FIJIAN GOVERNMENT DEBT

STATUS PAPER

FOR THE YEAR ENDING JULY 2016

MINISTRY OF ECONOMY (MoE)

SUVA

FIJI

December 2016

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1.0 INTRODUCTION

Despite improved economic outcomes for some advanced and emerging market economies recently, global financial and economic conditions remain weak mainly due to the impact of the surprise British exit vote from the European Union (EU). Consequently, the International Monetary Fund revised its 2016 global growth projection downward to 3.1 per cent from the 3.2 per cent forecast in April.

Domestically, notwithstanding the Tropical Cyclone Winston/weather-related contractions, real sector activity remained positive in the year to date. The Fijian economy is forecasted to grow by 2 per cent in 2016, taking into account the expansionary impact from the reconstruction work.[1]

Fiji's competitive tax regime, low interest rates, stable economic policies and reforms in the civil service and public sector have produced an environment of accessible financing and rising consumer and business confidence with increased scope of infrastructural developments to the Fijian economy at large.

The Fijian Government is committed to growing the economy and to achieving the highest growth levels as set out in the 2016/2017 fiscal framework through managing its debt prudently, ensuring consistency in economic growth and stability in the financial markets and different sectors in the economy that will benefit all Fijians. The prudent management of any Government's debt portfolio plays a crucial part in determining growth and stability and needs to be consistent with the overall fiscal framework and debt objectives in order to achieve the desired growth levels and ensuring macro-economic stability.

The introduction of the Medium Term Debt Strategy for Government with the assistance of the Commonwealth Secretariat team has provided a roadmap for the Government to establish and execute a strategy for managing the Government's debt. This will assist the Government to raise the required amount of funding at the lowest possible cost over the medium to long term, consistent with a prudent degree of risk.

In line with the adoption of the new financial year ending 31 July each year, this July 2016 Fijian Government Debt Status Paper begins a new era on Government's reporting on its debt position[2].

The paper also covers contingent liabilities to provide a more complete and robust outlook of Government's liability exposure.

2.0 GOVERNMENT DEBT POSITION

The Government debt position comprises of all outstanding domestic debt and external loans during the review period. As at July 2016, total Government Debt stood at $4,507.7 million, an increase of 2.8 per cent when compared to the same period last year. The increase was mainly driven by growth in domestic borrowing. In contrast, the debt to GDP ratio recorded 45.8 per cent, down from 47.6 per cent registered in July 2015 and 46.6 per cent in July 2014. More importantly, the overarching objective is to maintain an optimum debt mix and ensure sustainability of the debt. The steady decline in debt to GDP reflects strong growth performance and favourable debt dynamics.

As a percentage of the total debt, domestic debt comprises 72.0 per cent ($3.25 billion) while external debt consists of 28.0 per cent ($1.26 billion) at the end of July 2016. (Table 1)

1 RBF Quarterly review September, 2016

2 The July fiscal periods debt figures provided are unaudited.

Table 1: Total Debt Stock ($M)

Year	July 2013	July 2014	July 2015	July 2016
Total Govt Debt	**3,753.7**	**3,929.1**	**4,382.8**	**4,507.7**
Domestic	**2,713.2**	**2,847.6**	**2,997.5**	**3,245.0**
External	**1,040.5**	**1,081.5**	**1,385.3**	**1,262.6**
Govt Debt % of GDP	**48.6%**	**46.6%**	**47.6%**	**45.8%**
Domestic to Total Debt	**72.3%**	**72.5%**	**68.4%**	**72.0%**
External to Total Debt	**27.7%**	**27.5%**	**31.6%**	**28.0%**

Source: Ministry of Economy

Consistent with Government's key debt management objectives, total debt has been maintained at the desired domestic to foreign debt mix of 70:30 (+/- 5%). Maintaining this debt composition will assist in the development of the domestic debt market and keep the foreign exchange risk for Government at a prudent level.

3.0 DOMESTIC DEBT

3.1 Domestic Debt Stock

Development of the domestic debt market is a key objective in debt management as it diversifies the available sources of funding available to Government and therefore assists in managing the costs and risks of the debt portfolio. Government debt securities were issued with maturities ranging from 14 days to 1 year for T-bills and from 2 years to 15 years for Fiji Infrastructure Bonds. The other instrument that was introduced in 2012 is the Viti Bond, which is issued on tap with fixed interest rates.

[3]**Table 2: Domestic Debt Stock ($M)**

Year	July 2013	July 2014	July 2015	July 2016
Bonds	**2,607.4**	**2,761.8**	**2,831.8**	**3,079.8**
T-Bills	**99.5**	**82.6**	**165.7**	**165.2**
Loan	**6.3**	**3.2**	**0.0**	**0.0**
Total	**2,713.2**	**2,847.6**	**2,997.5**	**3,245.0**
% of GDP	**35.2%**	**33.8%**	**32.5%**	**32.9%**
Domestic debt service o/w:	**430.1**	**370.7**	**362.5**	**339.4**
Principal	**221.7**	**162.7**	**151.1**	**121.3**
Interest	**208.4**	**208.0**	**211.4**	**218.1**

Source: Ministry of Economy

Table 2 above shows a steady decline on domestic debt to GDP for the past 3 years with the exception of 2016 where an increase was noted, attributed to an increase in issuance of bonds and bills.

The weighted average interest rate for domestic debt as at July 2016 is 7.1 per cent, indicating more fixed interest rate instruments in the domestic debt portfolio that are issued at higher rates compared to the external debt loans with favourable concessional terms. (Table 5)

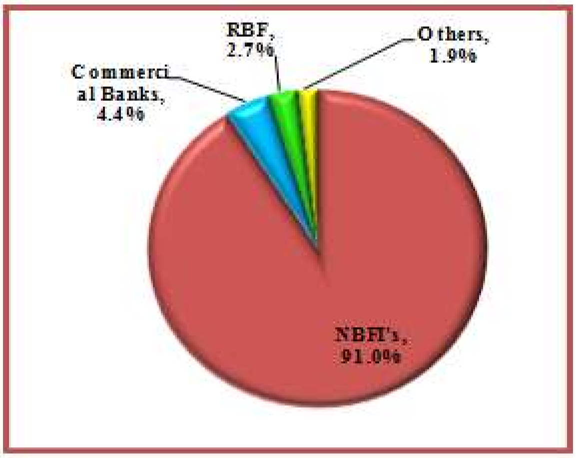
3.2 Holdings of Government Securities

Bonds: As at 31 July 2016, Government bonds outstanding stood at $3,079.8 million. The non-bank financial institutions (NBFI's) held 91.0 per cent, followed by the commercial banks holding 4.4 per cent, the Reserve Bank of Fiji (RBF) at 2.7 per cent and the remaining 1.9 per cent held by other investors including individual households (Figure 1). The NBFI's

[3] Bonds and T-bills figures reflect amounts payable on maturity; excludes unamortised premium and discount on bonds.

held the majority of the bonds with longer maturities due to their preference, return and other associated transaction costs. Commercial banks' preferences are for shorter tenor bonds to suit their operations and liquidity needs while the NBFI's invest more in longer term bonds to match their long term liabilities.

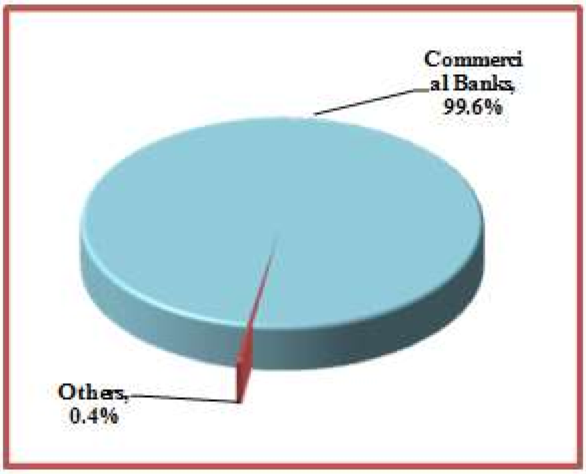
Figure 1: Fijian Government Bond Holders



Source: Ministry of Economy

<u>T-Bills:</u> Commercial banks held 99.6 per cent of T-bills while the remaining 0.4 per cent is held by other investors (Figure 2).

Figure 2: Fijian Government T-Bills Holders



Source: Ministry of Economy

Major changes were noted in the percentage movement of Treasury bills holdings for NBFIs and commercial banks over the years which have been mainly influenced by their different appetite for short term securities. As at July 2016, NBFI's held no short term securities with the majority held by the commercial banks. This indicates a higher preference of short term Government securities by the banks, as this will assist them in their operations and liquidity management.

3.3 Bond Allotment

The development of capital markets within a country and efficient implementation of monetary policy is promoted through issuance of debt instruments in the domestic market. From January to July 2016, Government issued $295.2 million worth of bonds in the domestic market, of which $290.4 million is for Fiji Infrastructure Bonds (FIBs) and $4.8 million for Viti Bonds. The raising of these bonds was to finance the Government deficit and debt servicing.

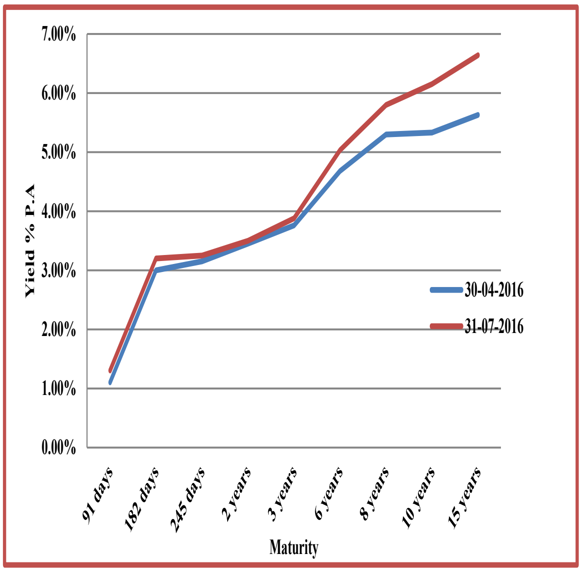
Viti Bonds issuances have been increasing over the past years since they started in 2012, implying greater public awareness of the instrument, which is tailor made to meet pensioners and retail investors' preferences. This retail bond offers fixed returns of 4.0 per cent for 5 years, 4.5 per cent for 7 years and 5.0 per cent for 10 years respectively.

For the financial year ending July 2016, investors' bond preferences were for 2, 6, 8, 10 and 15 year maturities, with the majority of the preferences in the longer term durations, indicating investor confidence in Government's long term debt securities.

3.4 Domestic Interest Rates Structure

The domestic bond market development requires a well-designed benchmark issuance programme that will ensure sufficient liquidity across the yield curve and eventually determining of the interest rates. Figure 3 provides a comparison on the borrowing costs for Bonds and Treasury bills as at the end of July 2016 compared to the previous quarter.

Figure 3: Yield Curves-T-Bills and Bonds



Source: Ministry of Economy & Reserve Bank of Fiji

As at July 2016, the domestic market yield curve showed a relatively increasing trend with Government securities trading at higher coupons for long term bonds. This implies that investors estimated rate of return increases with long term Government debt securities.

4.0 EXTERNAL DEBT

4.1 External Debt Stock and Servicing

Managing external debt in a sound and responsible manner is important due to the exchange rate exposure associated with offshore debts.

Government takes advantage of the affordable loan terms offered by multilateral and bilateral lenders in terms of attractive interest rates and longer term structures that reduce the risk of refinancing. On the contrary, Government is mindful of the exchange rate risks associated with external borrowings therefore sets indicative thresholds on the composition of external debt to 30 per cent (+/- 5 per cent) as a percentage of total Government debt. Government's major external creditors are China Development Bank (CDB), EXIM Bank of China (EXIM China), EXIM Bank of Malaysia (EXIM Malaysia), the Japan International Cooperation Agency (JICA), the Asian Development Bank (ADB) and the International Bank for Reconstruction and Development (IBRD).

From January to July 2016, total loan drawdown from all ongoing projects amounted to FJ$80.7 million, of which 99.5 per cent was attributed to the Chinese loan projects, 0.2 per cent for the ADB funded projects and the remaining 0.3 per cent for the World Bank's emergency recovery loan that was taken to assist in developments for the aftermath left by Tropical Cyclone Winston. Additional external borrowings were raised in October 2015 from the successful rollover of a third international bond amounting to US$200 million.

One of the key highlights for fiscal 2015 was the successful rollover of the global bond from US$250 million to US$200 million at a coupon rate of 6.625 per cent which is relatively lower compared to the 9.0 per cent coupon rate issued in 2011.

As at the end of July 2016, approximately $324.1 million of committed foreign loans remained undisbursed. This comprised of loans from ADB, EXIM China and the World Bank amounting to $207.6 million, $12.8 million and $103.7 million respectively. Of the total undisbursed sum, the World Bank loan of $103.7 million, equivalent to US$49.9 million was fully disbursed in September 2016 to fund the rehabilitation costs in relation to Tropical Cyclone Winston.

The Government external debt position as at July 2016 stood at $1,262.6 million, compared with $1,385.3 million recorded in July 2015. The almost 9 per cent reductions in external commitments were mainly attributed to the reduction in global bond refinancing and the decline in drawdowns as most of the projects reached completion. External debt to GDP has also slightly decreased to 12.8 per cent in July 2016, as compared to 15.0 per cent recorded in July 2015. (Table 3)

Table 3: Government Outstanding External Debt ($m)

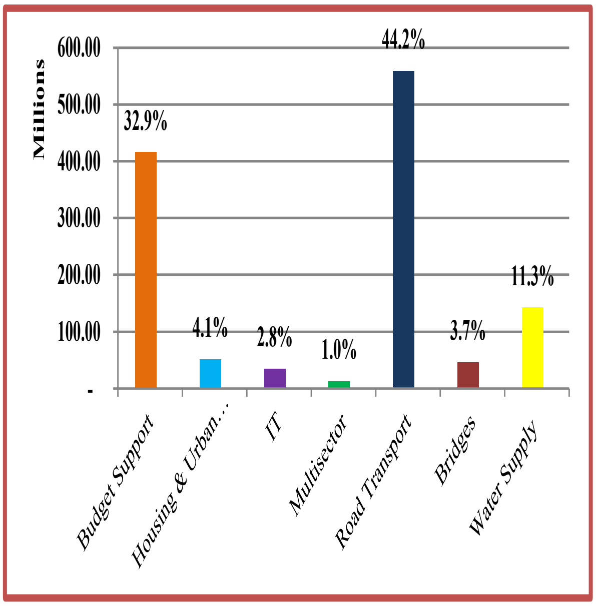
Particulars	July 2013	July 2014	July 2015	July 2016
External DOD Central Govt	1,040.5	1,081.5	1,385.3	1,262.6
Loans	566.6	617.8	849.6	846.9
Bonds	473.9	463.7	535.7	415.7
Total External Debt Service of which:	65.6	79.0	84.2	650.4
Principal	17.3	25.2	27.2	580.5
Interest	48.3	53.8	56.9	69.9
% of GDP	13.5%	12.8%	15.0%	12.8%

Source: Ministry of Economy

4.2 External Loans by Economic Sectors

The external loans classification by economic sector illustrates the percentage allocation of external loan funds to various sectors of the economy as shown in Figure 4. At the end of fiscal 2015, the road transport sector comprised the largest share of funding by economic sector basis (44.2 per cent) due to the commitment of new transport loans and drawdowns made for road projects. The budget support sector comprised (32.9 per cent), followed by water and sanitation (11.3 per cent), housing development (4.1 per cent), bridges (3.7 per cent), IT (2.8 per cent) and multisector (1.0 per cent).

Figure 4: Distribution of Debt by Economic Sector

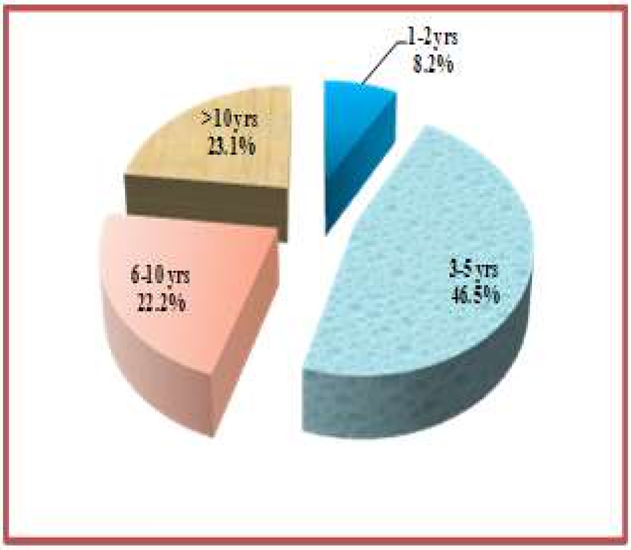


Source: Ministry of Economy

4.3 By Debt Maturity Profile

In terms of the amortisation profile, 46.5 per cent of foreign debt will mature between 3-5 years, 23.1 per cent over 10 years, 22.2 per cent between 6-10 years and 8.2 per cent between 1-2 years. Debt maturing between 3-5 years shows the highest percentage due to the bullet payment for the US$200 million bond in October 2020. (Figure 5)

Figure 5: Maturity Structure of Outstanding External Debt



Source: Ministry of Economy

The average term to maturity on external debt stood at 6.6 years as of 31 July 2016 compared to 7.3 years at the end of December 2015. (Table 5)

This will result in a slight increase in refinancing risk for the external debt portfolio over the medium term; however this can be managed by Government through refinancing the global bond with cheaper policy based loans offered by the multilateral and bilateral lenders.

4.4 External Debt by Creditor Category – July 2016

As at July 2016, the bilateral lenders still held the largest share of external debt stock at 46.4 per cent followed by the global bond at 32.9 per cent and the remaining 20.7 per cent held by the multilateral lenders. (Figure 6)

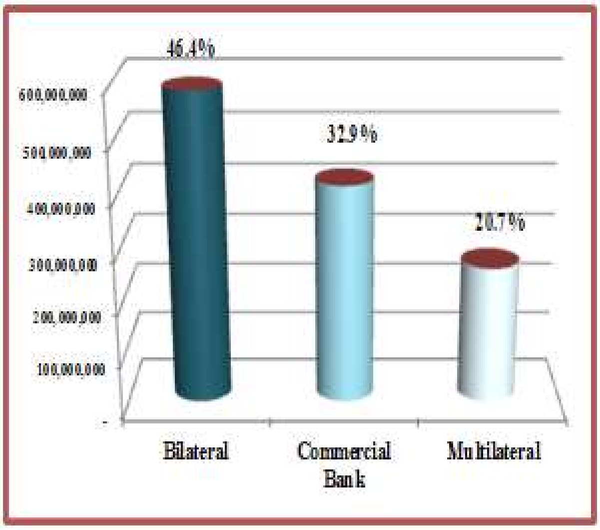
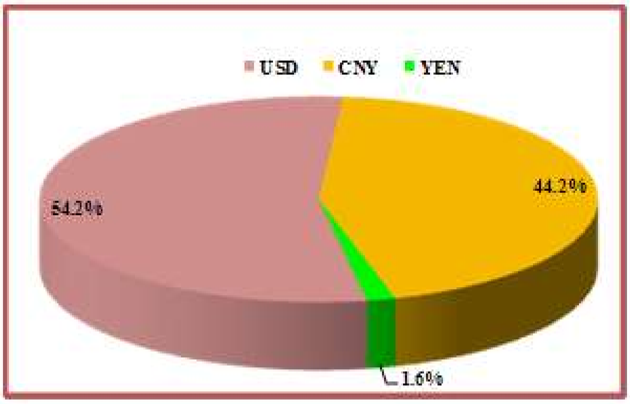


Figure 6: External Debt by Creditor Category – July 2016

Source: Ministry of Economy

In terms of the external debt portfolio's currency composition, the US Dollar continues to dominate at 54.2 per cent, followed by the Chinese Yuan (CNY) at 44.2 per cent and Japanese Yen (JPY) holding the least at 1.6 per cent. (Figure 7)

Figure 7: External Debt by Currency Composition



Source: Ministry of Economy

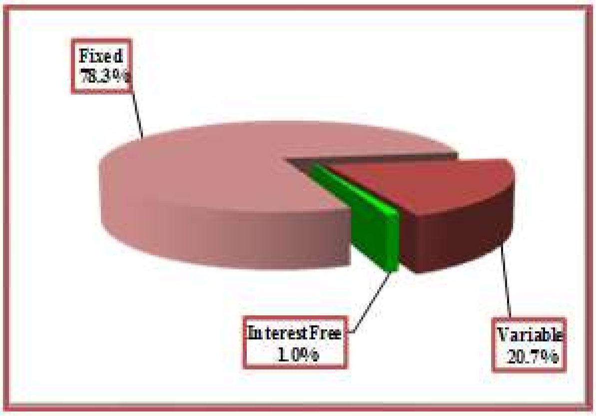
4.5 Interest Rates on the External Debt Portfolio

The interest rate structure for Government's external debt portfolio ranges from variable, fixed and zero interest with the majority of the external debt portfolio having fixed interest rates.

Fixed interest rate loans were offered by the bilateral lenders together with the global bond. Variable interest rates on the other hand were offered by the multilateral lender with rates based on the 6 months USD/JPY Libor rates plus a margin.

Government also has two interest free loans from the China Development Bank. As illustrated in Figure 8 below, 78.3 per cent of external debt stock is fixed, 20.7 per cent is variable and the remaining 1.0 per cent of the external debt stock is interest free.

Figure 8: External Debt Interest Rate Structure



Source: Ministry of Economy

The external debt portfolio's weighted average interest rate stood at 3.4 per cent as at July 2016. This is relatively low and is due to the concessionary loan terms offered by multilateral partners (Table 5).

5.0 CONTINGENT LIABILITIES

The contingent liabilities included herein consist of Government guaranteed debt of state owned entities, including statutory authorities' debt, which contributes to the overall public sector risk.

As at July 2016, total contingent liabilities declined by 4.3 per cent to $830.7 million compared to December 2015, attributed to decreases in implicit contingent liabilities underpinned by the settlement of various entities liabilities. As a percentage of GDP, this comprised 8.4 per cent. The total guaranteed debt (explicit liabilities) comprises of $787.4 million, which is equivalent to 8.0 per cent of GDP. (Table 4)

In 2015, the recognition of contingent liabilities was revised to record only those contingent liabilities that were reliably measured. As a result, FNPF has been excluded from the Contingent Liabilities register for current and previous periods.

[4]**Table 4: Contingent Liabilities**

Year	2013	2014	2015	July 2016
	($m)	($m)	($m)	($m)
Government Guarantee (Explicit)	812.4	832.6	824.5	787.4
As % of GDP	10.5%	9.9%	9.0%	8.0%
Total Contingent liabilities	821.6	848.1	868.4	830.7
As % of GDP	10.6%	10.1%	9.4%	8.4%

Source: Ministry of Economy

6.0 RISK ANALYSIS

6.1 Risk Indicators

The Fijian Government has to deal with a myriad of challenges and risks associated with debt management. Consistent with the debt management objectives, Government has formulated various strategies to minimise the cost and risks associated in relation to the overall debt portfolio and at the same time achieving its overall debt objectives.

Government has set out its key parameters that will be part of the Medium Term Debt Strategy and aims to achieve the desired level of debt sustainability through adopting strategies that will provide the lowest possible cost and risk in the medium to long term.

The key risk indicators measured were refinancing risk[5], interest rate risk[6] and exchange rate risk[7].

[4] Contingent liability extracted for new fiscal year beginning July 2016. Past years still reflect calendar year amounts as per the available certificate of balances.
5 Rollover risk (refinancing risk) is the possibility of having the debt rolled over at a higher interest.
6 Risks associated with variable costs of borrowing.
7 Risks associated with fluctuations of exchange rates.

Table 5: Risk Indicators as at Fiscal Year End July 2016

Risk Indicators		**External debt**	**Domestic debt**	**Total debt**
Amount (in millions of FJD)		1,262.6	3,245.0	**4,507.7**
Amount (in millions of USD)		607.4	1,561.2	**2,168.6**
Refinancing risk	ATM (years)	6.6	7.7	**7.4**
	Debt maturing in 1yr (% of total)	4.0	8.3	**7.1**
Interest rate risk	ATR (years)	4.9	7.7	**6.9**
	Debt refixing in 1yr (% of total)	23.4	8.3	**12.5**
	Weighted Av. IR (%)	3.4	7.1	**6.0**
FX risk	FX debt (% of total debt)	**28.0**		

Source: Ministry of Economy & MTDS Report-July 2016

Note:
Av. IR – Average Interest Rate
ATM – Average Term to Maturity
ATR – Average Time to Refixing
FX – Foreign Exchange

The refinancing risk for Government for fiscal period July 2016 is relatively low with an ATM of 7.4 years. This shows that Government has an average of 7.4 years to refinance its debt portfolio with 6.6 years for external and 7.7 years for domestic debt, respectively. Debt maturing in 1 year as a percentage of total debt is 7.1 per cent. External debt to be refinanced within a year as a percentage of total debt is 4 per cent compared to domestic debt at 8.3 per cent. This is due to the composition of debt and the different maturity terms. The ATM is still above 7 years thus allowing the Government ample time to plan on its debt servicing requirements.

The interest rate risk dictates the viability of interest rates under the various interest structures. The ATR describes the time taken in years to fix the interest rates thus a shorter ATR implies that the portfolio is more exposed to variable interest rate shocks. The ATR for total debt is 6.9 years with external debt at 4.9 years and domestic debt at 7.7 years. This implies that Government has adequate time to fix the interest rates in terms of interest rate shocks. The debt refixing in a year as a percentage of total debt is 12.5 per cent with domestic showing a relatively low percentage of 8.3 per cent compared to a 23.4 per cent for external debt due to variable interest rates applicable to the multilateral loans under the external portfolio.

Weighted average interest rate is relatively low at 6.0 per cent for the total debt stock with domestic debt having an average interest rate of 7.1 per cent compared to external at 3.4 per cent, largely reflecting the presence of concessional financing in the external portfolio with floating rate debt and low interest rates.

In terms of exposure to foreign exchange rate risk, approximately 28.0 per cent of the total debt portfolio is exposed to exchange rate volatility. This is in line with Government's debt management objective which is to maintain foreign debt at an optimum level in order to cushion the risks arising from the fluctuation of foreign exchange rates.

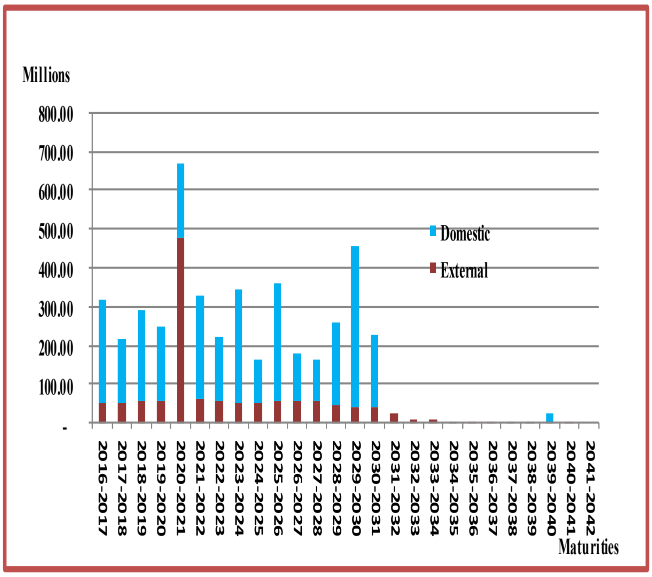
6.2 Government Debt Redemption Profile

The Government's redemption profile for the debt stock as at July 2016 shows a fairly smooth transition of payments for the external debt portfolio except in the fiscal 2020, attributed to the bullet payment for the US$200 million bond. With the exception of the global bond which has shorter term to maturity of 5 years, the remaining loans are long dated up to 20 years' maturity.

The domestic debt portfolio redemption profile however shows a significant proportion of the domestic portfolio maturing in fiscal July 2030 amounting to $416.8 million (12.8 per cent of total domestic debt) due to investor preference for the 15 year term bonds. (Figure 9)

In line with the new financial year, Government will look to manage risk by setting an upper limit on the amount maturing in any particular 12 month period. As at July 2016, refinancing risk is relatively low, therefore there is space to increase the amount of debt with shorter-tenors if it is justified in terms of a reduction in interest costs or development of the domestic financial market.

Figure 9: Redemption Profile of Government Debt in FJD millions as at Fiscal Year July End 2016



Source: Ministry of Economy

7.0 MAJOR HIGHLIGHTS – FISCAL JULY 2016

7.1 The Rollover of the 3rd Global Bond of US$200 Million

A key highlight of the July fiscal year is the successful settlement of the 2nd global bond and floatation of the US$200 million 3rd global bond in the international bond market. This was floated at a coupon rate of 6.625 per cent compared to 9.0 per cent for the US$250 million floatation in 2011. This was considered a milestone achievement, as it not only underscores investor confidence in the Government's public financial management system, but it also provided a strong outlook for the Fijian economy in terms of credibility and financial stability.

7.2 Technical Support and Debt Initiatives

With the recent approval of the Public Financial Management Improvement Plan (PFMIP) by Cabinet, the Debt Management Unit will work closely with bilateral partners in implementing some of the key strategies to strengthen and improve debt management. An important exercise is the development of the bond market to ensure market participants have access to a wide variety of instruments and an automated settlement process.

The introduction of the Bond Reopening is one of the immediate initiatives of the Ministry as announced by the Minister in his June 2016-2017 Budget address. This is critical in making the primary market modernised, as well as enhanced liquidity in the secondary market. Reopened bonds have the same maturity date and interest rate as the original bonds, but they are sold on different dates and usually at a different price. The objective is to build securities series with a large amount outstanding.

The Commonwealth Secretariat team assisted the Ministry of Economy in the formulation of the Medium Term Debt Strategy (MTDS) framework. This will assist Government in the adoption of a preferred strategy in line with the Government's debt management objectives that will focus on managing debt at the lowest possible cost together with a prudent degree of risk. The MTDS will also guide the Ministry in all loan negotiations and projects that require a significant financial investment and undertaking.

8.0 SUMMARY

For the period January to July 2016, the increase in debt level was mainly attributed to the net increase in domestic borrowing. However on a positive note, Debt to Gross Domestic Product (GDP) ratio dropped to 45.8 per cent, compared to the same period last year which was 47.6 per cent.

Overall, the Government debt stock as at the end of July 2016 fiscal year stood at $4,507.7 million; $3,245.0 million of which comprised domestic debt and $1,262.6 million external debt. Government will continue to strive to maintain the debt level at below 50 per cent of GDP in the medium term and also closely monitor guaranteed entities to ensure any emerging material risk is well managed.

In terms of cash management for Whole of Government, more proactive planning and monitoring will be carried out to effectively utilise idle cash and minimise any unnecessary borrowing. In addition, Government will continue to maximise returns on idle cash through short term investments and explore options for overnight investments in financial institutions.

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For further enquiries, please contact the

Debt and Cashflow Management Unit

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