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Monetary Operations and Liquidity Dynamics in Fiji

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Monetary Operations and Liquidity Dynamics in Fiji

Prepared by Sandra Milena Benitez Celis, Matteo Ghilardi, and Shivneel Kirpal*

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ABSTRACT: This paper examines the implementation of monetary policy in Fiji, with a focus on liquidity dynamics and their implications for monetary transmission. It documents how persistent surplus liquidity—shaped by foreign exchange inflows and fiscal cash-management practices—has influenced the transmission of the policy rate and short-term money-market conditions. It also assesses how liquidity conditions have interacted with the existing operational framework and discusses options to strengthen monetary implementation and transmission.

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Monetary Operations and Liquidity Dynamics in Fiji

Republic of Fiji

Prepared by Sandra Milena Benitez Celis, Matteo Ghilardi, and Shivneel Kirpal [1]

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MONETARY OPERATIONS AND LIQUIDITY DYNAMICS IN FIJI[1]

This paper examines the implementation of monetary policy in Fiji, with a focus on liquidity dynamics and their implications for monetary transmission. It documents how persistent surplus liquidity—shaped by foreign exchange inflows and fiscal cash-management practices—has influenced the transmission of the policy rate and short-term money-market conditions. It also assesses how liquidity conditions have interacted with the existing operational framework and discusses options to strengthen monetary implementation and transmission.

A. Introduction

1. This paper provides an analysis of monetary policy implementation in Fiji, with a particular focus on the role of liquidity dynamics under the exchange-rate peg. In Fiji's small, open, and import-dependent economy, monetary policy operates within a constrained environment in which external stability, reserve adequacy, and domestic liquidity conditions are closely intertwined. As a result, the effectiveness of monetary policy depends not only on the formal framework and stated policy instruments, but critically on how liquidity is generated and managed through the financial system in practice.

2. Against this background, this paper documents how Fiji's institutional framework and operational practices have interacted with external inflows and fiscal cash flows to produce a prolonged period of structural excess liquidity. It first outlines the monetary policy framework and instruments, emphasizing how the formal corridor-based framework has operated de facto as a floor system. It then analyzes recent liquidity developments and their structural drivers, before assessing the implications for monetary transmission under the exchange-rate peg. The paper concludes by summarizing operational priorities identified by recent IMF technical assistance aimed at strengthening monetary policy implementation within the existing policy framework.

B. Fiji's Monetary Policy Framework, Instruments, and Operational Implementation

3. Fiji's monetary policy framework is anchored in a dual mandate that places external stability and price stability at the center of policy implementation. The Reserve Bank of Fiji operates under the Reserve Bank of Fiji Act of 1983, as revised in 2010, which assigns it responsibility for maintaining price stability and ensuring an adequate level of foreign exchange reserves, while supporting sustainable economic growth and a sound financial system. In practice, these objectives are closely interlinked in a small, open, and import-dependent economy where inflation dynamics are heavily influenced by external price developments and where confidence in

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the domestic currency is closely tied to reserve adequacy.

4. The current framework reflects a gradual transition from direct administrative controls toward market-based monetary instruments, shaped by financial deepening and institutional development over time. During the 1970s and 1980s, when domestic financial markets were shallow and credit allocation mechanisms limited, the RBF relied extensively on direct tools such as interest-rate ceilings, sectoral credit controls, and foreign-exchange rationing. As financial liberalization progressed from the 1990s onward, these controls were gradually dismantled and replaced with indirect instruments aimed at influencing liquidity and market interest rates. A key milestone in this transition was the introduction of the Overnight Policy Rate (OPR) in May 2010, which provided a transparent policy signal and aligned Fiji's framework more closely with international central banking practices, even as the fixed exchange-rate regime continued to constrain full monetary independence.

5. The exchange-rate peg remains the central nominal anchor of Fiji's monetary policy framework and fundamentally conditions the role and effectiveness of policy instruments. Since 1975, the Fiji dollar has been pegged to a trade-weighted basket of currencies, primarily comprising the Australian dollar, New Zealand dollar, U.S. dollar, euro, and Japanese yen. This arrangement has played a stabilizing role by anchoring import prices, containing inflation volatility, and supporting external competitiveness in an economy where imports account for a large share of consumption and investment. Over time, the peg has been associated with relatively low inflation—below 3 percent—and with the accumulation of foreign exchange reserves typically equivalent to four to six months of imports. At the same time, the fixed exchange-rate regime necessarily limits the scope for independent interest-rate policy, placing greater operational emphasis on liquidity management, balance-sheet operations, and the accommodation of external inflows and outflows.

6. The RBF's monetary policy implementation framework is formally organized around an interest-rate corridor supported by a range of liquidity-management instruments. The OPR serves as the central policy signaling rate, flanked by a Lending Facility (repo) rate set 25 basis points above the OPR and a Deposit Facility rate set 25 basis points below it. The OPR has remained at 0.25 percent since March 2020, with the Lending Facility rate at 0.50 percent and the Deposit Facility rate at 0.00 percent. In principle, this corridor is designed to guide short-term interbank rates toward the policy rate by establishing clear upper and lower bounds for overnight liquidity conditions.

7. Monetary policy has operated within a policy environment shaped by the exchange-rate peg and the exchange rate restrictions in place. These restrictions form part of the institutional context within which liquidity management is conducted and can influence how monetary operations affect financial conditions. By limiting certain foreign-exchange transactions and capital movements, they affect the channels through which external developments are transmitted to domestic liquidity and capital flows. Such restrictions add frictions that limit capital flows that would otherwise arbitrage interest rate differentials, by providing the central bank with some degree of monetary policy independence under the exchange rate peg.

8. Monetary policy implementation is supported by the following conventional liquidity-management instruments:

- *Open market operations*, used to absorb or inject liquidity on a discretionary basis, primarily through the issuance or purchase of RBF Notes. In practice, the RBF Notes have not been issued since 2010 and no repo transaction has occurred in the past five years.

- *Statutory Reserve Deposits (SRDs)*, currently set at 10 percent of eligible deposits, SRDs establish a structural demand for reserves and serve both liquidity-management and prudential purposes. While historically adjusted countercyclically during periods of stress, changes in reserve requirements have limited impact in an environment of large excess liquidity, and therefore function primarily as a structural anchor rather than an active policy instrument.

- *Foreign-exchange operations*, undertaken to maintain the exchange-rate peg, with FX purchases during periods of inflows injecting domestic liquidity and FX sales withdrawing liquidity. Given the scale and persistence of recent inflows from tourism, remittances, and official financing, net FX purchases have become a dominant autonomous driver of liquidity conditions.

- *Standing facilities (operational backstop).* The lending and deposit facilities provide backstop access to central bank liquidity and support orderly market functioning. Under conditions of structural surplus liquidity, usage has been highly asymmetrical, with banks predominantly placing excess reserves at the deposit facility and rarely accessing the lending facility (repo).

9. In addition to conventional instruments, the RBF has developed and deployed a range of targeted or unconventional measures during periods of macroeconomic stress to preserve financial stability and support credit flows. These measures have typically been introduced in response to large external shocks, natural disasters, or systemic disruptions—most notably during the COVID-19 pandemic—when conventional monetary transmission was impaired and confidence was weak. These instruments operate as targeted credit programs in an environment characterized by shallow financial markets, recurrent natural disasters, and high exposure to external shocks. The main targeted and unconventional measures include:

- *Import Substitution and Export Finance Facility (ISEFF)*, a concessional refinancing facility providing funding to commercial banks for on-lending to exporters, large-scale agriculture, renewable-energy projects, and selected import-substitution activities. The facility is now suspended; however existing loans are rolled over at the discretion of RBF.

- *Housing Facility Scheme*, a low-cost refinancing facility channeled through approved financial institutions to support mortgage lending for affordable and low-income housing and has been active since 2012.

- *Agriculture Loans Ratio (ALR) and Renewable Energy Loans Ratio (RELR)*, targeted lending requirements designed to increase bank credit to agriculture and renewable-energy sectors. These arrangements are currently active although under review by the RBF.

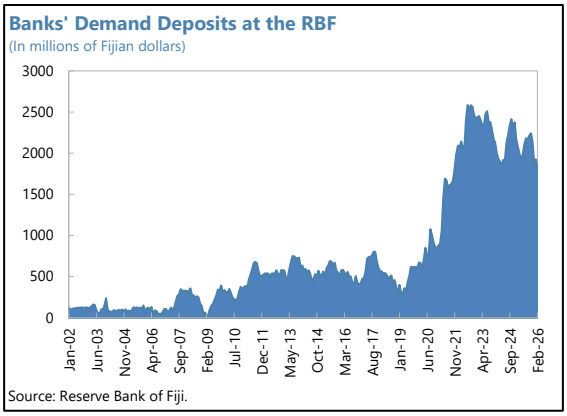
- *Natural Disaster Rehabilitation Facility (NDRF)*, a concessional financing facility providing support to households and businesses affected by natural disasters, including cyclones and flooding. However, this facility is now closed.

- *COVID-19 credit and guarantee measures*, a package of temporary refinancing facilities, credit guarantees, loan-repayment moratoria, and prudential relief introduced only during the pandemic to sustain credit provision to affected sectors.

10. Taken together, Fiji's monetary policy framework combines a fixed exchange-rate anchor, an interest-rate corridor, and a set of liquidity management instruments designed to support price stability and external balance in a small open economy. In practice, however, liquidity management has remained largely passive, allowing surplus liquidity to persist and leaving short-term rates anchored at the floor of the corridor. The prominence of the exchange-rate peg implies that domestic monetary conditions remain influenced by external inflows, reserve management, and fiscal cash flows. Within this institutional setting, the effectiveness of monetary policy continues to depend critically on prevailing liquidity conditions in the financial system

C. Liquidity Conditions and Structural Drivers

11. Liquidity conditions in Fiji's financial system have shifted markedly over the past decade toward a regime characterized by persistently elevated excess reserves. While short-term liquidity fluctuations have long reflected seasonal patterns in tourism, remittances, and fiscal operations, developments since the late 2010s represent a qualitative change in both the scale and persistence of surplus liquidity. Excess liquidity has remained structurally high for extended periods, reflecting the interaction of sustained foreign-exchange inflows, fiscal cash-management practices, and limited sterilization. These factors have materially altered the environment in which monetary policy is implemented.

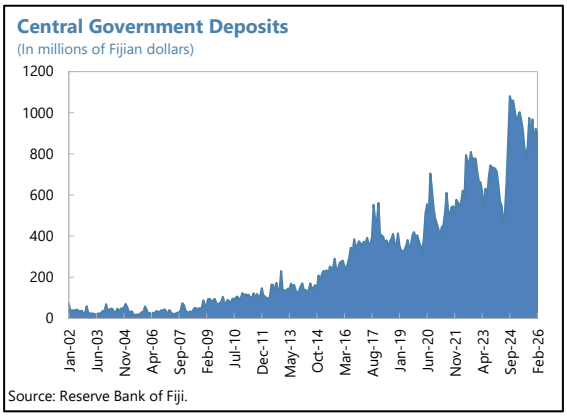


12. The buildup of system liquidity began well before the COVID-19 shock, following a prolonged period of accumulation over the 2010s. During 2010–2019, banks' reserves rose steadily from the low levels observed in the early 2000s, averaging about FJ$520 million compared with approximately FJ$145 million during 2002–2009, indicating a sustained—though still moderate—upward shift in liquidity conditions prior to the pandemic. This pre-COVID buildup reflected a combination of stronger foreign-exchange inflows associated with tourism, remittances, and external financing, as well as higher fiscal deposits held within the banking system. Foreign-exchange interventions undertaken to maintain the exchange-rate peg resulted in net injections of domestic liquidity, while government deposits increased owing to the timing of external disbursements linked to reconstruction and investment projects and uneven expenditure execution. During this period, sterilization operations remained limited.

13. Liquidity conditions intensified significantly during 2021–22, when reserves reached unprecedented levels peaking at about FJ$2.6 billion in 2022. This surge reflected a combination of exceptional external and fiscal factors. The 2021 allocation of Special Drawing Rights generated a one-off increase in foreign reserves and a corresponding injection of domestic liquidity. This was followed by a rapid recovery in tourism as borders reopened, alongside remittance inflows that remained well above pre-pandemic levels. In parallel, government deposits expanded sharply as large external budget-support loans, capital grants, and project-specific financing were received in sizeable tranches but not immediately spent.

14. Although liquidity declined somewhat in late 2023, it increased again in 2024, remaining at high levels of around FJ$1.8–2.2 billion, well above pre-pandemic levels. This rise reflected continued accumulation of government deposits associated with donor-financed climate-resilience and infrastructure programs, as well as ongoing foreign-exchange inflows from tourism and remittances that remained strong relative to historical norms.

15. A defining feature of Fiji's liquidity environment is the close and persistent relationship between government deposits and banking-system liquidity. As the government manages the bulk of its cash balances through accounts at commercial banks, increases in government deposits—arising from external loan drawdowns, donor disbursements, or delays in capital spending—translate mechanically into higher balances held by banks at the central bank. This relationship has been observed consistently across recent liquidity episodes, including those in 2018–19, 2021–22, and 2024, reflecting institutional arrangements governing fiscal cash management and the absence of a centralized Treasury Single Account. Movements in government deposits between the central bank and commercial banks have therefore been a key autonomous driver of system liquidity, alongside foreign-exchange interventions**.**



16. In sum, recent developments point to a sustained surplus-liquidity regime driven by the interaction of external inflows, fiscal cash-management practices, and the absence of sterilization operations in recent years. The scale and persistence of excess liquidity distinguish the current environment from earlier cyclical fluctuations and represent a fundamental shift in the monetary operating landscape. These conditions provide the backdrop for assessing the effectiveness of monetary operations and the scope for strengthening liquidity management within the existing policy framework.

D. Implications for Monetary Policy Transmission and Operational Normalization

17. This section discusses how the structure of the monetary policy framework and

prevailing liquidity conditions affect the transmission of monetary policy in Fiji. Under the pegged exchange-rate regime, monetary policy has been implemented in an environment of limited sterilization and persistent surplus liquidity. These conditions have shaped the functioning of the operating framework and limited the pass-through from the policy rate to short-term market interest rates. The section highlights the main constraints on transmission and discusses the role of liquidity management in supporting monetary policy implementation.

18. Monetary policy transmission has been constrained by an operational framework that operates de facto as a floor system in the presence of a large and persistent surplus of liquidity. With excess reserves consistently exceeding banks' transactional and precautionary needs, marginal funding conditions are not determined through market-based interbank activity but are instead shaped by administered central bank facilities. In this setting, the policy interest rate does not influence banks' marginal cost of funds, limiting the effectiveness of the interest rate channel. As a result, short-term money-market outcomes reflect the prevailing liquidity environment.

19. Monetary policy signaling has been further weakened by the prolonged stability of the floor rate. Since its introduction in 2010, the standing deposit facility rate—the floor of the corridor—has remained at zero, and the policy rate has not been increased. In an environment of abundant liquidity and limited money-market activity, this configuration has reduced the signaling value of the policy rate and dampened pass-through to retail deposit and lending rates. As a result, the effectiveness of the interest-rate channel under tightening conditions has not been tested in practice.

20. Strengthening liquidity management is central to restoring an effective monetary policy transmission mechanism by re-establishing the role of short-term interest rates as the marginal price of liquidity. Persistent foreign exchange inflows, refinancing and credit-support measures introduced during the COVID period, and the limited use of sterilization operations have resulted in a structural surplus of reserves. Regular and predictable liquidity-absorbing operations, calibrated to liquidity forecasts and aligned with the policy-rate corridor, would gradually reduce surplus reserves and increase the sensitivity of short-term rates to policy signals. This would strengthen the operational link between the policy rate and money-market conditions.

21. Structural excess liquidity can be reduced through the activation of open market operations, in particular the regular issuance of Reserve Bank of Fiji notes. A predictable issuance program, priced in reference to the policy rate, would provide an effective absorption mechanism for persistent liquidity surpluses and establish a clear operational anchor at the short end of the yield curve. By linking the policy rate to a regularly offered central bank instrument and reinforcing it through active liquidity management, the central bank would strengthen the transmission of its policy stance to short-term market rates. As liquidity conditions gradually normalize, interbank activity would be expected to resume, supporting price discovery and enhancing the broader monetary policy transmission.