GOVERNMENT OF THE REPUBLIC OF THE FIJI ISLANDS
PROVISIONAL FISCAL DEBT REPORT

2008

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Ministry of Finance
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1.0 INTRODUCTION

1.1 Following a 6.6 percent decline in 2007, Fiji's economy is estimated to have grown by 1.2 percent in 2008. Growth in 2008 was supported by most sectors of the economy. However, negative contributions were registered by the electricity, water and community, social & personal services sectors.

1.2 Similarly, the global economic and financial conditions deteriorated further during the December quarter. The deepening credit crisis in major developed market economies underpinned the economic downturn. This was preceded by bank failures, dwindling global demand, gloomy labour market prospects, falling commodity prices and the plummeting stock market price among others. Most of Fiji's major trading partners-the USA, Western Europe, Japan and New Zealand economies are already in recession.

1.3 Government has over the years operating under a deficit budget. 2008 is no exception considering the size of civil service, significant operating costs and large infrastructure projects that requires funding by Government. Total estimated expenditure for 2008 was $1.527 billion compared with revenue of $1.411 billion. The shortfall of revenue over expenditure reflects the deficit level: the primary factor behind government borrowing which ultimately increases debt level.

1.4 The debt report outlines the debt position of government for the period ending December 2008. The report highlights the level of debt outstanding, major holders of government securities, major lenders, interest rates movement and other factors influencing government debt position.

1.5 This report is structured into 3 main areas. The first part highlights domestic market conditions and debt policies of government. The second section covers total debt composition, that is, foreign and domestic debt and finally a detailed analysis of domestic and foreign debt. There are issues for consideration highlighted in this paper that needs to be considered in designing future fiscal policies of the government.

2.0 PUBLIC FINANCE

2.1 For 2008, Government's underlying deficit is estimated at $92 million or 1.5 percent of GDP lower than the 2 percent of GDP announced in the 2008 National budget. There has been a consolidated effort by the Government to restrain spending during the year.

2.2 Government expenditure in 2008 is estimated to have increased by 1.6 percent on annual basis, which is mainly attributed to the increase in operating costs by 0.9 percent and in total capital spending by 35 percent. The increase in capital spending over 2007 levels is mainly attributed to a rise in capital construction, which is estimated to have increased by almost 60 percent over the year.

2.3 The Government's percent share of expenditures between operating and capital outlays in 2008 was 82:18.

2.4 Government expects non-tax revenue to be more than budget while tax revenue to fall marginally in 2008.

3.0 GOVERNMENT DEBT POLICY

3.1 Government has set itself a target debt level of 45 percent of GDP in the medium term. To effectively achieve this, Government has committed itself to consistently reduce the net deficit (as percentage of GDP) over the medium – to long-term. A sustainable reduction in the net deficit is largely achievable if Government's operating savings increases over time, thus reducing the need to borrow to finance the net deficit. However the approved 2009 Budget presents a major challenge to the management of government debt as it sets net deficit at 3.0 percent of GDP.

3.2 Government's debt policy for 2008 onwards focuses on introducing debt management strategies to reduce exchange loss and other costs associated with borrowing abroad. On the domestic front, Government will continue to refine its policies and guidelines for developing the domestic capital which is currently characterized by limited investment opportunities and lack of securities.

3.3 In terms of debt sustainability, the debt to GDP ratio is 48.0 percent, which is classified as moderate by international standards. In pursuance of its medium target of 45 percent Debt to GDP, Government's debt management policy will continue to manage the issuance of domestic and foreign debt to reduce debt-servicing costs. Furthermore, Government will continue to build capacity and adhere to well-formulated debt and risk management strategies. This will necessitate thorough consideration of appropriate domestic-external debt compositions, bearing in mind the opportunities and risks.

3.4 Government has worked at strengthening its cashflow management to provide a more transparent and systematic approach to its borrowing. With better and enhanced cashflow techniques, Government borrowed within the approved ceiling and managed to minimize its reliance on overnight borrowings to finance its cash-flow shortfalls. Debt strategies in 2008 were mostly focused on sourcing funds domestically.

4.0 TOTAL GOVERNMENT DEBT

4.1 Total Government debt stood at $2.887 billion at the end of 2008 registering an increase of 6 percent from the preceding year. The major factors attributed to the increase were the net increase in domestic bond issuance and the impact of exchange rate movement on the value of our US$150.0 million Global Bonds.

Table 1: Total Government Debt

TOTAL GOVERNMENT DEBT OUTSTANDING($Million)				
	2005	**2006**	**2007**	**2008 (P)**
Domestic Debt	2,258.4	2,446,4	2,337.8	2,410.9
External Debt	164.1	416.7	397.0	475.9
Total Debt	2,422.5	2,863.1	2,734.8	2,887.2
Source: Ministry of Finance				

4.2 Of the total outstanding, $475.9 million is associated with external borrowing of which $250.0 million was raised through issuance of the first ever global bond in 2006. The balance reflects loans from multilateral and bilateral creditors. See Table 1.

4.3 Domestic debt is comprised mostly of bonds and t-bills. Approximately 97.0 percent of domestic debt outstanding is bonds that are issued in the domestic capital market. Details of domestic and external debt are explained in the next paragraphs.

5.0 GOVERNMENT DOMESTIC DEBT

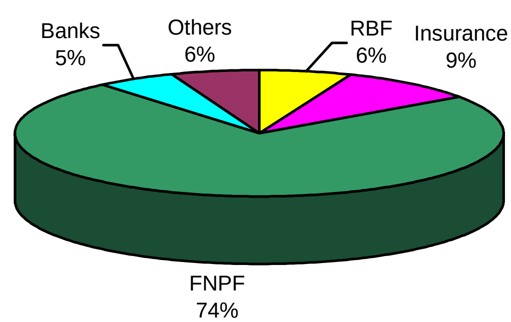
Table 2: Government's Domestic Debt Outstanding

Table 2: GOVERNMENT'S DOMESTIC DEBT OUTSTANDING ($Million)					
	2004	**2005**	**2006**	**2007**	**2008 (P)**
Domestic Debt	2,114.8	2,258.4	2,446,4	2,337.8	2,410.9
Bonds	1,986.5	2,121.4	2,300.7	2,196.2	2,346.2
Treasury Bills	126.9	136.0	145.7	141.6	64.7
Source: Ministry of Finance					

5.1 Government's borrowing in the domestic market is through the issuance of medium to long term Bonds and short term Treasury Bills. Government borrowings are based on the funding program approved by the Debt Policy Committee at beginning of the year in accordance with the borrowing provisions in the 2008 approved Budget. Domestic debt stood at $,2410.9 million at the end of 2008, or increased by 3.0 percent the previous year. Refer Table 2.

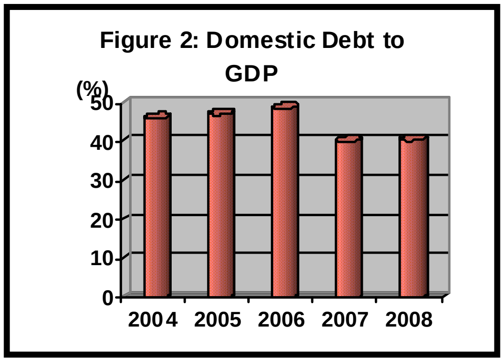
5.2 Borrowing in the domestic market was dominated by a few market players, and the Fiji National Provident Fund (FNPF) accounting for 74.0 percent of total outstanding. Insurance companies and Commercial Banks held 9.0 and 5.0 percent respectively of outstanding stock, Reserve Banks account for 6 percent whist the remaining 6.0 percent are held by other institutions, trusts and individuals. Refer Figure 1.

Figure 1: Government Domestic Debt Holdings Dec 2009



5.3 Domestic debt outstanding at the end of 2008 increased by $73.2 million or 3.1 percent when compared to 2007. The net increase in bonds issuance was an increase of $150.1 million or 6.83 percent whilst treasury bills holdings recorded a substantial decline of $76.9 million or 55 percent (See Table 3).

(a) Domestic Debt-to-GDP Ratio

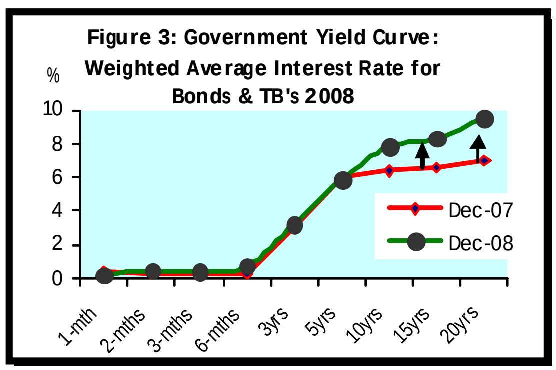


5.4 As a share of GDP, the Government's domestic debt remained constant between the years 2007 and 2008 with domestic debt to GDP as 40.1 percent and 40.5 percent respectively.

5.5 Despite sourcing its deficit domestically in 2008, Government's ability to maintain domestic debt to GDP ratio at 40.0 percent resulted mainly from the significant reduction in short term domestic debt or Treasury Bills. See Figure 2.

(b) Development in Interest Rates

5.6 Figure 3 shows the Government yield curves (i.e. the structure of interest rates from short term to long term). The yield curve shows the remarkable increase in interest rates for both long term debt instruments in December 2008.



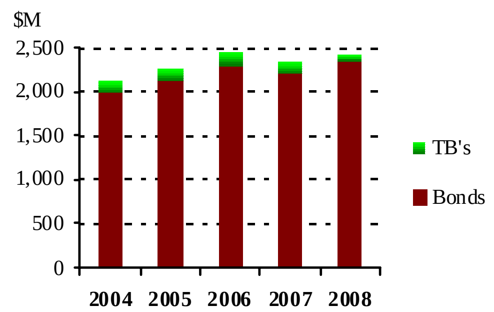
5.7 One of the contributing factors was the tightening of monetary policy by RBF which was underpinned by shortage of liquidity in the banking system thus, increasing the borrowing costs in all types of interest rates. Tight liquidity conditions have forced the rates to increase and high interest rates would be unfavorable to Government as they increase the cost of borrowing in 2009.

(c) Domestic Debt Instruments

5.8 At the end of 31 December 2008, Government bonds outstanding stood at $2,346.2 million, an increase of 6.83 percent compared to 2007.

5.9 Treasury Bills outstanding fell significantly by $76.9 million or 54.5 percent when compared to 2007. Treasury bills were raised mainly to cover revenue shortfall and to offset timing differences between inflows of revenue and major payments by Government. Refer Figure 4.

Figure 4: Domestic Treasury Bills & Bonds Outstanding 31 December 2008



(d) Issuance in the Domestic Market

5.10 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 it's borrowing in the domestic market.

(e) Issuance in the Money Market-Treasury Bills

5.11 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 days. See Table 3.

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

Table 3: Treasury Bills Management 2008

Treasury Bills Management													
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	
	136.4	123.1	131.1	111.4	103.3	119.5	134.4	107.9	121.3	115.3	96.3	64.7	
Net Issuance per Month derived as New Issuance less Redemptions													
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Net Issuance Dec 07-08
	(5.2)	(13.3)	10.0	(19.7)	(8.1)	16.2	14.9	(26.5)	13.4	(6.0)	(19)	(31.6)	($76.9m)

5.12 With Reserve Bank no longer issuing its own Notes for monetary policy purposes, the excess liquidity in the market for the first 9 months of the year enabled the oversubscriptions of Treasury Bills. However towards the end of the last quarter the market was faced with tight liquidity and with the conservative approach taken by investors as an indirect effect on the US financial crisis, T-Bills were heavily undersubscribed and this resulted in a significant reduction in the outstanding amount to $64.7 million.

(f) Issuance in the Capital Market-FDL Bonds

5.13 Table 4 below makes a comparison of the funding program approved by DCPC Committee early in the year and the actual issuance in the market.

Table 4: Funding Program 2008

Funding Program 2008 ($M)													
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
Bond	**50**		**60**		**40**	**30**	**50**		**50**		**50**	**40**	**370**
Actual Issuance in the Capital Market ($M)													
Bond	**50**		**30**		**30**	**20**	**20**	**30**	**40**	**30**	**39**	**42**	**331**

5.14 In absolute terms, a total of $331m million was allotted in government bonds in 2008 against $370.198 million approved in the 2008 Budget to support deficit financing for the year.

5.15 Under the existing Government Bond Prospectus, Government has the right for a call option[2] on its high interest rates bonds. As at the end of 2008, a total of $1.897

[2]The right of Government to pay-off high rate bonds before maturity.

billion or 86 percent of bonds outstanding are callable, while $298.6 million or 14 percent are not callable.

(g) Domestic Debt Servicing

5.16 Domestic debts servicing both in terms of principal and interest payment comprise a significant component of government expenditure for the past 5 years.

5.17 Table 5 summarizes the domestic debt servicing trend over the last 5 years which has shown an escalating trend up to 2007 but it was $26.8 million or 7.32 percent lower in 2008.

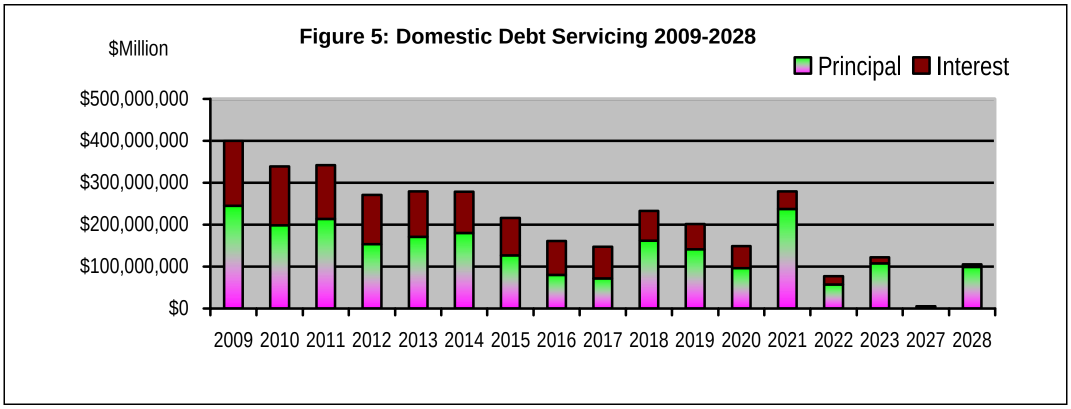
Table 5: Domestic Debt Servicing: 2004-2008 ($M)

Domestic Debt Servicing : 2004-2008					
	2004	2005	2006	2007	2008 (P)
FDL-Principal Payment	145.4	185.1	177.5	204.9	191.2
FDL-Interest	108.6	120.2	138.7	148.1	147.4
T-Bill Interest	4.3	2.4	5.4	13.0	0.6
Total Domestic Debt Service	258.3	307.7	321.6	366.0	339.2

(h) Domestic Debt Servicing Commitments over the next 20 Years

5.18 For the next 20 years, meeting all debt servicing obligations by Government presents major challenges. As shown in Figure 5, the future interest and principal repayments on domestic loans would form a considerable portion of Government Expenditure in years to come.

Figure 5: Domestic Debt Servicing 2009-2028



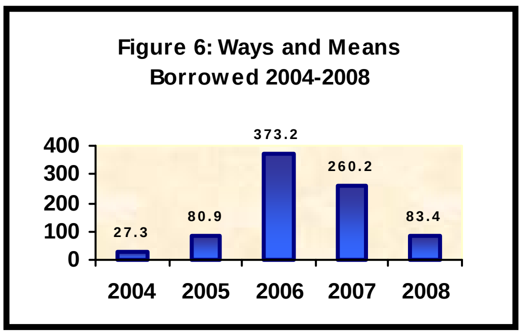
5.19 In 2008, there was noticeable demand for 20-year bonds and this is reflected in the maturity structure with $100.0 million maturing in 2028. Efforts are put in place to undertaking alternative cheaper forms of borrowing that would reduce the debt burden in the long run.

6.0 CASH MANAGEMENT

(a) Ways and Means Utilization

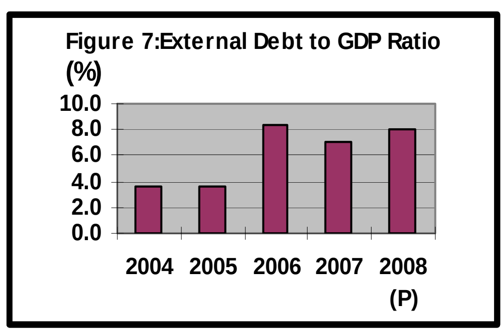
6.1 Section 59(c) of the Finance Management Act 2004 states that the Minister may on behalf of the State, borrow money by means of overdrafts or advances, but so that the total amount outstanding by way of overdrafts and advances does not at any one time exceed $20.0 million. This facility is available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

6.2 Total borrowings from Ways and Means in 2008 stood at $83.4 million. This marked a decline of $176.9 million or 68.0 percent when compared to $260.2 million borrowed from the facility in 2007. Improved cash and debt management practices, favorable market conditions and proactive control of government cashflow in 2008 reflected a reduced reliance on the overnight borrowings facility to service debt and operating payments. See Figure 6.



7.0 GOVERNMENT EXTERNAL DEBT

7.1 Government's external borrowings comprise loans obtained from our multi-lateral and bilateral lenders and also from the 1st ever global bond issuance made in 2006 to JP Morgan. To date, government's largest multi-lateral lender, the Asian Development Bank



(ADB), holds approximately $140.3 million of outstanding debt, whereas the Japan Bank for International Cooperation (JBIC), our largest bilateral lender holds $37.7 million of it.

7.2 Government's external debt outstanding has increased significantly (19.9%) over the Dec-07 quarter and also over the Sep-08 quarter (12.4%). The increase was mainly due to the appreciation of the three (3) major servicing currencies against the Fiji dollar over the period, an increase equivalent to 8.0% of the GDP. (Refer Table 6).

Table 6: Government External Disbursed Outstanding Debt (F$M)

	2002	2003	2004	2005	2006	2007	2008 (P)
DOD							
Central Govt.	195.0	171.5	165.4	164.1	416.7	397.0	475.9
Debt Service							
Total	**30.1**	**23.4**	**17.1**	**18.2**	**19.2**	**39.3**	**33.3**
Principal Payment	20.8	16.3	11.2	12.7	13.5	17.1	12.5
Interest Payments	9.3	7.1	5.9	5.5	5.7	22.2	20.8
Debt to GDP Ratio	**4.9%**	**3.9%**	**3.6%**	**3.6%**	**8.3%**	**7.1%**	**8.0%**
As %age of export of goods & services	1.4%	1.0%	0.7%	0.7%	0.8%	1.4%	1.0%
Total Disbursements	28.2	9.3	9	15.7	15.7	18.3	4.4

Source: Ministry of Finance & National Planning

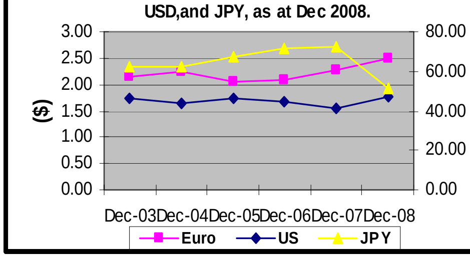
7.3 Debt servicing when compared to the preceding year dropped by $6.0 million. This was mainly due to the prepayment of two of governments most expensive ADB loans, with interest rates of 9.65% and 10.25% in 2007, and also in the significant decline in commitment fees outlaid in 2008.

7.4 Disbursements made during the period were around $4.4 million, of which approximately $0.77 million was disbursed for ADB's 3rd Upgrading Project and $3.6 million for its Suva Nausori Water Supply funded project.

(a) Exchange Rate Movement

7.5 Figure 8 below depicts the exchange rates movement of the Fiji dollar against its three major currencies of repayment for the past 6 years. As can be seen, there has been a steady growth of the Euro and the US dollar against the Fiji dollar. The Fiji dollar has depreciated significantly in value over the same period last year and also over the Sep-08 quarter.

Figure 8: Exchange Rate for FJD against EUR, USD,and JPY, as at Dec 2008.



7.6 Over the Dec-07 quarter, the Fiji dollar weakened against the Euro (11.8%), the Japanese yen (28.4%) and the US dollar (5.7%), and over the last quarter, the Fiji dollar slightly improved against the Euro (4.4%), the Japanese yen (19.4%) but weakened further against the US dollar (6.9%).

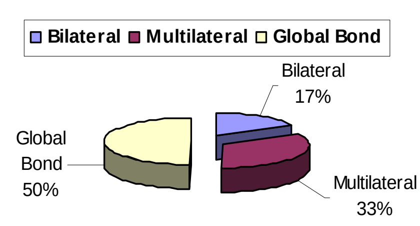
7.7 The impact of this low Fiji dollar value would be greatly felt while servicing the external loans, hence measures such as allocating funds to governments sinking fund account will be crucial to safeguard in this regard.

7.8 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 $50.0 million has been set aside for this purpose.

(b) Debt Composition - By Creditor Category

7.9 Overall, the outstanding debt forecast rose by approximately $79.0 million from 2007; the global bond servicing value increasing by $31.90 million, multi-lateral loans by $30.80 million and the bilateral loans by $16.2 million.

Figure 9: Creditor Category

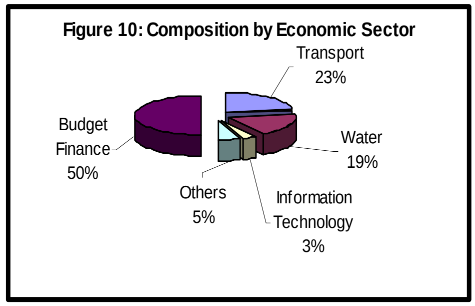


7.10 By end December 2008, Global Bond made up 50 percent of the total external debt outstanding, followed by multilateral lenders of 33 percent and bilateral lenders, 17 percent. Refer Figure 9.

7.11 Furthermore, prepayments of the 6 existing Euro loans are being considered for 2009, which should reduce total external debt stock. However, with the continuous appreciation of the debt servicing dollar, ceteris paribus, value of this stock is expected to rise.

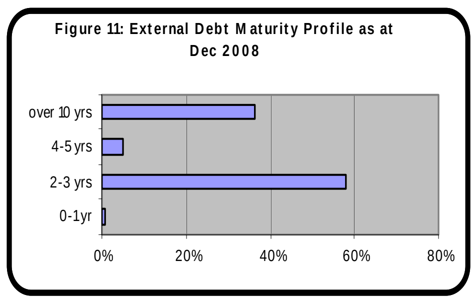
(c) By Economic Sector

7.12 The budget Finance (Global bond) sector continued to lead the distribution of debt by 50 percent, followed by the Transport sector (ADB 2nd & 3rd Road Upgrading, Maintenance) of 23 percent, Water sector (Suva Nausori Water Supply & Sewerage) of 19 percent, the IT sector (E-Gov) of 3 percent and the remaining sectors (Telecom, Rural Development, Forestry & Agriculture), by 5 percent. Refer Figure 10.



(d) By Debt Maturity & Currency Profile

7.13 Approximately 37.0 percent of the total external debt has maturities greater than 10 years, 5.0 percent in the next 4 – 5 years, 58.0 percent in the next 2-3 years and less than 1 percent in 2009. Refer Figure 11.



7.14 The currency composition of debt continued to be dominated by the US dollar (73%), followed by the Japanese Yen (16%), the Euro (8%) and then the Chinese Yuan (3%).

8.0 CONTINGENT LIABILITIES

Table 7: Total Contingent Liabilities

State Guarantees and Contingent Liabilities			
	2006	**2007**	**2008(P)**
Total Contingent Liabilities ($m)	**3,036.7**	**3,326.4**	**3,262.7**
Of which the major components includes:			
Section A:	**2,984.1**	**3,274.7**	**3,204.4**
FNPF (Members Funds)	2,347.16	2,481.08	2,622.50
FEA (Loan Guarantee)	165.6	156.17	235.8
FDB (Loan Guarantee)	271.57	415.17	279.37
HA (Loan Guarantee)	118.8	106.5	90.21
Section B:	**52.56**	**51.71**	**58.32**
International Subscriptions (ADB,IBRD,IDA)	52.56	51.71	58.32
Source: Ministry of Finance			

8.1 In contrast to real Government debt which rose by 5.9 percent in 2008, contingent liabilities on the other hand fell by 1.9 percent. Government's contingent liabilities outstanding stood at $3,262.7 million as at the end of 2008, or approximately 48.0 percent of GDP. This was mainly due to loan guaranteed outstanding from institutions such as the Fiji Development Bank and Housing Authority that have continued to decrease or subsequently paid off their respective debts. See Table 7.

8.2 The Fiji National Provident Fund (FNPF) continues to be a major liability exposure for Government at $2,622.50 million or 80.0 percent of the total contingent liabilities. However, given the net exposure liability, FNPF revised exposure amounts to $879.2 million[3], thus, bringing the revised Government's liability exposure to approximately $1,602.5 million or 25.0 percent of GDP.

8.3 The Fiji Electricity Authority (FEA) accounted for an increase in liability exposure to 50.0 percent as compared to the previous year. This was mainly due to its capital projects loan disbursements during the year.

8.4 In respect to the call on guarantee, Government through Cabinet's directive is now servicing the Fiji Sports Council guaranteed debt with FNPF for $0.37 million on an annual basis.

[3]Net FNPF liability exposure - is when the total FNPF government guaranteed bonds are excluded from the total members funds contributions [$2,622.50 million minus $1,743.3 million]

9.0 CONCLUSION

9.1 In contrast to preceding year when total debt stock fell marginally, total debt rose by 5.6 percent in 2008. The rise was mostly associated with net issue of government securities during the year. Apart from rise in debt stock, Government faces the challenge of increase in interest rates towards the latter part of the year. Total Debt as percentage of GDP stands at 48 percent against 40 percent as normally considered to be the international benchmark. Government will continue to focus on domestic capital markets as major source of borrowing in future.

9.2 At the same time, more effort will be put into reducing contingent liabilities to minimize risks of becoming real debt. The rise in number of defaults in payments and more requests from guarantee entity to convert debt into equity has further led to more borrowing and rise in government real debt stock.

9.3 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.

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

- Repayment of expensive and high coupon bonds;
- Reduce to nil holdings of short-term debt;
- Utilize proceeds from dividends, government owned entities profits for prepayment;
- Restructure of debt portfolio; and
- Ensure an effective cashflow forecasting and management; and
- Effectively coordinate with the market and Reserve Bank of Fiji as well as the line ministries/departments in respect to borrowing funds to meet cashflow needs.

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