GOVERNMENT OF FIJI

DEBT REPORT FOR THE YEAR 2009

PREPARED BY THE DEBT AND CASHFLOW MANAGEMENT UNIT
FINANCIAL ASSET MANAGEMENT DIVISION
MINISTRY OF FINANCE

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Executive Summary

For 2009, Government adopted an expansionary fiscal stance. As such, Government's position was budgeted for a headline deficit of $192.8 million, equivalent to 3% of GDP for the year . The fiscal performance during the year did not turn out as expected especially in revenue performance thus resulting in provisional net deficit of 4.0 percent estimated as the actual outcome.

The weak fiscal performance resulted in higher debt level as government continued to borrow to finance the operational and capital expenditure. Total debt outstanding grew by 8.5 percent over the year and at same time, sourcing funds from domestic market was getting expensive with the cost of borrowing averaging between 5.35% and 7.12% respectively for Treasury-Bills and Bonds.

On the external front, there were no new lenders; however the impact of the 20% devaluation resulted in a higher external disbursed outstanding debt value at the end of 2009. Overall, the domestic market remained a major source of financing the deficit budget of the government in 2009 and this trend is expected to continue in years to come.

Amortisation of loans always has a huge impact on net deficit, with $191 million recorded for 2009 and this is likely to increase in 2010 with the rise in cost of borrowing during the year under review. Government and RBF have embarked on a strategy of issuing fixed coupon bonds to maintain costs below 8% or even lower.

The 2009 Debt report highlights the overall debt portfolio of the Fiji Government. With the Debt to GDP ratio currently standing at 54%, the main target is to reduce to below 40% by 2012. Together with the structural reforms by Government with improved fiscal management, this is achievable in order to maintain a sustainable debt level in the long run.

1.0 TOTAL GOVERNMENT DEBT

The total Government debt stock at the end of 2009 was $3.1 billion, an increase of 8.5 percent from the preceding year. The major factors attributed to the increase were the net issuance of domestic debt instruments and the impact of exchange rate movement on the value of external debt stock.

Table 1: Total Debt Stock $(000)

	2006	2007	2008	2009
Domestic Debt	2,446.3	2,337.8	2,411.0	2,605.0
External Debt	416.7	397.0	476.0	527.5
Total Govt. Debt	2,862.0	2,734.8	2,887.0	3,132.5

Of the total outstanding debt, $527.5 million is associated with external borrowing while the balance was raised domestically through issuance of bonds and T-bills. In spite of net redemption of external debt by $18 million, the value of external debt stock rose because of revaluation arising from devaluation of the Fiji Dollar last year.

With a gross deficit of around $522 million set at beginning of year, government manage to raise only $404 million domestically. This was in line with revision to the expenditure as a result of downturn in revenue collection.

1.1 Costs of Borrowing

Costs of borrowing have been computed to identify the costs associated with all borrowings (short/long) domestically and abroad. As evident from table below, costs of borrowing in the domestic market has increased for both t-bills and bonds. Costs of borrowing by T- bills grew by 4.57 percentage point while bonds grew by 42 basis points. The increase reflects the high bids submitted by institutional investors considering the quantum of debt instruments issued by the Fiji Government. In contrast to the domestic borrowing, the weighted average costs of borrowing from abroad fell by 2 percentage point after effects of global financial crisis begin to melt down as well as high liquidity in the international financial system.

Table 2: Costs of Borrowing (% pa)

	2007	2008	2009
Weighted Average-Short Term (Domestic)	6.20%	0.78%	5.35%
Weighted Average-Long Term (Domestic)	6.60%	6.70%	7.12%
Weighted Average (External)	6.41%	5.48%	3.49%

2.0 GOVERNMENT DOMESTIC DEBT

2.1 Domestic Debt Composition

Apart from fulfilling its borrowing requirements, Government is also tasked with developing the domestic capital market with its frequent issue of bonds and Treasury Bills. Moreover, the limited investment opportunities available locally has raised institutional apetite for government securities. Government borrowings are in accordance with the borrowing provisions in the 2009 approved Budget. The Table belows shows the domestic debt composition for the last 3 years.

Table 3: Domestic Debt ($M)

Year	2007	2008	2009
Bonds	2,196.2	2,346.3	2,505.1
Treasury Bills	141.6	64.7	99.9
Total Domestic Debt	**2,337.8**	**2,411.0**	**2,605.0**

Domestic debt outstanding at the end of 2009 increased by $194.0 million or 8.0 percent when compared to 2008. This increase was attributed by a net increase of $159m in bonds and $35million in treasury bills holdings.

Figure 1: Bond Holders

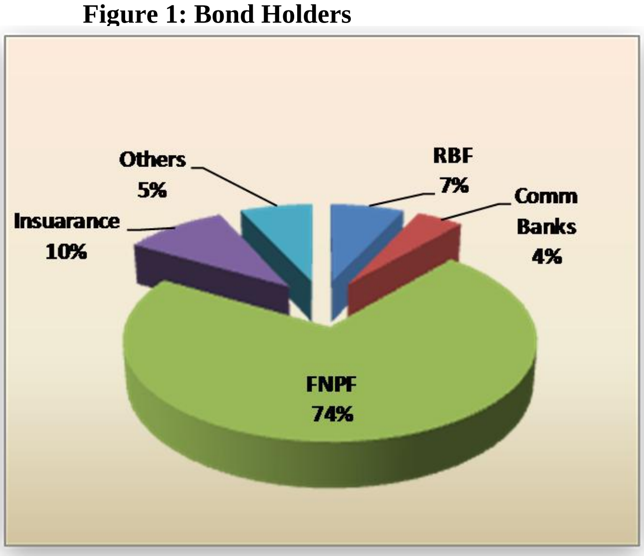
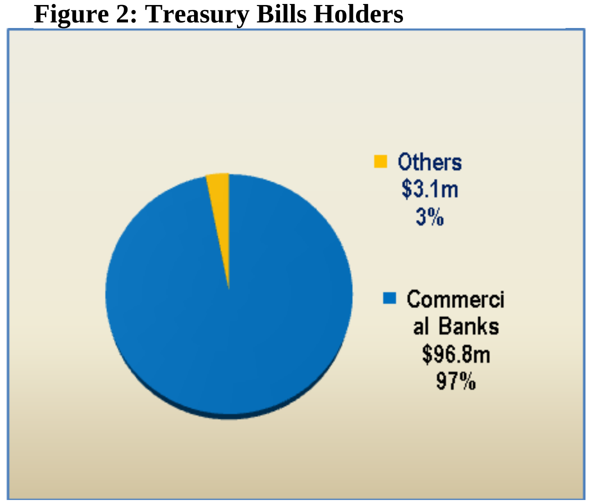


Figure 2: Treasury Bills Holders



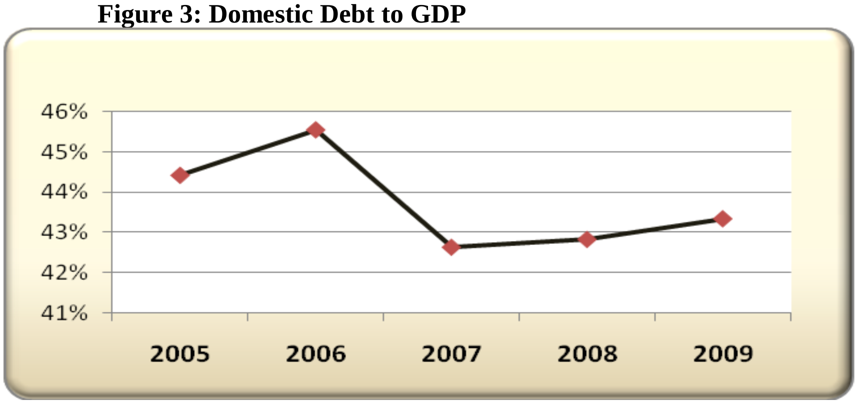
Borrowing in the domestic market was dominated by a few market players with the Fiji National Provident Fund (FNPF) accounting for 74.0 percent of total long term debt in the form of Government bonds. Short term debt issuance as of December 2009 in the form of

Treasury Bills saw the Commercial banks holding 97% of the $99.9m outstanding whilst individuals and other holders make up the remaining 3%.

2.2 Domestic Debt to GDP

As a share of GDP, the Government's domestic debt increased steadily over the past 2 years with Domestic Debt to GDP rising from 42.4 percent in 2008 to 43.3 percent in 2009 as represented in Figure 3. It must be noted that Government relied heavily on domestic borrowings to finance its budget deficit between 2008 and 2009 and this trend is likely to continue in 2010 as the budget deficit is to be mainly financed from domestic borrowings.

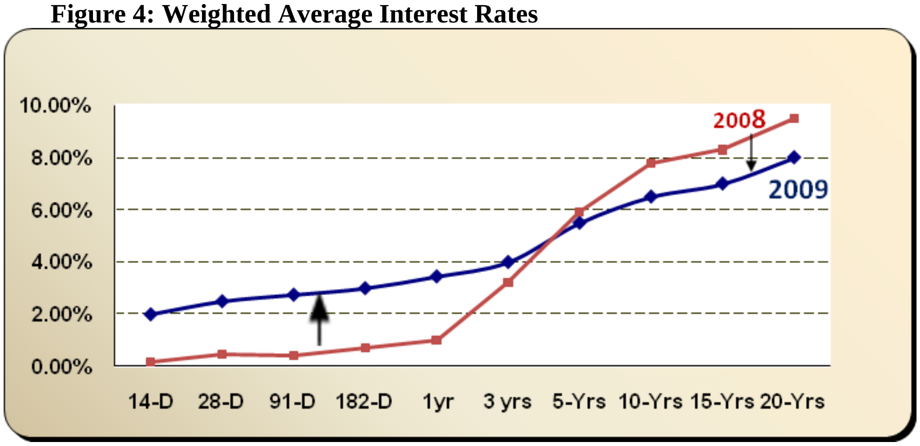
Figure 3: Domestic Debt to GDP



2.3 Domestic Interest Rates

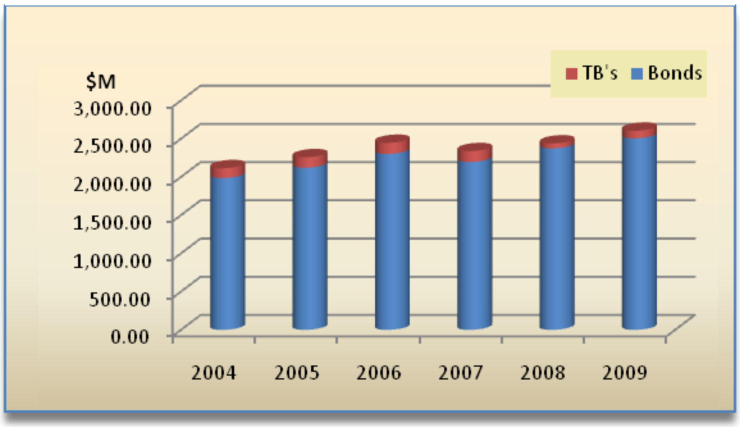
Figure 4 shows the Government yield curves representing the structure of interest rates from the short term to long term. The yield curve depicts the remarkable increase in interest rates in 2009 which called for an intervention by the Reserve Bank in consultation with the Ministry of Finance to regulate interest rates in the market to curb the progressive increase in rates in the domestic market. The impact of an introduced ceiling on interest rates is evident from the graph whereby the rates for the long term instruments in December 2009 were lower than weighted average rates in December 2008.

Figure 4: Weighted Average Interest Rates



2.4 Domestic Debt Instruments

Figure 5: T-Bills and Bonds Outstanding



At the end of 31 December 2009, Government bonds outstanding stood at $2.505 billion, an increase of 6.8 percent compared to 2008.

Treasury Bills outstanding increased significantly by $35.2 million or 54.4 percent when compared to 2008. Treasury bills were raised mainly to cover revenue shortfall and to offset timing differences between inflows of revenue and major payments by Government.

Government Bonds and Treasury Bills are issued in the market with due consideration to the forecast budget and actual shortfall in the government cashflow[1]. In this regard, Government has strengthened its cashflow management to provide a more transparent and indicative approach in its borrowing in the domestic market.

Figure 6: Bond Allotment by Maturity ($m)

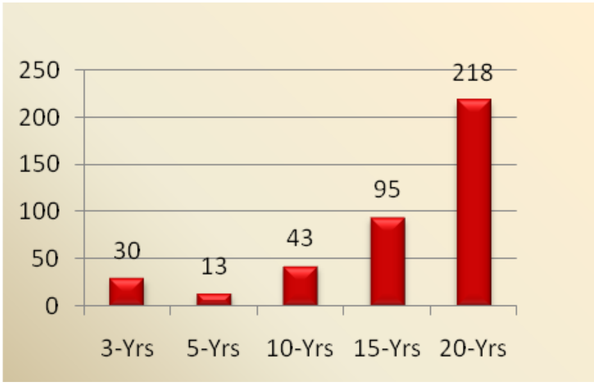
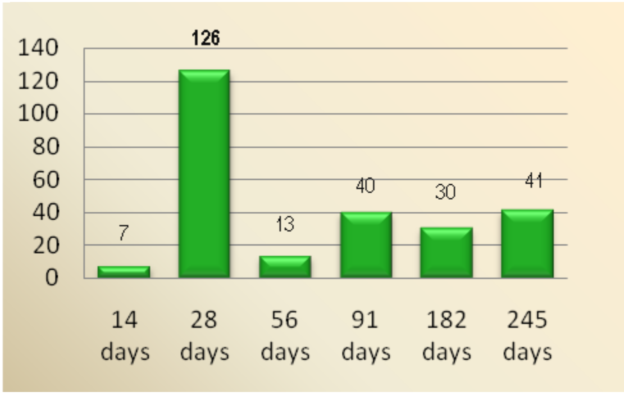


Figure 7: T-Bill Allotment by Maturity ($m)



Treasury Bills has the following maturities; 14 days, 28 days, 56 days, 91 days and 182 days. It is evident from the above charts that Investors opted to invest more in the short end with $126m of the outstanding T-Bills maturing in 28 days.

[1]It is to be noted that the current financial system of Government runs on Cash-Accounting Basis.

Investment in bonds is geared towards longer end that is 15 and 20 years bonds. On the otherhand, demand for medium term bonds (3, 5 and 10 years) has gradually decline when compared to previous years.

2.5 Domestic Debt Servicing

Domestic debts servicing both in terms of principal and interest payment comprise a significant component of government expenditure for the past 3 years. Table 4 summarizes the domestic debt servicing trend from 2007 to 2009. At end of last year, debt servicing rose by 21 percent over the year and 12 percent two years ago.

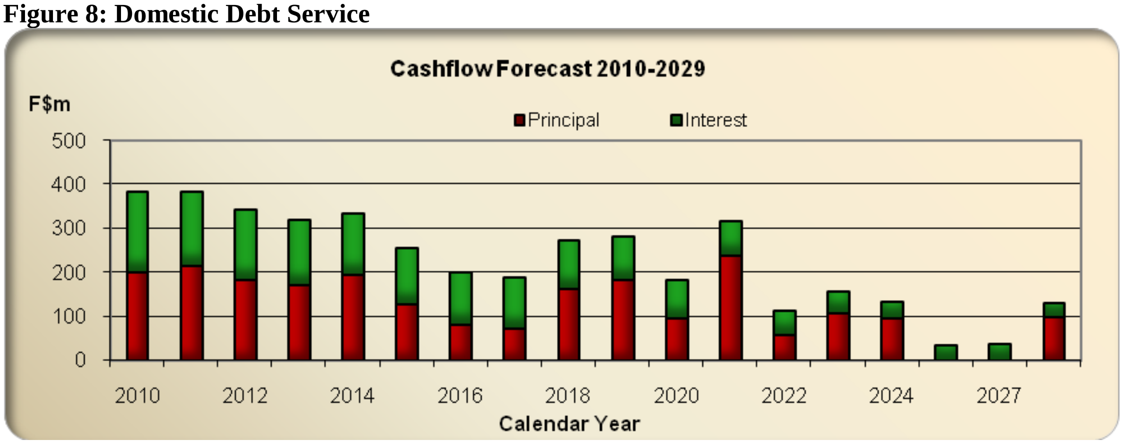
The year 2009 recorded $245m in principal repayments, this is mainly explained by a rise in government bond redemptions. Moreso a higher interest payment is projected for 2010 due to higher bond yields issued by government over the years.

Table 4: Domestic Debt Servicing: 2007-2010 ($M)

	2007	2008	2009
FDL-Principal Payment	204.9	191.2	245.4
FDL-Interest	148.1	147.4	165.3
T-Bill Interest	13.0	0.6	1.2
Total Domestic Debt Service	**366.0**	**339.2**	**411.9**

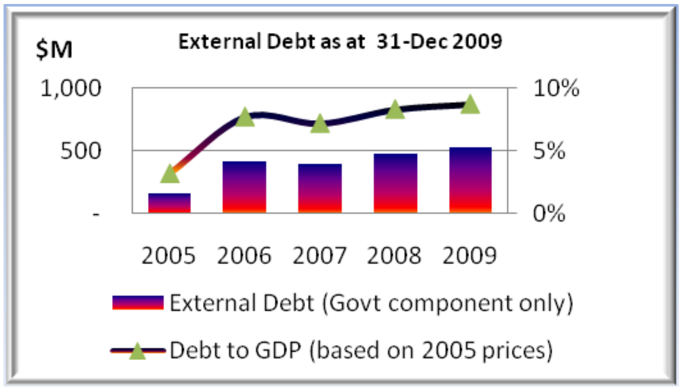
For the next 20 years, meeting all debt servicing obligations by Government presents major challenges. As shown in Figure 8, the future interest and principal repayments on domestic loans would form a considerable portion of Government Expenditure in years to come.

Figure 8: Domestic Debt Service



Efforts are put in place to undertaking alternative cheaper forms of borrowing that would reduce the debt burden in the long run.

3.0 GOVERNMENT EXTERNAL DEBT



External borrowing grew by 10.8 percent to $527.5 million at end of last year. The increase was mainly attributed by the appreciation of the three (3) major servicing currencies of the loans against the Fiji dollar, an increase equivalent to 8.8% of the GDP.

Their were no new lenders registered during year, the existing lenders namely the Asian Development Bank (ADB), two existing bilateral lenders; Japan Bank for International Cooperation (JBIC) and the Export and Import Bank of the Republic of China (EIBRC), and the balance was kept in the form of Global Bond with JP Morgan. To date, government's largest multi-lateral lender, ADB, holds approximately $167.8 million of outstanding debt, whereas the largest bilateral lender holds $38.4 million.

Table 5: Government External Disbursed Outstanding Debt (F$M)

	2007	2008	2009
External DOD Central Govt.	397.0	476.0	527.5
Total External Debt Service of which:	**39.3**	**33.3**	**45.6**
Principal Payment	17.1	12.5	21.2
Interest Payments	22.2	20.8	24.4
External Debt to GDP Ratio	**7.1%**	**8.0%**	**8.8%**
Ext Debt Service as %age of Export of goods & services	1.4%	1.0%	1.0%

Government has been allocating funds in the national budget to build up the sinking fund account, in order to support the repayment of the Global Bond due in September 2011 and so far, approximately US$50.0 million has been set aside for this purpose.

Debt servicing when compared to the preceding year increased by $12.3 million. This was mainly due to the prepayment of four of Governments oldest loans; the 1979 EEC-Outer Island Jetties Loan, 1979 EEC Regional Telecommunication Network loan, 1984 Netherland Investment Bank loan and the 1989 French Treasury loan.

Loan Disbursements

Table 6: External Loan Disbursements (F$M)

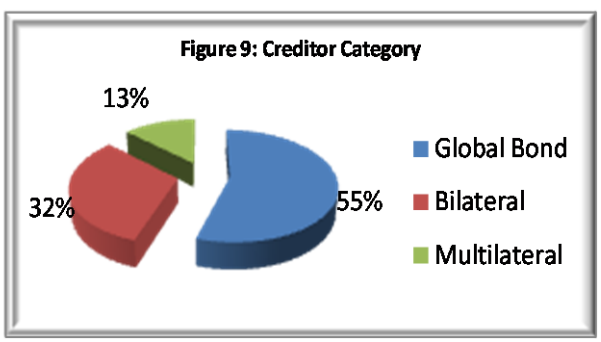
Drawdown Method	2007	2008	2009
A. Direct Payment ($M)	**1.6**	**15.5**	**23.1**
Exim Bank of China	0.0	5.1	15.7
ADB	1.6	10.4	7.4
B. Reimbursement ($M)	**18.3**	**4.4**	**2.9**
ADB	18.3	4.4	2.9
Total Disbursement [A+B]	**19.9**	**19.9**	**26.0**

The drawdowns of loans from abroad are either by reimbursement method or direct payment. Reimbursement method has been a practice in the past as funds are deposited in the Consolidated Fund Account for payment of projects being implemented. Direct payment however, has resulted in funds being paid directly to the Contractor after works has been certified and approved by line Ministry before the Finance Ministry gives clearance to Lender to pay contractor.

During period under review, total Cash disbursement credited to the Consolidated Fund Account totaled $2.9 million, $4.4million less than preceding year. This mostly relate to the ADB FRUP III road program. Loan drawdown through direct payment increased by $7.6 million to $23.1 million at the end of last year. The rise was mainly attributed by growth in the Exim Bank of China, E-Governance project loan disbursement.

3.1 Debt Composition

By Creditor Category

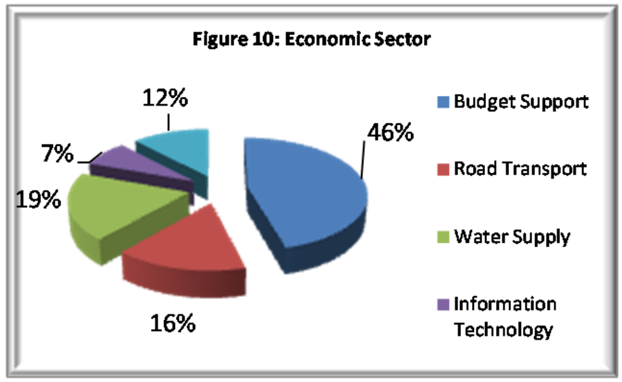


Overall, the outstanding debt forecast rose by approximately $52.0 million from 2008; the global bond value increasing by $25 million (9.3%), multi- lateral loans by $11 million (7.1%) and the bilateral loans by $15.7 million (29.4%).

By end December 2009, Global Bond made up 55 percent of the total external debt outstanding, followed by the multilateral lenders of 32 percent and bilateral lenders, 13 percent. Refer Figure 9. Of the six existing Euro loans that were considered for prepayment in 2009, only 2 were paid off during the year. In total, Government managed to prepay four project loans during the year and these also includes the French Treasury loan and the Netherlands Investment Bank loan.

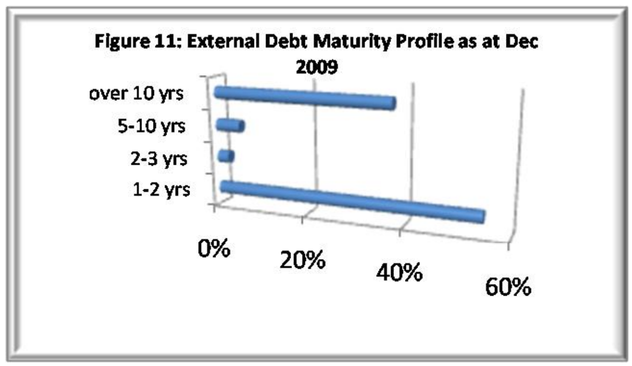
By Economic Sector

In terms of distribution by sectors, the global bond dominates with 46%, followed by the Road Transport sector 16 percent, Water 19 percent, the IT sector (E-Gov) of 7 percent and the remaining sectors (Telecom, Rural Development, Forestry & Agriculture), by 12 percent. Refer Figure 10.



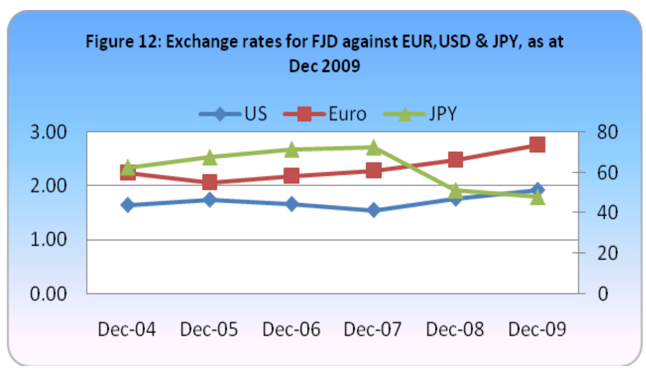
By Debt Maturity & Currency Profile

Approximately 37.0 percent of the total outstanding external debt has maturities greater than 10 years, 5.0 percent in the next 4 – 5 years, 2% percent in the next 2-3 years and 55.0 percent in the next year, 2011. Refer Figure 11. The currency composition of debt continued to be dominated by the US dollar (79.06%), followed by the Japanese Yen (12.83%), the Euro (2.44%) and then the Chinese Yuan (5.67%).



3.2 Exchange Rate Movement

In terms of the exchange rates movement of the Fiji dollar against its three major debt servicing currencies for the past 6 years; it can be seen that there has been a steady growth of the Euro and while the US dollar has fluctuated over the period, the Japanese yen show declining trend over most of the period.



Over the year, the Fiji dollar weakened against the Euro (10.3%), the Japanese yen (6.4%) and the US dollar (8.5%), but strengthened against the Euro (2.7%), the Japanese yen (3.6%) and the US dollar (1.01%) over the last quarter. The significant weakening of the Fiji dollar over the year was mainly due to the 20% devaluation of the Fiji dollar enforced in April 2009.

4.0 CASH MANAGEMENT

4.1 Ways and Means Utilization

Section 59(c) of the Finance Management Act 2004 states that the Minister may on behalf of the State, borrow money by means of overdrafts or advances, but so that the total amount outstanding by way of overdrafts and advances does not at any one time exceed $20.0 million. This facility is available to Government through the Reserve Bank of Fiji.

Table 7: Ways and Means (F$M)

Year	Ways and Means Borrowed and Fully Repaid
2005	80.9
2006	373.2
2007	260.2
2008	83.4
2009	152.0

Total borrowings from Ways and Means in 2009 stood at $152 million. This marked an increase of $69 million when compared to $83.4 million borrowed from the facility in 2008. Under subscription in Government securities under the difficult market conditions affected government cash-flow operations in 2009 reflecting an increased reliance on the overnight borrowings facility to service debt repayments.

Despite the cash flow challenges in 2009, the level of reliance on this facility to fund cash shortfalls is comparatively low compared to borrowing levels in 2006 and 2007.

5.0 CONTINGENT LIABILITIES

Contingent liabilities represents government guarantees of other state owned entities and statutory authorities' debts which would have to be settled by government should these entities fail to pay.

In contrast to real Government debt which rose by 8.5 percent in 2009, contingent liabilities fell by 4 percent. A policy decision by Cabinet in 2009 approved that the FNPF investment in Government stock be excluded from the calculations of Government's contingent liabilities.[2]

[2] [2] CP (09) 325 : Cabinet Special Meeting on 18/12/2009

At the end of 2009 the total value of contingent liability of Government stood at $1.68billion comprising 26.5% of GDP.

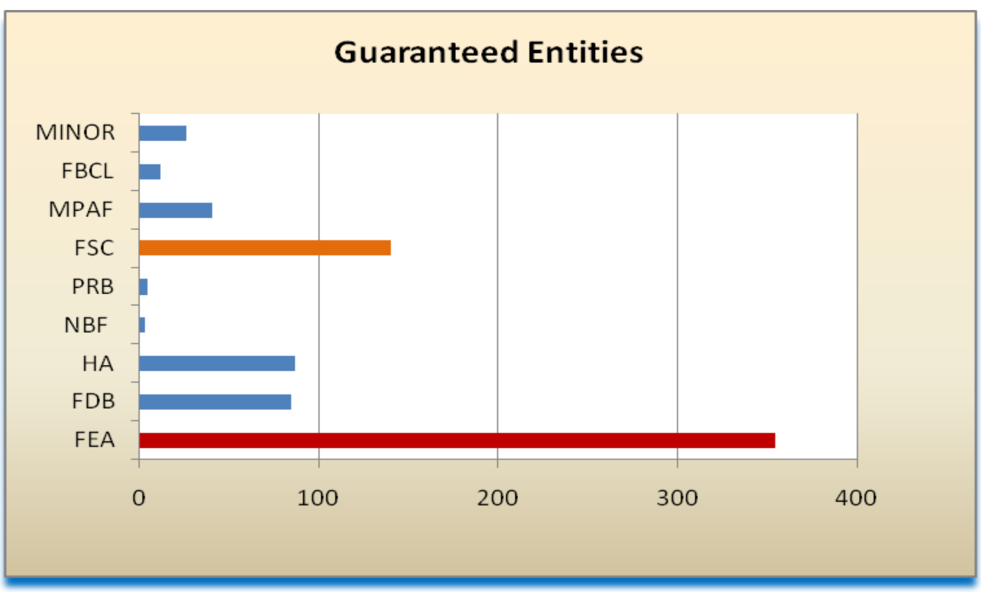
Table 8: Contingent Liability

	2005	2006	2007	2008	2009
Loans & Other G/tees ($M)	**1,222.8**	**1,362.8**	**1,718.6**	**1,755.7**	**1,680.0**
Of which the main components are:					
FNPF	629.1	643.7	873.3	874.7	866.0
Other Institutions	541.8	666.4	793.6	822.7	750.9
Subscriptions to Foreign Institutions	51.9	52.6	51.7	58.3	63.1
Contingent Liability as a %age of GDP	**25%**	**25%**	**32%**	**30%**	**26%**

Guaranteed Institutions

Of the outstanding contingent liabilities, $354million was for the Fiji Electricity Authority, $14Om for the Fiji Sugar Corporation, $84million for the Fiji Development Bank and $86million for the Housing Authority loans.

Figure 13: Contingent Liability – 31 Dec 2009



Guaranteed Loans for the (FEA) as well as the FSC are mainly for loans to fund their respective capital projects and mill upgrades. In respect of the call on guarantee, Government through a Cabinet directive in 2005 is now servicing the Fiji Sports Council guaranteed debt with FNPF for $0.37 million on an annual basis and an arrangement is in progress for the council to commence repayment in 2010 towards the total sum paid by Government in servicing the guaranteed debt.

6.0 ARREARS OF REVENUE

Arrears of revenue represent dues in the forms of fines, rates, fees and charges in respect of goods and services provided by Government through the various ministries and departments. The total Outstanding Revenue in 2009 amounted to $167.4 million which is an increase of $9.7 million or 6.2 percent compared to 2008 which recorded $157.7 million of outstanding arrears.

Figure 14 Compositions of Arrears for 2009

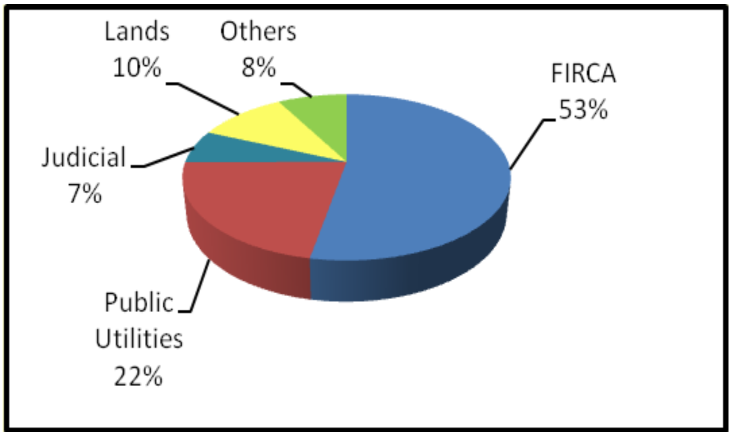


Figure 14 shows the four agencies which make a significant portion of the outstanding arrears for 2009 which includes FIRCA, Public Utilities, Judicial and Land. FIRCA recorded $88.7 million of outstanding Taxes. Approximately $36 million was owed to the Government in the form of unpaid water rates, $10.8 million in terms of court fees, fines and charges and $17.48 million were from the outstanding arrears of land rent

Table 9 shows the ministries outstanding revenue for 2009 compared to 2008 that depicts increasing trend for Land crown rent arrears as well as a $4million rise in water rates.

Table 9: Trend in Arrears : 2008-2009

Ministry/Departments	2008	2009
FIRCA	90,518,552.00	88,679,627.00
Public Utilities	32,730,039.00	36,755,411.01
Judicial	10,574,640.00	10,828,342.00
Lands	10,223,341.00	17,486,273.84
Others	13,637,285.00	13,629,736.15
TOTAL	**$157,683,857.00**	**$167,379,390.00**

7.0 CHALLENGES FOR DEBT AND CASH MANAGEMENT

The year 2009 posed considerable challenges in the raising of government debt to finance the budget deficit, servicing debt servicing obligations, minimising the cost of borrowing and the daily control of overall expenditure within the revenue strength of Government. Some of the major challenges in 2009 were:

- Under subscription in long term securities in the domestic market as majority of the investors were risk averse following the effects of the global financial crisis
- Under-developed secondary market for Government securities
- Concentration and rise in expenditure in the last quarter of the year
- Financing un-presented cheques from the previous financial year
- Continuous pressure on Government to honour its social obligations in the form awarding guarantees to poor performing entities.
- The failure of guaranteed corporations to honour financial commitments poses a great risk to government budget and fiscal management
- The failure of agencies to institute effective recovery mechanisms to recover arrears of revenue

8.0 CONCLUSION

Total debt rose by 8.5 percent in 2009. The rise was mostly associated with net issuance of government securities during the year to finance the budget deficit. Apart from rise in debt stock, Government faced the challenges of raising debt financing in the first 6 months of the year. Total Debt as percentage of GDP stands at 52 percent against 40 percent as normally considered to be the international benchmark. Government will continue to focus on domestic capital markets as a major source of borrowing in the future.

At the same time, considerable efforts will be directed towards reducing contingent liabilities to minimize risks of these contingencies becoming real debt. The rise in number of defaults in payments and increasing requests from guaranteed entity to convert debt into equity has further led to more borrowing and rise in government real debt stock.

Coordination with revenue earning agencies would be strengthens in order to boost their efforts in recovering arrears of revenue. It is important the government agencies honor their tax obligations to FIRCA to reduce tax liability.

Cashflow management in whole of government will be enhanced to minimize wastage and unplanned expenditure which normally attribute to rise in unnecessary borrowings. Overall, the aims is to maintain a relatively even maturity profile for term debt across the yield curve to reduce pressure on domestic bond market when supply increases unexpectedly and provide the government with greater flexibility in an environment of fiscal surpluses.

In moving forward, the Government will proactively undertake the following measures to reduce debt to a sustainable level as well implement effective cashflow management:

- Repayment of expensive and high coupon bonds;
- Reduce short-term debt;
- Utilize proceeds from dividends, government owned entities profits for debt prepayment;
- Restructure of debt portfolio;
- Ensure an effective cashflow forecasting and management;
- Effectively coordinate with the market and Reserve Bank of Fiji as well as the line ministries/departments in respect to borrowing funds to meet cash-flow needs.
- Strengthen coordination with the Reserve Bank and Financial Institutions on the development of the "Secondary Bond Market" for government securities.
- Consider building up of the sinking fund to support repayment of Global bond in 2011.
- Integrate debt reduction strategies with the budget strategies.

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