

**Republic of Fiji–Assessment Letter for the Asian Development Bank
and Asian Infrastructure Investment Bank
June 10, 2020**

Recent Development, Outlook and Risks

1. **The COVID-19 pandemic has dramatically altered near-term projections.** Prior to the onset of the pandemic, Fiji's real GDP growth was expected to reach 1.8 percent in 2020, underpinned by resilient tourism and remittances, more supportive financial conditions, and recovered business confidence. However, staff now project GDP to contract by 18.4 percent in 2020.

2. **The contraction is caused primarily by a decline in tourism. Tourism's direct contribution to Fiji's GDP is estimated at 18 percent, but there are also strong linkages to other sectors of the economy.** The virtual elimination of tourism flows for a significant part of the year will affect growth directly and have negative spillovers to such related industries as retail trade, construction, transport, real estate and finance. Moreover, the measures put in place to contain the local COVID-19 outbreak – e.g. border closures, urban lockdowns, business closures and curfews – have further impacted domestic economic activity (currently there are no remaining active COVID cases). Government investment is also projected to fall steeply. Finally, remittance inflows, which represent about 4 percent of GDP, are expected to decline by 20 percent in 2020.

3. **This outlook is subject to considerable uncertainty.** There are large upside and downside risks present, and staff estimate a confidence margin of about 2 percentage points on either side of the baseline -18.4 percent growth projection. On the downside, key sources of uncertainty include the progression of the epidemic in key source markets for tourism (notably Australia and New Zealand), the severity and duration of future local outbreaks, the depth of spillover effects from tourism to other sectors of the economy, and the relative speed of recovery in the global economy. On the upside, there is the potential for a resumption of tourism earlier (through a regional travel bubble), and stronger growth in some sectors through a reallocation of resources (e.g., from the tourism sector to other services or agriculture and fisheries).

Policy Response and Settings

Fiscal policy

4. **To mitigate the impact of the COVID-19 pandemic, the Fijian authorities announced a stimulus package of FJ\$1 billion (10.4 percent of GDP) in the supplemental budget on March 26, 2020.** Most of the stimulus comes from non-budgetary support via the pension fund (FNPF), loan repayment holidays offered by commercial banks, and concessional loans from the central bank. The package also includes supplemental

transfers and expenditures on public health as well as tax and tariff reductions. The budgetary impact of these measures is more than fully offset by reduced spending on capital projects and non-essential programs.

5. **The stimulus package is appropriate given the severity of the shock and the need for a counter-cyclical response, as well as the financing constraints facing the government.** Despite the net reduction in public spending, the overall fiscal deficit is projected to rise to 14 percent of GDP in 2020, driven mainly by sharp declines in revenue and the contraction in GDP. The deficit is projected to decline to 8 percent of GDP in 2021 and 5 percent in 2022 in the context of an economic rebound. The widening of the deficit in 2020 should ideally be embedded in a longer-term fiscal framework, where the fiscal deficit is gradually reduced to achieve a downward path in the ratio of public debt-to-GDP.

Monetary and exchange rate policy

6. **The Reserve Bank of Fiji (RBF) has eased monetary policy to counter the economic impact of COVID-19.** On March 18, the overnight policy rate was cut to 0.25 percent from 0.5 percent. Given recent disinflationary trends and the projected emergence of a large negative output gap, the Reserve Bank of Fiji's move to lower the policy rate was justified. High uncertainty surrounding business prospects could justify further easing in the months ahead but should be weighed carefully. Any temporary increase in headline inflation owing to the weakening of the exchange rate should be accommodated.

7. **The pandemic engendered an initial wave of depreciation in the value of the Fijian dollar relative to the US dollar—a fall of 10 percent between the beginning of 2020 and end-March (-2.8 percent in real effective terms).** However, this largely reflected appreciation of the U.S. dollar vis-à-vis other currencies in the basket. Since that time the value of the Fijian dollar relative to the US dollar has returned to its end-2019 level. Looking ahead, continued monitoring will be needed with respect to currency movements and the stability of the peg to the basket.

8. **Fiji maintains exchange restrictions for payments on current international transactions, some of which were tightened on April 2.** These restrictions include: i) limits on large external payments and ii) the tax certification requirement for the transfer of profits and dividends abroad, proceeds of airline ticket sales, and for making external debt and maintenance payments. These restrictions are inconsistent with Article VIII, hamper Fiji's international trade, and discourage foreign investment. They should be phased out with a view to proper sequencing based on Fiji's tax compliance risks and consistency with the peg.

Financial sector policies

9. **The banking sector is well capitalized and liquid.** Its stability is underpinned by the dominance of large foreign banks that operate as branches and have access to their parent banks for capital and liquidity. As such, banks should be able to absorb credit losses and a

liquidity squeeze if the crisis is relatively short-lived. However, vulnerabilities in banks' balance sheets may emerge as a result of loan repayment holidays (as announced in the supplemental budget) or liquidity shortages and debt-servicing difficulties arising from the economic disruption.

10. **Pockets of vulnerability lie in non-bank financial institutions (NBFIs).** Credit unions and financial cooperatives are not fully regulated (there is a lack of detailed and reliable information on credit unions, since no regular statistics are maintained, and less information on thrifts and credit cooperatives). The three big public NBFIs (Fiji National Provident Fund (FNPF), Fiji Development Bank (FDB) and Housing Authority (HA)) have governance shortcomings in terms of the tenure, independence, and expertise of their board members.

11. **Given available buffers, banks should have sufficient capital and liquidity to absorb a deterioration of credit risk if the crisis is short-lived.** Continuing to implement prudential rules will be necessary to make the impact of the crisis on the soundness of the banking sector as transparent as possible. If capital and liquidity buffers fall below regulatory minima, the RBF should agree with banks on plans to bring capital and liquidity above the minimums required, while showing some flexibility on the timing considering the length of the crisis. The RBF should encourage banks to restructure the debt of temporarily illiquid but otherwise solvent borrowers with viable prospects under normal conditions.

Structural issues

12. **Enhancing the business environment and strengthening governance are essential to foster private investment and raise potential growth.** Reducing impediments to doing business would boost competitiveness, enhance productivity and catalyze private sector development. Regular and more frequent consultation of policy changes with the private sector would also contribute to a more enabling business environment. Another priority should be to tackle the gender gap in labor force participation in order to boost potential growth and make it more inclusive.

Debt Sustainability

13. **Public debt in Fiji is assessed to be sustainable but the medium-term path is vulnerable to significant risks.** The public debt-to-GDP ratio is expected to rise sharply this year due to the fallout of the COVID-19 pandemic. Facing a severe economic contraction, fiscal revenue is projected to slump by about 8 percent of GDP in 2020, including as a result of reduced taxes and tariffs in the government's stimulus package. Reduced government spending is expected to partially offset the temporary loss of revenue, but the overall 2020 fiscal deficit is nonetheless projected to reach 14 percent of GDP. Under current policies, the deficit is forecast to narrow to 8 percent of GDP in 2021 and to gradually decline in the medium-term as the economy recovers. The debt-to-GDP ratio is projected to reach 69 percent by 2025 after peaking at about 75 percent in 2020. Downside risks to this

projection include a deeper contraction in output, a slower economic recovery, materialization of contingent liabilities from state-owned enterprises, and the possibility of a severe natural disaster affecting Fiji in the coming years, similar to cyclone Winston in 2016.

IMF Relations

14. **Fiji is on a standard 12-month Article IV consultation cycle.** The 2019 Article IV consultation was concluded by the IMF's Executive Board on February 24, 2020, and the staff report was published shortly thereafter (IMF Country Report No. 20/80).

15. **Fiji has requested financing under the Rapid Financing Instrument equivalent to 50 percent of quota to support its COVID-19 response and close external and fiscal financing gaps.** In the absence of support to fully close these gaps, the remaining external financing gap will be closed with a drawdown of gross official reserves, and the remaining fiscal financing gap with additional domestic financing or rationalization of spending. Beyond the upcoming fiscal year (which begins in August), the authorities have indicated their desire to meet future financing gaps through a mix of multilateral, bilateral, and domestic financing in the context of a fiscal strategy that balances continued support with fiscal prudence and efficiency of expenditure.

16. **The Fund provides technical assistance and training from headquarters, PFTAC, and the Singapore Training Institute.** The regional resident representative is also based in Suva and is in frequent communication with the authorities.