GOVERNMENT DEBT REPORT

FOR THE YEAR ENDING DECEMBER 2010

MINISTRY OF FINANCE

SUVA

FIJI

MAY 2011

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INTRODUCTION

According to the IMF and World Bank, a government's debt portfolio is usually the largest financial portfolio in the country which often contains complex and risky financial structures and can generate substantial risk to the government's balance sheet and to the country's financial stability.[1]

The 2010 Budget adopted an expansionary stance with the deficit level targeted at 3.5% of Gross Domestic Product. The expansionary fiscal stance was adopted to generate economic activity in light of low private sector investment and foreign direct investments (FDI). To fund the budget deficit, however government continued to borrow in the domestic market to finance the maturing debt and fund capital expenditure.

The 2010 Government Debt Report presents the actual debt position and the debt portfolio as at the end of 2010. Particular emphasis is drawn to the sustainability of the overall debt level when compared to the rate of growth and this calls for a concerted effort and strong political will to pave the way for a sustainable path and that a credible strategy is put in place to reduce excessive levels of debt.

1.0 OVERALL DEBT POSITION

The Overall debt position of the Fiji Government stood at **$3.383 billion** as at 31st December 2010, which comprises $2.834 billion domestic debt and $548.5 million external debt. This represents an increase of 8 percent when compared to the 2009 debt level of $3.132 billion. Financing of the 2010 budget deficit was mostly through raising of government securities in the domestic market and the net issue of government bonds resulted in the rise in the domestic debt level.

Table 1: Total Debt Stock

Year	2006	2007	2008	2009	2010
Domestic Debt	2,423.5	2,337.8	2,411.0	2,605.0	2,834.7
External Debt	416.7	397.0	476.0	527.2	548.5
Total Debt	**2,840.2**	**2,734.8**	**2,887.8**	**3,132.2**	**3,383.2**
% of GDP	**53.3%**	**49.9%**	**50.8%**	**56.6%**	**57.7%**

2.0 GOVERNMENT DOMESTIC DEBT

2.1 Domestic Debt Stock

Domestic debt is the sum of outstanding Treasury Bills and Bonds at any given time. The domestic market continues to be major source of funding for Government over the years. On a year to year basis, the total domestic debt increased by $229.7 million or 8.8% from $2.605 billion the previous year to $2.834 billion at the end of December 2010.

Tabulated below is the 5 year trend for domestic debt.

Table 2: Domestic Debt ($M)

Year	2006	2007	2008	2009	2010
Bonds	2,277.8	2,196.2	2,346.3	2,505.1	2,759.3
Treasury Bills	145.7	141.6	64.7	99.9	75.4
Total Domestic Debt	**2,423.5**	**2,337.8**	**2,411.0**	**2,605.0**	**2,834.7**
% of GDP	**45.1%**	**42.6%**	**42.4%**	**47.1%**	**48.4%**

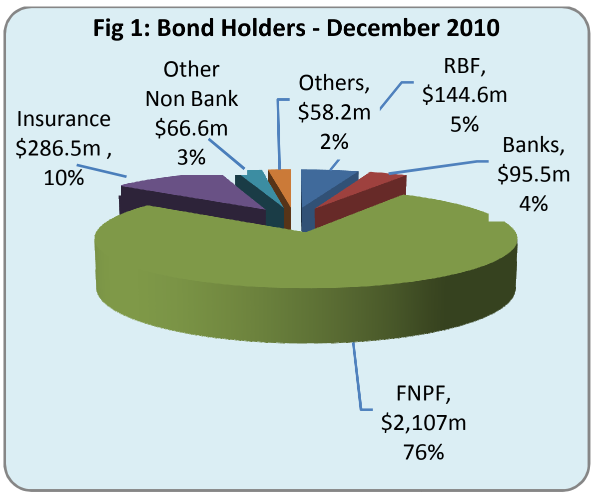
As stated in Table 3, total domestic debt outstanding at the end of 2010 increased by $229.7 million to $2.834 billion. The increase was associated with net issue of bonds of

[1] Guidelines for Public Debt Management- IMF and World Bank, 2001

around $254 million. Treasury bills decline over the year as a result of net redemptions.

2.2 Domestic Debt by Holder Category

Fiji's only superannuation company, the Fiji National Provident Fund continues to be the leading creditor holding 76 percent of total Government bonds. Other institutional investors comprise of the insurance sector which held 10%, followed by RBF with 5 percent and commercial banks held 4 percent. Other Non Bank Financial institutions, individuals and other investors make up the remaining 5 percent.

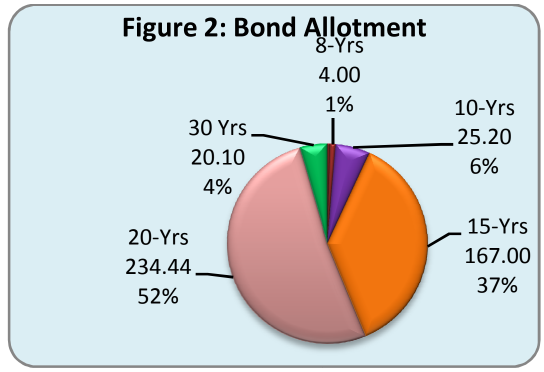


An analysis of short term debt holdings as of December 2010 saw the Commercial banks holding 99% of the $75.4m outstanding Treasury Bills whilst individuals and other holders make up the remaining 1%.

2.3 Domestic Debt Allotment by Instrument

Domestic debt is mainly comprised of government bonds with maturities ranging from 3 years to 20 years. Apart from bond raising to meet the budget deficit, the issuance of medium to long term bonds is vital for the development of the domestic financial markets. On the other hand treasury bills are issued to cover shortfall in revenue collections.

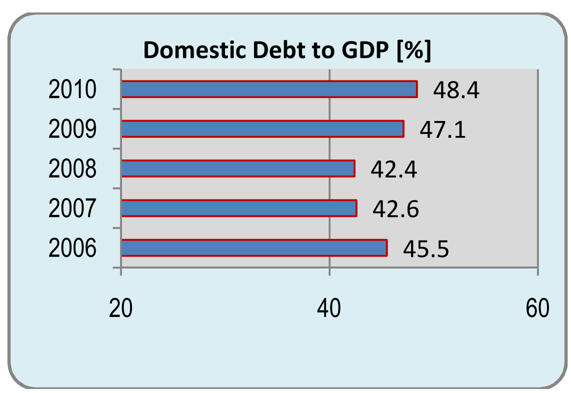
Figure 2 shows the distribution of bond allotment by maturity with the 6 and 8 years bonds and 30 years bonds introduced during the year.



2.4 Domestic Debt to GDP

As depicted in Figure 3, the Government's domestic debt to GDP increased progressively over the past 3 years with Domestic Debt to GDP rising from 42.4 percent in 2008 to 47.1 percent in 2009 and then to 48.4 percent in 2010. As a result of sourcing most of its deficit domestically in 2010, Government's ability to maintain domestic debt to GDP ratio at below 40 percent is a challenge. This however remains a medium term target.

Figure 3: Domestic Debt to GDP

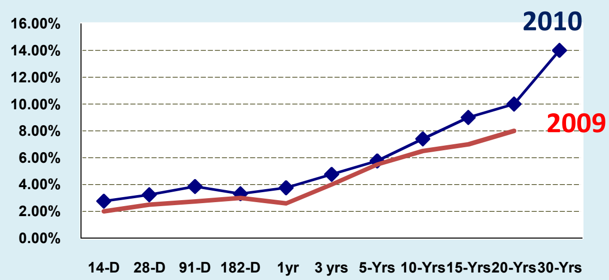


2.5 Domestic Interest Rates Structure

In 2010, interest rates for both short and long term debt instruments rose during the year. The increase was due to high borrowing requirements by Government and Statutory bodies.

The yield curve in figure 4 depicts the increase in interest rates in 2010 from the 14 days treasury Bills right up to the 20 year bonds. The new 30 year bond attracted interest rates of 14 percent.

Fig 4:Weighted Average Interest Rates - December 2010



Treasury Bills as a means of short term borrowings for Government were raised with the following maturities; 14 days, 28 days, 56 days, 91 days and 182 and 245 days.

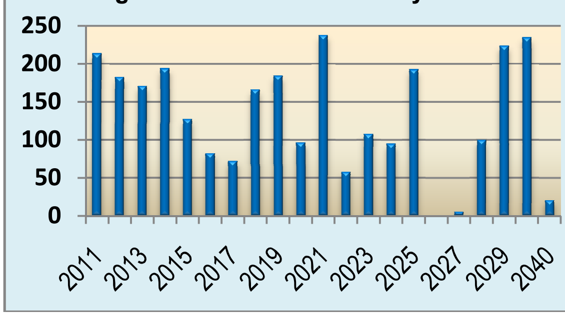
2.6 Domestic Debt Servicing

Table 3: Domestic Debt Servicing: 2006-2010 ($M)

	2006	2007	2008	2009	2010
Principal	177.5	205.0	191.2	245.4	198.5
Interest	135.6	147.5	147.6	165.3	190.7
T-Bill Interest	5.4	13.0	0.6	1.2	4.3
Total Domestic D/ Service	**318.5**	**365.4**	**339.4**	**411.9**	**393.5**

The Government managed to settle all principal and interest payments due in 2010. Of the total $393m, Government successfully repaid $198.5 million for maturing loans. Figure 6 shows the government's maturity structure.

Fig 5:Domestic Debt Maturity



3.0 GOVERNMENT EXTERNAL DEBT

The Government's external debt level continued to increase over the years with the disbursed outstanding balance totaling $548.5m at end of the review period. The increase was mainly attributed to the disbursements of loan funds for on-going capital projects executed under the ADB and EXIM Bank of China loans.

Table 4: Government External Disbursed Outstanding Debt

	2007	2008	2009	2010(e)
External DOD Central Govt.	397.0	476.0	527.5	548.5
Total External Debt Service of which:	**39.3**	**33.3**	**45.6**	**41.3**
Principal Payment	17.1	12.5	21.2	17.6
Interest Payments	22.2	20.8	24.4	23.7
External Debt to GDP Ratio	**7.2%**	**8.4%**	**9.5%**	**9.4%**
Ext Debt Service as %age of Export of goods & services	1.4%	1.0%	1.0%	1.0%

During the year 2010, several loans were contracted from the Exim Bank of China as well as Exim Bank of Malaysia and these loans will be used to finance mostly infrastructural and housing development projects around the country. With the contraction of these loans, the distribution of external debt under the Government's bilateral creditor category will increase. External debt servicing reduced by $4.3m to $41.3m in 2010. While external debt to GDP dropped slightly to 9.4% in 2010, the external debt to export ratio was unchanged.

3.1 Loan Disbursements

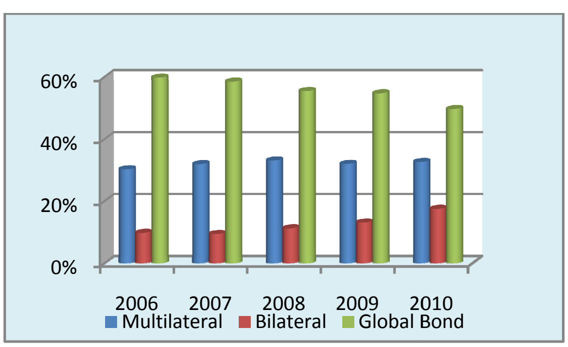
The disbursements of loan funds for 2010 were made up mostly of E-Government loan, Supplementary FRUP 3 loan, Flood Recovery loan, and the Suva Nausori Water Supply & Sewerage project. The total loan disbursed in 2010 amounted to $46.3 million, of which $43.3 million was through the more favorable disbursement method called Direct Payment.

3.2 Debt Composition

By Creditor Category

During the review period, a total of $44.7m or 13% of total disbursement was from bilateral loans, whilst multilateral lenders recorded $230.8 million or 23%. Multilateral lenders comprise of ADB ($170.5m) and Exim Bank of China ($60.3m). Fiji's bilateral lenders are mostly EIB ($8.8m) and JBIC ($35.9m). The Global bond registered a balance of $272.9m at end of the year.

Fig 6: : Distribution of Debt Creditor Category – December 2010



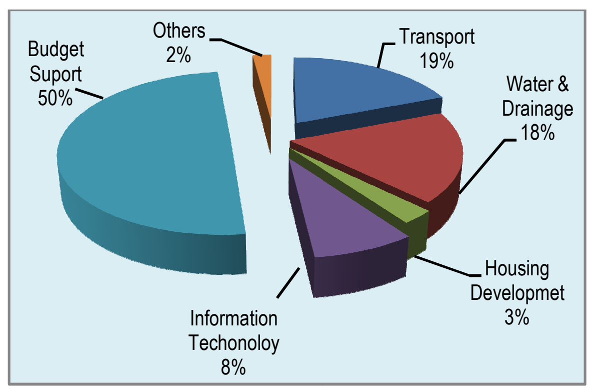
The Global Bond's expected date of repayment is set for September, 2011. As a result of the strengthening of Fiji dollar against USD, the value of the Global Bond fell to $272.9m from $289.3m registered in December, 2009.

In 2010, the Government prepaid three loans of which one was from ADB and two from the European Investment Bank with a total value of $4.2m.

By Economic Sector

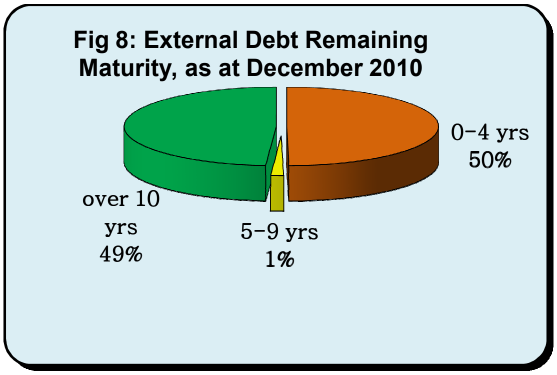
In terms of distribution by sectors, the global bond dominates with 50%, followed by the Road Transport sector 19 percent, Water 18 percent, the IT sector 8 percent, Housing Development 3% and the remaining sectors (Telecom, Rural Development, Forestry & Agriculture), by 2 percent.

Fig 7: Distribution of Debt by Economic Sector



By Debt Maturity & Currency Profile

At the end of December 2010, the maturity structure for the Government's external debt portfolio showed that 50% of it its external debt will mature from 0 – 4 years time, 1% from the next 5 – 9 years time and the remaining 49% over the next 10 years.



Moreover, in terms of its currency composition, the US dollar continued to be dominated by the US dollar 79.0% followed by the Japanese Yen 10.3%, Chinese Yuan 9.4% and the remaining 1.0% to the Euro Dollar. Interesting to note the Chinese Yuan which has picked up significantly and this reflects the Government's new commitment to the Chinese Government in terms of loan contraction and assistance and Euro has reduced significantly to 1% which should be phased out once we repay the remaining 3 loans outstanding to EIB in the near future.

3.3 Interest Rates

The major 2 classification of interest rates surrounding external debt are fixed and variable interest rates. The fixed interest rate was 2.0 percent while the variable interest rate was around 3.5 percent during the review period. The fixed rate loan is mostly associated with concessional loans from Exim Bank of China while variable rate is market based US-Libor rate that multilateral lenders charge for their loans.

4.0 PERFORMANCE

4.1 New Loans Contracted in 2010

There were six new external loans that were contracted in 2010 to fund capital projects in priority sectors.

Table 5: New External Loans in 2010

Lender	Project	Loan Value
EXIM Bank of China	Low Cost Housing [Housing Authority]	F$50.0m
EXIM Bank of China	Low Cost Housing Public Rental Board	F$20.0m
ADB	FRUP III Supplementary	USD$26.8m
ADB	Suva Nausori Supplementary	USD$23.0m
ADB	Flood Recovery	USD$17.6m
EXIM Bank of Malaysia	Road Rehabilitation	USD$40.0M

ADB- Fiji Road Upgrading Project - FRUP III

The purpose of this project is to help Government to improve the efficiency of road sector services, increase private sector participation and improve management of road sector assets and sector resources. All project components were completed in 2005 with the exception of the upgrading of Korovou to Lodoni and Kings Road which is targeted to be completed in 2012 from the Supplementary Loan taken in 2010. The original loan of US$40 million was taken in 1998, whilst the supplementary loan of US$26.8 million was taken in 2010.

ADB-Suva Nausori Water & Sewerage Project

The main purpose of this project is the rehabilitation and augmentation of water supply and sewerage systems within the Suva/Nausori Region of Fiji and institutional reform of the Water Supply and Sewerage Department. The other objective is to improve efficiency, reliability, transparency, accountability and customer services. The project is planned to be completed in 2012. The original loan of US$47 million was contracted in 2004 while the supplementary loan was taken in 2010.

ADB-Flood Recovery

The government undertook this loan to rehabilitate public infrastructure that was damaged by floods that occurred in January 2009.The rehabilitation includes the main and rural roads, agricultural drainage schemes, water supplies and sewerage. The loan taken for this project was US$17.56 million.

EXIM Bank of China-Low Cost Housing Project

The Government, on 21st October 2008 approved that Public Rental Board and Housing Authority undertake a Public Housing Strategy to ensure a consistent, coordinated and effective approach towards meeting the constitutional provision, that every citizen of Fiji has a basic right to housing. Therefore this loan valued at F$20 million was approved for Public Rental Boards to assist in the construction of affordable homes in Raiwai and Raiwaqa areas. A sum of F$50 million was approved for Housing Authority to fund land development, provision of housing lots and construction of new homes in the Tacirua and Waila areas.

EXIM Bank of Malaysia-Queens Highway Development Project

The loan is focused on improving the quality of roads in Fiji. Under this project, a total of four (4) contract packages will be awarded and will be funded under the US$40 million loan. These 4 packages mainly cover the Queens roads from Navua to Sigatoka and Nadi to Rakiraki roads. The project is undertaken by Malaysian Company known as *Naim Holdings Berhad*.

4.2 Loans Prepaid in 2010

Government aims to reduce its debt stock in the medium term and one of the strategies is to prepay expensive debts. In 2010 two overseas loans contracted way back in 1979 were paid fully repaid.

Table 6: Prepayment in 2010

Loan	Currency	Payment in F$
2005 ADB Alternative Livelihood	USD	972,934.78
1979 NLTB/NLDC	EUR	781,962.05
1979 Vanua Levu Road	EUR	2,476,213.18
Total External Loan Prepaid		**4,231,110.01**

Source: MOF

The redemption of the three loans resulted in a reduction of external debt stock by $4.23million in 2010. Other economic benefits of prepayment would be in the from of interest savings Government would have been servicing in years to come.

4.3 Loan Funded Project Completed in 2010

The E-Government project was the first concessional loan funded by the EXIM Bank of China with US$20 million, the project was undertaken to increase the efficiency of Government through the use of information and communication technologies and particularly the internet, as a tool to achieve a better Government. The project was undertaken by *Alcatel Shanghai Bell Lucent Company*, an approved Chinese contractor.

The loan was fully disbursed in December 2010 in line with the loan availability period within the Loan agreement. One of the vital components of the loan is the Construction of a Government Data Centre and this has been successfully completed.

4.4 Domestic Loans Fully Paid in 2010

A total of six domestic loans raised in the form of government bonds were fully paid in 2010. This consisted of bonds raised between 1995 to 1997, with interest rates ranging from 8.23% to 9.00%.

Table 7: Bonds Fully Paid in 2010

Loan	Rate	Amount
1995 FDL 1	8.83%	$5.0m
1995 FDL 5	8.90%	$5.0m
1995 FDL 6	8.975%	$2.6m
1995 FDL 7	9.00%	$0.3m
1996 FDL 2	8.23%	$7.7m
1997 FDL 4	8.50%	$5.9m

Source: MOF

5.0 ISSUES AND CHALLENGES

5.1 Sustainability

Sustainability is the ability of the Government to continue to service its debt, and is measured by the ratio of Government debt to the Gross Domestic Product. The internationally recognized benchmark for the percentage of debt to the Gross Domestic Product is 40% of GDP for developing economies like Fiji. For the last ten years Fiji's Government Debt as percentage of GDP was way above 40%, which reveals that Fiji's debt level is costly to government as it chews up most of the useful resources that can be directed to other important sectors of the economy.

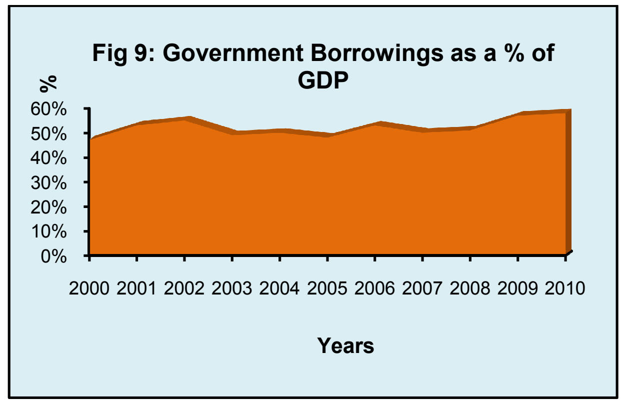
Table 8 : Debt to GDP

Year	Government Debt ($m)	GDP ($m)	Govt. Debt as a % of GDP
2000	1,438.7	3,049.1	47
2001	1,686.1	3,199.5	53
2002	1,891.0	3,442.9	55
2003	2,133.8	4,325.4	49
2004	2,282.2	4,539.0	50
2005	2,421.5	5,084.5	48
2006	2,858.7	5,371.5	53
2007	2,734.5	5,483.2	50
2008	2,886.8	5,682.9	51
2009	3,130.1	5,531.3	57
2010	3,273.0	5,861.9	58

Source: MOF

The total Government debt as a percentage of GDP as at 31st December 2010 was 58%, surpassing the 50% line.

The above shows an upward trend in the Government debt to GDP ratio, with debt rising faster than GDP indicating that the debt burden to individuals is rising. In 2010, the percentage increase in government debt relative to the GDP increased by 1 percentage point to 57% compared to year 2009.



5.2 Government Guarantee Exposure

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. Table 9 below reflects the level of Contingent liabilities outstanding for Government for the year s 2006 to 2010.

Table 9: Guarantee v GDP

Year	2006	2007	2008	2009	2010
Govt Guarantee	1,332,6	1,718.6	1,755.2	1,955.3	1,869.9
As % of GDP	24.8%	31.3%	30.8%	35.3%	31.9%
Total Debt to GDP	53.3%	49.9%	50.8%	56.6%	57.7%
Total Exposure % of GDP	78.1%	81.2%	81.6%	91.9%	89.6%

As of 31st December 2010, the balance was $1.869.9 billion which was equivalent to 31.9% of GDP. When compared to 2009 contingent liabilities declined by $85.4 million or 4.3%. For the 5 year period, contingent liabilities as percentage of GDP averaged 30%.

5.2.1 New Guarantees

Tabulated below are the new guarantees approved by Cabinet in 2010.

Table 10: New Guarantees

Entity	Approved	Utilized	Balance
FDB	$130m	$79.6m	$50.4m
FEA	$141m		$141.0m
FSC	$120m	-	$120m
TOTAL	$391m	$79.6m	$311.4m

Cabinet approved $391 million in new guarantees in 2010. Fiji Development Bank (FDB) utlised a total of $79.6 million during the review period and this is in the forms of bonds and promissory notes issue. Due to the risks associated with Fiji Sugar Corporation (FSC); there were no uptakes for their bond and promissory notes issuance. This further resulted in Government stepping in to meet the Corporation's debt service obligations. There was no borrowing undertaken by FEA following the Cabinet approval in November 2010. However, they borrowed US$11million in Quarter 1 of 2010 using the approved Government guaranteed endorsed by Cabinet in 2009.

6.0 SUMMARY

Debt management continues to face enormous challenges bearing in mind the risks associated with public debt. The demise of the Fiji Sugar Corporation Ltd has demonstrated the major risks of some government owned entities that are and have been performing under par over the years. Considering contingent liability being estimated at 32% of GDP at end of 2010, Government's commitment to the various reforms, including the financial sector, civil service and public enterprises are being undertaken at the same time. With other factors being constant, the benefits of these reforms together with positive spin-offs from government capital spending program will boost economic growth and therefore, allow Government to consolidate its fiscal position more strongly in the medium term.

In terms of cash management, Government is very stringent with the utilization of funds. Close collaboration with Government agencies and departments has resulted in improvement in forecasting and cashflow management on a daily basis for whole of Government.

Borrowing for medium and long-term maturity instruments will be the main strategy going forward. Minimising issuing of Treasury-Bills will remain a target as government does not want to commit too much funds in the short-term. Most importantly, to support the repayment of global bond, the sinking fund account will be maintained offshore.

In the medium term, if there are improvements in the key macroeconomic variables like decline in interest rates and appreciation of the Fiji dollar, the Government will continue to have savings in the budget through reduced cost in debt servicing and may therefore direct these savings to: retire expensive domestic and external loans; and divert funds to other priority development areas such as Education, Health, and upgrading of existing infrastructure to enhance economic development.

For further enquiries, please contact the

Debt and Cashflow Management Unit

Ministry of Finance, Suva