FOR INFORMATION

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From: The Secretary

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***If the authorities consent to the publication of this assessment, it may be published by the AsDB.**

Republic of Fiji—Assessment Letter for the Asian Development Bank

May 4, 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, in the April 2020 *World Economic Outlook*, GDP growth is projected to contract by an estimated 5.8 percent in 2020.

2. **The contraction is caused primarily by a decline in tourism, whose direct contribution to GDP represents about 18 percent and which has strong linkages to other sectors.** The virtual elimination of tourism flows for a significant part of the year will affect growth directly and have a negative impact on related industries such as retail trade, construction, transport, real estate and finance. Moreover, the measures put in place to contain the local COVID-19 outbreak – e.g. lockdowns, business closures and nationwide curfew – will further depress domestic economic activity. Finally, remittance inflows, which represent about 4 percent of GDP, are expected to decline.

3. **Risks to the outlook are skewed to the downside**. The economic projections noted above are likely to be revised downward as the full impact of the crisis is realized and more data becomes available. Key sources of uncertainty include the severity and duration of the local outbreak, the progression of the epidemic in key source markets for tourism (notably Australia and New Zealand), the spillover effects from tourism to other sectors of the economy, the depth of the global economic downturn, and the speed of recovery.

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 (8.7 percent of GDP) in the supplemental budget on March 26, 2020.** Supplemental expenditures on public health, lump sum payments through the Fiji National Provident Fund (FNPF), tax and tariff reductions, and loan repayment holidays aim at protecting public health, supporting the economy, and ensuring food security.

5. **The fiscal stimulus, although appropriate given the severity of the shock and the need for a counter-cyclical response, is projected to expand the overall fiscal deficit to 10.6 percent of GDP in 2020.** This is necessary to prevent the further spread of COVID-19 and appropriate given the projected opening of a significant negative output gap. However, this 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 recent 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 Fijian dollar has depreciated by as much as 10 percent vis-à-vis the US dollar since the beginning of 2020** (-2.8 percent through March in real effective terms), partly reflecting appreciation of the U.S. dollar vis-à-vis other currencies in the basket. The recent depreciation of the Fijian dollar is appropriate given the sharp deterioration in the current account deficit and need for the exchange rate to help absorb the shock and restore external balance. Some of the initial depreciation has reversed itself in recent weeks. Looking ahead, further movement of the Fijian dollar will need to be monitored with respect to stability of the peg. The use of FX intervention should be limited to address disorderly market conditions.

8. **Fiji maintains exchange restrictions for payments on current international transactions--some of which were tightened in April**. 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 properly regulated. 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. Better 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. **Preliminary analysis suggests that public debt—despite rising quickly in the context of the current pandemic—remains manageable despite rising quickly, with significant downside risks.** Both the external and overall risk of debt distress remains moderate, in line with the results of the 2019 MAC Debt Sustainability Analysis (DSA). Under the April 2020 WEO baseline projection, public debt will rise to about 61 percent of GDP this year from 48 percent of GDP in 2019, in part due to the contraction in output (denominator effect). Public debt is projected to stabilize around 60 percent of GDP in subsequent years, helped by a rebound in growth that should boost fiscal revenues and increase the denominator of the debt-to-GDP ratio. External central government debt is projected to rise to 16.6 percent of GDP this year (from 13.1 percent in 2019) and is forecast to stabilize around 16 percent of GDP in subsequent years. Downside risks to this projection include a deeper contraction in output, a slower economic recovery, 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). 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.

15. Current Classification: FOR OFFICIAL USE ONLY

Table 1. Fiji: Selected Economic Indicators, 2016-21

Quota: SDR 98.4 million
GDP per capita (2018): US$6,208
Nominal GDP (2018): US$5.5 billion

	2016	2017	2018	2019	2020	2021
					Proj.	
Output and prices (percent change)						
Real GDP	2.5	5.4	3.5	0.5	-5.8	7.0
GDP deflator	5.8	0.7	3.0	2.4	1.5	1.9
Consumer prices (average)	3.9	3.4	4.1	1.8	1.2	1.5
Central government budget (percent of GDP)						
Revenue	26.1	27.6	27.1	25.6	19.5	24.0
Expenditure	27.4	29.4	32.6	30.5	30.1	28.6
Fiscal balance	-1.3	-1.8	-5.5	-4.9	-10.6	-4.6
Public debt	44.0	43.7	46.2	48.0	60.8	60.3
Money and credit (percent change)						
Net domestic credit depository corporations	7.6	5.9	9.7	4.9	...	...
Private sector credit	12.9	13.9	14.9	15.9	...	...
Broad money (M3)	4.8	8.2	2.7	2.8	...	...
Monetary base	0.5	18.4	-9.9	15.2	...	...
Central Bank Policy rate	0.5	0.5	0.0	0.0	...	...
Commercial banks deposits rate	3.0	3.2	3.4	n.a.	...	...
Commercial banks lending rate	5.8	5.6	5.7	n.a.	...	...
External sector (in percent of GDP)						
Current account balance	-3.7	-6.7	-8.4	-13.6	-8.2	-6.0
Trade balance	-20.3	-20.4	-24.4	-26.1	-18.2	-19.5
Services (net)	16.3	15.5	16.7	14.9	11.6	16.2
Primary Income (net)	-5.5	-7.9	-6.5	-8.2	-6.6	-7.9
Secondary Income (net)	5.8	6.1	5.7	5.8	5.0	5.2
Capital account balance	0.1	0.1	0.1	0.1	0.1	0.1
Financial account balance (+=inflows)	6.2	9.5	12.1	10.6	6.5	6.5
FDI (net)	8.2	7.2	8.6	6.5	6.7	6.4
Portfolio investment (net)	-0.6	-0.8	-0.6	0.3	-3.5	-1.3
Other investment (net)	-1.4	3.0	4.2	3.8	3.3	1.4
Errors and omissions	-2.6	0.3	-6.0	3.7	0.0	0.0
Change in reserve assets (+=increase)	0.0	3.2	-2.2	0.8	-1.6	0.5
Gross official reserves (in millions of U.S. dollars)	915	1,103	940	1,033	953	982
Gross official reserves (in months of retained imports)	4.8	4.9	3.9	5.9	5.2	4.6
External central government debt (In percent of GDP)	13.1	12.6	12.6	13.1	16.6	16.5
Miscellaneous						
Output gap	0.5	2.5	2.8	0.7	-7.3	-2.3
Real effective exchange rate (average)	110.1	111.9	112.7	...	...	...
Exchange rate (Fiji dollars per U.S. dollar; period average)	2.09	2.07	2.09	...	...	...
GDP at current market prices (in millions of U.S. dollars)	4,930	5,353	5,537	5,505	4,893	5,269
GDP per capita (in U.S. dollars)	5,621	6,050	6,223	6,153	5,439	5,824
GDP at current market prices (in millions of Fiji dollars)	10,327	11,065	11,557	11,892	11,370	12,397

Sources: RBF, Ministry of Economy and IMF staff estimates and projections.