.7	N/A	N/A
Trade Balance (USDm)	-363.4	-451.0	-388.0	-378.6	-394.9	-361.9	N/A	N/A
Foreign Exchange Reserves (USDm)	966.9	936.9	928.5	873.2	892.87	913.3	845.0	951.2
Total (Retained) Import Cover	4.9	4.9	4.5	4.4	4.7	4.6	4.4	5.0

* estimate.

Source: Reserve Bank of Fiji, National Statistics Office, ANZ Research

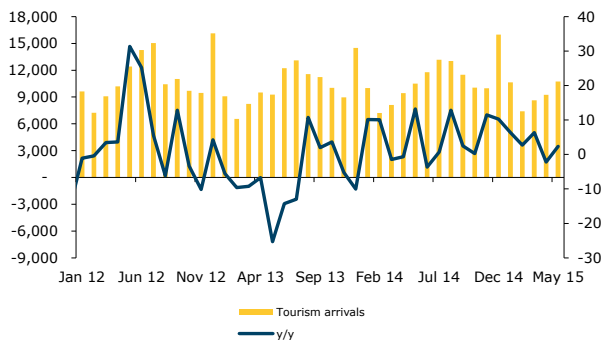
COUNTRY UPDATES

FIGURE 1. CONTRIBUTION TO GDP GROWTH



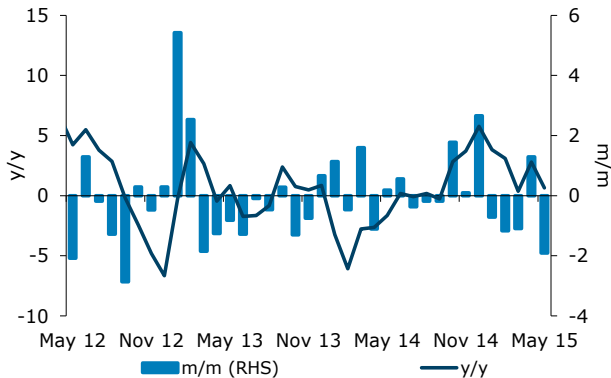
Source: Samoa Bureau of Statistics, ANZ Research

FIGURE 2. TOURISM ARRIVALS



Source: Central Bank of Samoa, ANZ Research

FIGURE 3. CPI INFLATION



Source: Samoa Bureau of Statistics, ANZ Research

SAMOA

March 2015 GDP growth slowed to 0.9% y/y from 1.6% for FY 2014, suggesting downside risks to our 2.5% full year forecast for FY 2015. The downturn was led by construction, which likely faltered after a temporary boost from the SIDC conference in September 2014. The upcoming Commonwealth Youth Games in September 2015, however, should provide another temporary boost.

- Visitor arrivals, too, slowed to 0.1% y/y from 5.1% in Q1CY15. As a result, tourism earnings contracted 1.2% y/y, reversing a decent 5.1% y/y expansion in Q1CY15.
- Official foreign reserves, however, improved by a solid USD28m to USD138.7m end-June from USD110.6m end-March. A smaller trade deficit might have helped to a certain extent – the deficit narrowed to an estimated average of USD21m April-May 2015, lower than the recent peak of USD34m mid-2014. However, the narrowing in the trade deficit due to weak mineral imports rather than a step-up in exports.
- The CBS kept monetary policy accommodative to support the economic recovery. The official interest rate stands at 0.14%, while commercial bank lending and deposit rates inched marginally lower to 9.45% and 2.40% respectively. Looking ahead, policy makers would likely to maintain accommodative policies to encourage lending, given that inflation looks set stay to stay below the target of 3%.
- Along with a slowdown in economic activity, inflation also cooled to 0.7% y/y in May, from an average 2.1% in the previous three months. Inflation should remain low given expectations of flat commodity prices.
- Bank credit accelerated further to 17.4% y/y in June 2015 from a sub-15% pace at the start of CY2015. Much of the improvement came from credit to the manufacturing sector, with loans to the sector contracting by a much smaller 6% y/y compared to -40% at the beginning of the year.

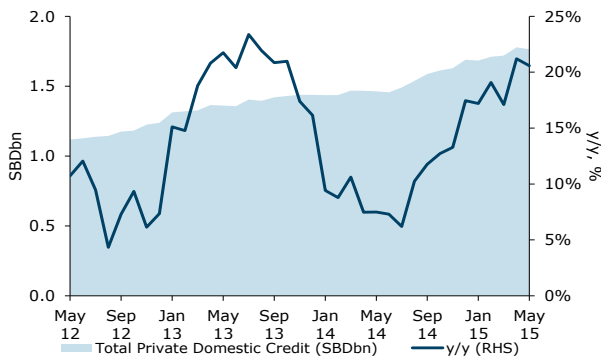
Devika Mehndiratta

QUARTERLY ECONOMIC DATA	SEP-13	DEC-13	MAR-14	JUN-14	SEP-14	DEC-14	MAR-15	JUN-15
Consumer Price Index y/y (%)	2.4	0.9	-2.8	0.2	-0.3	4.1	2.4	N/A
M2 y/y (%)	-0.5	6.4	7.3	18.8	10.4	9.6	5.2	1.1
Exports y/y (%)	-32.1	-10.3	12.3	5.1	35.7	12.1	13.8	N/A
Imports y/y (%)	10.6	8.5	10.2	1.5	11.0	1.4	-5.0	N/A
Trade Balance (USDm)	-82.5	-79.7	-72.9	-78.6	-90.1	-80.1	-68.3	N/A
Foreign Exchange Reserves	149.1	151.7	149.7	157.9	141.7	124.2	110.6	138.7
Total Import Cover (months)	5.7	5.6	5.3	5.4	4.8	4.4	4.5	N/A

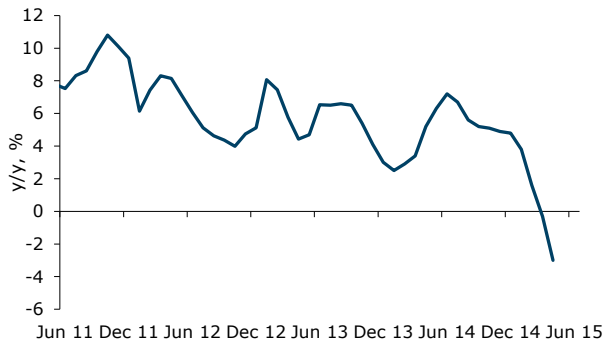
¹Figure from Samoa Bureau of Statistics.

Source: Central Bank of Samoa, Samoa Bureau of Statistics, ADB, IMF, World Bank, ANZ Research

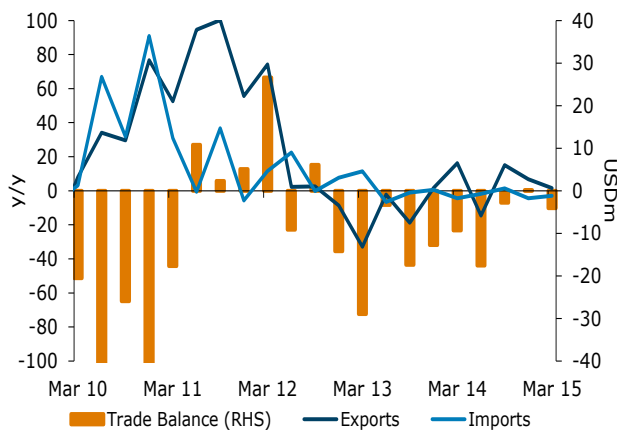
COUNTRY UPDATES

FIGURE 1. PRIVATE DOMESTIC CREDIT STILL STRONG

Source: Central Bank of Solomon Islands, ANZ Research

FIGURE 2. INFLATION IN NEGATIVE TERRITORY ON LOWER FOOD AND ENERGY PRICES

Source: Central Bank of Solomon Islands, ANZ Research

FIGURE 3. TRADE BALANCE NARROWS

Source: Central Bank of Solomon Islands, ANZ Research

SOLOMON ISLANDS

The World Bank expects growth to accelerate to 3.5% (2014: 2.0%) in 2015 and 2016; rebounding strongly from the April floods and Gold Ridge mine closure. Near-term development would be led by agriculture, tuna processing and construction sectors, helped by cheaper commodity and energy prices. Looking ahead, growth prospects would be largely determined by how quickly future mining projects (bauxite & nickel) or the halted Gold Ridge dam operations can come online.

- Local new owner Gold Ridge Community Investments is trying to restart gold mine operations, although low gold prices and tailing dam sunk cost makes this difficult.
- The government recorded a preliminary deficit of USD40m in May, largely due to increases in goods and services spending. Planned fiscal spending, especially those on infrastructure, should boost growth.
- Headline inflation sank deeper into negative territory in June, down 4.8% y/y 3mma from 3.0% y/y in April (May data unavailable). This was driven by a current draft of subdued imported food and energy prices.
- Private domestic credit growth was up 21% y/y in May compared to end-2014 growth rate of 18%. A sectorial breakdown of growth is unavailable through 2015. However, personal mortgage financing formed the bulk of the increase in 2014.

The government plans to improve financial sector efficiency with recent improvements, such as: 1) The introduction of mobile banking services, 2) The inclusion of new insurance companies and bank, and 3) the setting up of a credit bureau.

- May's trade deficit narrowed to USD0.4m, down from April's USD1.3m. Export growth remains strong at 16.4% y/y albeit slightly weaker from April's. Generally, agricultural exports picked up the slack from weaker log export volumes. Notably, bauxite ore exports more than doubled to USD7m. Import growth was -1.1% y/y, down from 18.9% in April, due to weak energy prices and lower machinery payments.
- Gross foreign reserves remained largely stable at USD556.4m in May, sufficient to cover 10.9 months of imports. Looking ahead, expected declines in aid payments from development partners may weaken reserve buffers.
- The [CBSI monetary policy stance](#) would remain accommodative with a bias toward addressing the excess liquidity in the banking system. CBSI hinted that the cash reserve requirement ratio 'could be raised in the course of the next six months.'

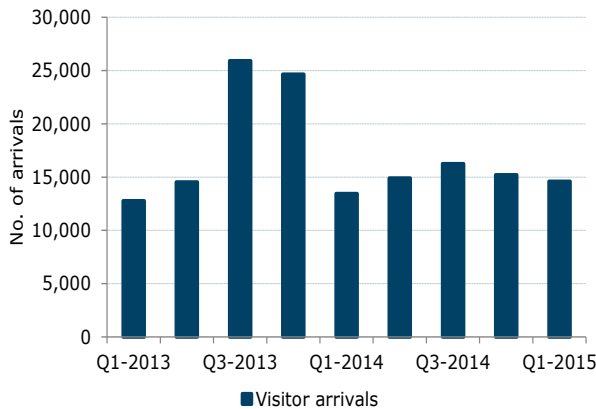
Eugin Lee

QUARTERLY ECONOMIC DATA	JUN-13	SEP-13	DEC-13	MAR-14	JUN-14	SEP-14	DEC-14	MAR-15
Private Credit y/y (%)	20.4	19.6	16.2	10.6	9.1	11.8	17.5	22.5
Consumer Price Index y/y (%)	5.2	6.5	3.0	3.4	7.2	5.2	4.8	-0.3
Exports quarterly y/y (%)	-2.2	-18.8	1.7	16.2	-14.6	21.7	6.8	2.3
Imports quarterly y/y (%)	-6.7	-1.1	0.6	-4.4	-1.8	-1.4	-4.4	-5.5
Trade Balance (USDm)	-3.3	-17.4	-12.8	-9.3	-17.6	0.4	0.1	-2.9
Foreign Exchange Reserves (USDm)	511.0	518.4	536.0	550.7	584.0	526.0	505.9	569
Total Import Cover (months)	11.4	10.7	11.0	11.6	13.5	10.5	13.8	15.6

Source: Central Bank of the Solomon Islands, ANZ Research

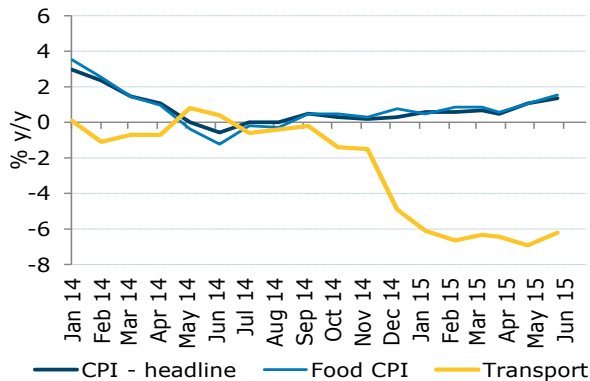
COUNTRY UPDATES

FIGURE 1. VISITOR ARRIVALS



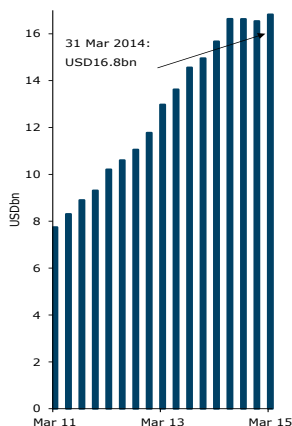
Source: Timor-Leste National Directorate of Statistics, ANZ Research

FIGURE 2. INFLATION INCHING UP BUT STILL MILD



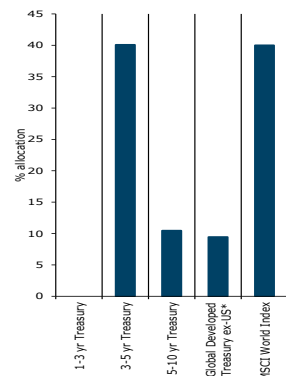
Source: Timor-Leste National Directorate of Statistics, ANZ Research

FIGURE 3. PETROLEUM FUND ASSETS



Source: Central Bank of Timor-Leste, ANZ Research

FIGURE 4. PETROLEUM FUND ALLOCATION



TIMOR-LESTE

Inflation remains subdued; growth in visitor arrivals and government spending, however, picked up in Q1 2015. A full update covering developments in the petro fund and monetary sector is pending the latest data from the central bank.

- Inflation has increased marginally to 1% in Q2 2015, but is still subdued given weak global commodity prices and a strong USD (Timor's currency). Education and housing maintenance costs are up but not enough to push overall inflation higher.
- Government spending was up sharply in Q1 2015 (103%) driven by a surge in 'minor capital'. The deficit hence widened as total revenues actually contracted 3% y/y.
- The tourism sector rebounded in Q1 with visitor arrivals up nearly 9% y/y vs two consecutive quarters of y/y falls. The mix of tourists remained broadly similar, with Indonesians leading the pack; the proportion of Australians, however, dropped a little to 17% from an average 21-24% in 2014.
- Vehicle registrations surged 75% y/y in 2014, despite slipping to 6,288 vehicles in Q4 from 7,221 vehicles in Q3. The increase in registrations was led by motorcycle and light vehicles, suggesting a growing economy with better access to markets, optimism for future income, improved infrastructure and higher disposable income.
- While tourist arrivals and government spending picked up in Q1, imports fell by as much as 62% q/q, pulled down by mineral fuels. The drop in global fuel prices does not fully explain this, suggesting that volumes must also have decreased. On the other hand, exports have remained steadily weak during the year at less than USD1m through May 2015.

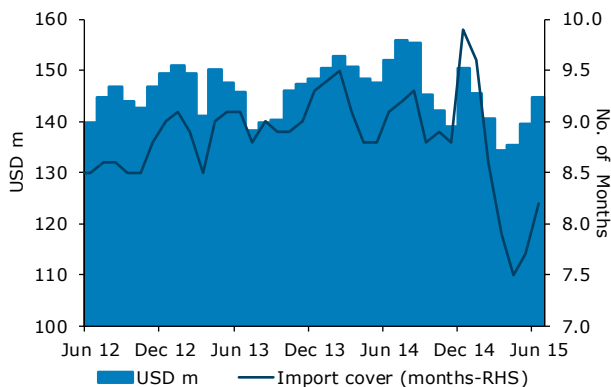
Devika Mehndiratta

QUARTERLY ECONOMIC DATA	SEP-13	DEC-13	MAR-14	JUN-14	SEP-14	DEC-14	MAR-15	JUN-15
Motorcycle Registrations y/y (%)	7.5	-1.8	49.9	-3	156.2	98.1	19	N/A
Visitor Arrivals y/y (%)	73.6	77.8	5.3	2.5	-37.3	-38.3	8.7	N/A
Consumer Price Index y/y (%)	10.6	4.0	2.3	0.2	0.2	0.3	0.6	1.0
Exports (USDm)	26.3	15.2	5.9	3.8	67.1	15.1	2.5	N/A
Imports (USDm)	121.7	228.4	178.8	332.8	196.5	276.9	103.3	N/A
Trade Balance (USDm)	-95.5	-213.2	-172.9	-329.0	-129.3	-261.7	-100.8	N/A
Petroleum Fund Balance (USDbn)	14.6	15.0	15.7	16.6	16.6	16.5	16.8	N/A

Source: Central Bank of Timor Leste, ANZ Research

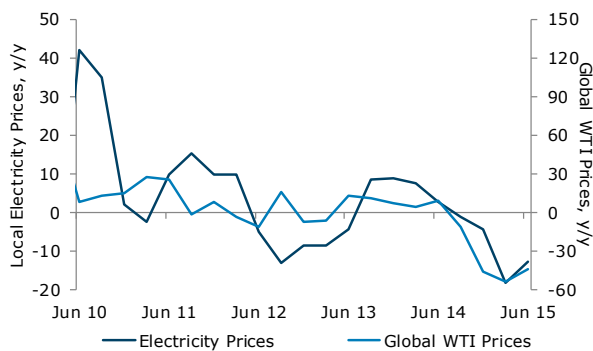
COUNTRY UPDATES

FIGURE 1. IMPORT COVER IS SLOWLY RISING



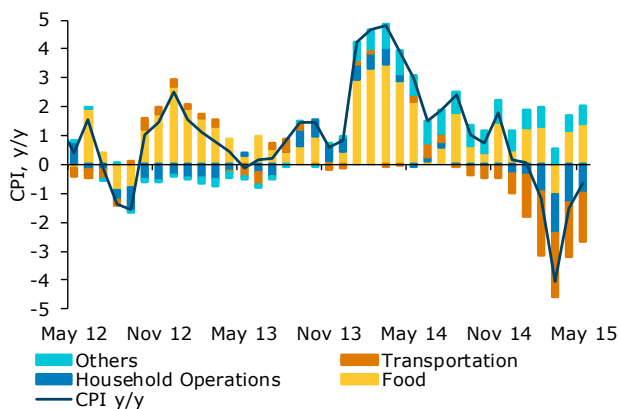
Source: National Reserve Bank of Tonga, ANZ Research

FIGURE 2. LOCAL ELECTRICITY PRICES FOLLOW GLOBAL OIL PRICES



Source: National Reserve Bank of Tonga, ANZ Research

FIGURE 3. TRANSPORT PRICES KEEPING INFLATION IN THE RED



Source: Tonga Dept of Statistics, ANZ Research

Eugenia Fabon Victorino

QUARTERLY ECONOMIC DATA	SEP-13	DEC-13	MAR-14	JUN-14	SEP-14	DEC-14	MAR-15	JUN-15
Consumer Price Index y/y (%)	0.8	0.9	4.5	2.8	1.8	0.9	-1.7	-0.7
Private Sector Credit y/y (%)	-7.5	-2.9	-5.3	-4.4	-4.4	-2.5	7.2	N/A
Exports y/y (%)	16.7	25.9	37.5	27.3	28.6	-20.6	N/A	N/A
Imports y/y (%)	-2.3	-1.2	0.8	4.4	23.1	6.1	N/A	N/A
Trade Balance (TOPm)	-65.7	-57.1	-61.3	-61.9	-80.7	-62.4	N/A	N/A
Foreign Exchange Reserves (USDm)	140.4	148.5	150.8	151.9	145.3	150.5	135.5	143.4
Total Import Cover (months)	8.9	9.3	9.1	9.1	8.8	9.9	7.9	8.2

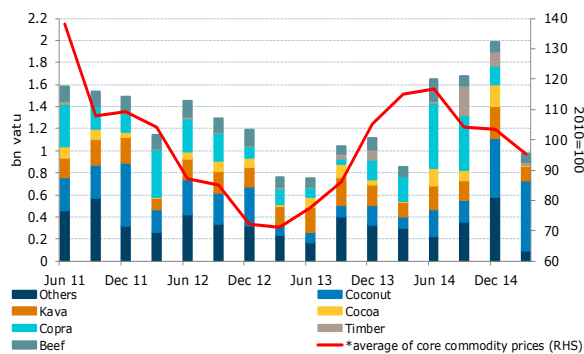
Source: National Reserve Bank of Tonga, Tonga Dept of Statistics, ANZ Research

TONGA

The expectation for a recovery in Tonga is intact. Domestic activity growth remains on a gradual uptrend. Inflation will likely remain soft due to expectations of low oil prices through 2016 amid an expected increase in world supply. Sluggish credit growth is still capping economic activity, although lending to households and businesses is picking up.

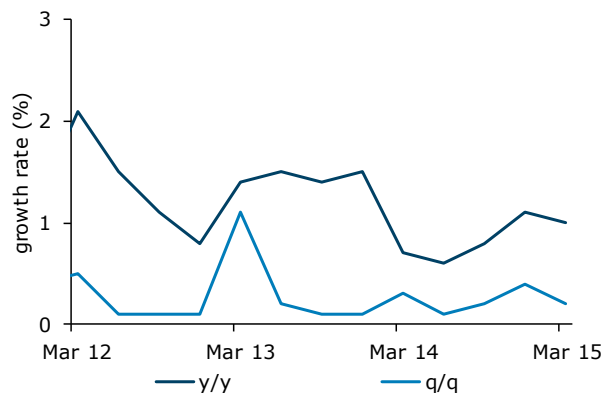
- Total credit increased 7.8% y/y in June, on the back of a 13.7% expansion in household credit. Loans to businesses climbed in June, driven by lending to the manufacturing and construction sectors.
- Travel receipts are improving. Meanwhile, remittances of around TOP24.7m in June remained high. This is the second highest level recorded in 2015.
- Money supply rose 9.3% y/y in June as net domestic asset increased to 5.4%, while net foreign assets climbed 2.7%. Meanwhile, banking liquidity also improved from higher deposits and foreign reserves.
- The level of overseas exchange transactions posted another month of surplus in June. At TOP7.8m, the surplus is lower than in May as imports in June rose.
- Over the month of June, the TOP fell against the AUD and USD, while strengthening against the NZD. The central bank reported that both the NEER and the REER fell by around 1.0% y/y.
- Foreign reserves rose for two straight months, reaching USD144.7m (TOP289.7m) in June. Import cover also increased to 8.2 months.
- Electricity price inflation has been contracting since H2 2014, mimicking the movement of international oil prices. As of June, electricity prices fell 12.6% y/y. Consequently, the central bank of Tonga expects the soft outlook on electricity prices to likely ease inflation by 1.4 ppt.
- Inflation has bottomed out after posting a 0.2% y/y gain in June, marking the first annual rise after four straight months of negative inflation. Despite the relatively strong domestic price gains, imported inflation is still contractionary.

COUNTRY UPDATES

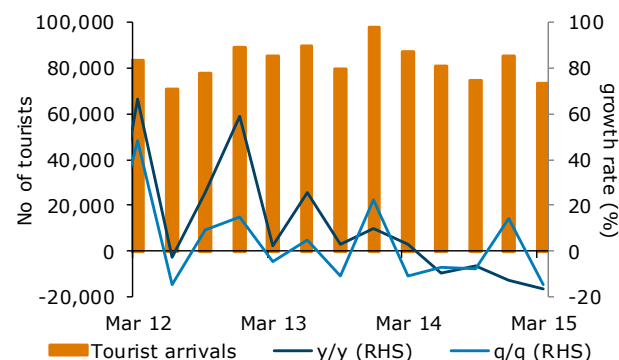
FIGURE 1. CYCLONE PAM HAS WEIGHED ON AGRICULTURAL OUTPUT

*Simple average of copra, coconut oil and cocoa prices.

Source: Reserve Bank of Vanuatu, Vanuatu National Statistics Office, ANZ Research

FIGURE 2. INFLATION EDGED LOWER

Source: Reserve Bank of Vanuatu, Vanuatu National Statistics Office, ANZ Research

FIGURE 3. TOURIST ARRIVALS CONTINUED TO SLIDE

Source: Reserve Bank of Vanuatu, Vanuatu National Statistics Office, ANZ Research

VANUATU

Growth prospects will likely be derailed by Cyclone Pam, with the agricultural and tourism sectors the most affected. Damage is estimated to be nearly 65% of GDP, suggesting that the amount of funding required for reconstruction efforts is much more than what development assistance can provide. If the government has to borrow, it needs to guard against excessive borrowing, given the already existing outlay of concession loans for a pipeline of new infrastructure projects. Debt management and access to finance will be critical for Vanuatu's long-term economic sustainability.

- In the aftermath of Cyclone Pam, the government has made a few significant moves: 1) waiving VAT and duty on building materials; 2) doubling of the constituency allowance for 2015; 3) facilitating members to withdraw 20% of their retirement accounts to fund rebuilding efforts; and 4) approved a sizeable supplementary budget. While these measures would lend support to households in the aftermath of Cyclone Pam, the government's fiscal balance will be under significant pressure.
- Recent economic data showed that tourist arrivals continued to slide in Q1 and will face significant headwinds ahead as tourist infrastructure has been destroyed by tropical Cyclone Pam.
- Exports also declined 38% due to the underperformance of all commodity exports, such as copra (-45%) and beef (-11%).
- Inflation edged lower to 1.0% y/y with increases in transport and education mitigating declines in recreation and household supplies. Inflation still printed within the RBV's target range of 0-4%.
- Looking ahead, the Cyclone Pam recovery phase could deepen the trade deficit further with increased demand for reconstruction and agricultural imports. Crop destruction could also disrupt agricultural output/exports. Furthermore, a fall in global prices of domestically-produced commodities would weigh on exports.
- As Vanuatu prioritises spending during reconstruction phase, a proactive strategy to rebuild the tourism sector is paramount to ensure its medium term economic sustainability.

Weiwen Ng

QUARTERLY ECONOMIC DATA	JUN-13	SEP-13	DEC-13	MAR-14	JUN-14	SEP-14	DEC-14	MAR-15
Consumer Price Index y/y (%)	1.5	1.4	1.5	0.7	0.6	0.8	1.1	1.0
Tourist Arrivals (thousands)	89.5	80.0	98.0	87.5	81.2	77.6	85.5	73.1
Exports y/y (%)	-48.4	-20.8	-5.7	11.0	120.6	64.0	77.5	44.8
Imports y/y (%)	8.4	-4.9	15.0	2.1	-9.0	10.0	12.6	6.0
Trade Balance (USDm)	-65.5	-66.6	-72.8	-58.6	-49.7	-67.9	-72.1	-54.5
Foreign Exchange Reserves (USDm)	163.26	166.2	170.0	162.8	173.3	185.8	174.9	183.5
Total Import Cover (months)	6.7	6.8	6.8	6.6	7.1	7.2	-6.0	6.8

*ANZ estimate

Source: Reserve Bank of Vanuatu, Vanuatu National Statistics Office, ANZ Research

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