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 World Bank and the AsDB.**

Republic of Fiji–Assessment Letter for the World Bank and the Asian Development Bank
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Recent Development, Outlook and Risks

1. **The COVID-19 pandemic has had a severely negative impact on the Fijian economy.** Fiji was quick to act in the early days of the outbreak—enacting travel restrictions and self-quarantine requirements on visitors from affected countries. Fiji experienced two local outbreaks, but these were contained successfully (42 cases in total, two reported deaths, and 7 active cases in border quarantine, as of 30 November 2020). Nevertheless, with the evolution of COVID-19 to a global pandemic, and the closure of borders to all but freight and essential travel, tourism earnings are projected to decrease by 82 percent in 2020. Tourism directly contributes about 18 percent to annual GDP and is closely interlinked with related industries such as retail trade, construction, transport, real estate, and finance. As such, real GDP is expected to contract by 19.0 percent and inflation to fall to -3.0 percent in 2020.

2. **While the balance of payments has deteriorated, foreign exchange reserves have been less affected**. Notwithstanding the loss of tourism inflows, the trade balance has improved in 2020—reflecting an offsetting reduction in imports from the tourism sector as well as lower aggregate demand. Fiji has also benefited from continued growth in inward remittances—by 7.5 percent in 2020 despite lower economic growth in host countries. The overall current account is expected to deteriorate from a deficit of 12.7 percent in 2019 to a deficit of 16.8 percent in 2020. The impact on the balance of payments has been offset by increased financing flows (mostly loans from multilateral and bilateral creditors). As a result, foreign exchange reserves are expected to increase marginally by end-year.

3. **The fiscal impact of the COVID-19 pandemic is significant.** Fiscal revenue is projected to slump by an estimated F$1,100 million (about 11.6 percent of GDP) in CY2020, driven by reduced economic activity as well as reduced taxes and tariffs as part of the government's March stimulus package and the FY2020-21 official budget. Reduced government spending is expected to partially offset the revenue impact on the fiscal balance, with the 2020 fiscal deficit projected at 14.4 percent of GDP in CY2020 (corresponding to deficits of 8.1 percent and 15.5 percent in FY19-20 and FY20-21, respectively. Overall public debt is projected to increase to 75.3 percent of GDP by end-2020, from 48.9 percent in 2019. Domestic financing has taken the brunt of the fiscal financing need. Domestic and external public debt are projected to rise to 55.1 percent and 20.2 percent of GDP in 2020, compared to 36.2 and 12.7 percent, respectively, in 2019.

4. **The outlook is subject to considerable uncertainty and hinges in large part on when borders can be reopened to allow for a resumption of inbound tourism**. Under a baseline scenario that assumes some partial border opening in July and overall tourist arrivals at about one-third 2019 levels, real GDP growth in the range of 5 percent could be achievable in 2021. Higher growth would be possible in 2022 and beyond with full reopening, a normalization of tourism flows, and higher activity in associated sectors. There are upside and downside risks to this scenario. On the upside, some reopening may be possible earlier, based on travel corridors with source countries that have achieved greater success in containing COVID. On the downside, delays in vaccine distribution, slower

reopening of borders, or reluctance by tourists to resume travel could also materialize. In the event that borders open late in 2021, real GDP growth could well be flat.

Policy Response and Settings

Fiscal Policy

5. **To mitigate the impact of the COVID-19 pandemic, the Fijian authorities first announced a stimulus package of FJ$1 billion (10.4 percent of GDP) in a supplemental budget on March 26, 2020.** Most of the stimulus came from non-budgetary support via the Fiji National Provident Fund (FNPF), loan repayment holidays offered by commercial banks, and concessional loans from the central bank. The package also included supplemental transfers and expenditures on public health as well as tax and tariff reductions.

6. **The second stage of the fiscal response came through the FY2020-21 budget and included major changes to Fiji's tax and tariff regime**. The budget provides immediate support to the private sector and is intended to position the tourism sector to be competitive in the post-pandemic environment. A centerpiece of the budget announced in mid-July is a reduction or elimination of fiscal and import excise duties on over 1,600 items. The budget also included removal of the service turnover tax, and cuts to the Environment & Climate Adaptation Levy (ECAL—including a raising of the threshold), and the departure tax. The budget also entails a total of F$100 million for unemployment assistance (administered through the FNPF) and a subsidy to Fiji Airways of F$60 million to boost tourism in 2020-21.

7. **The authorities acknowledge that the revenue profile created by these changes is not sustainable over the medium-term and are committed to fiscal consolidation post-pandemic**. The downward shift in government tax revenue that results from the measures and the recession is equivalent to 5.5 percentage points of GDP in FY20-21 relative to the previous year. The broad reduction in taxation was deemed necessary by the authorities to make Fiji price competitive in the tourism market once borders reopen and sustain domestic consumer spending. To avoid such a shift becoming permanent, the authorities have reiterated to staff their commitment to achieving an overall fiscal deficit of 5 percent of GDP in FY21-22, and 3 percent of GDP (equivalent to a small primary surplus) in FY22-23—in line with the domestic financing constraint as well as their pre-pandemic plans. Such an adjustment will likely require a reduction in recurrent expenditure to about 15-16 percent of GDP (from a peak of 20.8 percent in CY2020) mainly through phase-out of temporary measures after the economy normalizes and efforts to contain personnel expenses, accompanied by a significant revenue reform package beginning next fiscal year to bring tax revenues up to roughly 22-23 percent of GDP on a sustainable basis (compared with an estimated 16.9 percent in CY2020 but close to the 22.5 percent of GDP achieved in CY2019).

8. **The fiscal outlook carries significant risk.** While the staff views the fiscal adjustment underlying the baseline scenario-an adjustment of 9.5 percent of GDP over the next two years—as feasible, it is vulnerable to various risks. The measures taken in the FY20-21 budget should make Fiji more price competitive in the global tourism market, they do so at the cost of raising fiscal vulnerabilities going forward (Table 1). A first area of concern is the assumption of border reopening and a resumption of tourism in the second half of 2021. While not unreasonable, the uncertainties surrounding production and distribution of a vaccine and about whether confidence to resume travel will rebound are still imponderables

at this stage. Second, while it is technically feasible to rationalize public spending and raise revenues going forward (particularly given Fiji's strong base of tax revenue in the pre-pandemic period), careful planning and political commitment will be needed: a critical milestone in this respect is the forthcoming FY21-22 budget, which will need to lay out in detail the steps to be taken. Third, Fiji remains vulnerable to climate change, natural disasters, and other external shocks—at a time when fiscal buffers have largely been depleted: should unfavorable shocks materialize, they would need to be met through a combination of new loans, grant financing, and compression of public spending (most likely capital expenditures).

Monetary and Exchange Rate Policy

9. **The Reserve Bank of Fiji (RBF) moved early to ease 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 disinflationary trends and the large negative output gap, the lower policy rate was justified. With inflation likely to remain in negative territory into 2021, maintaining the current stance seems appropriate. Careful review will be needed as economic growth resumes. Any temporary increase in headline inflation owing to the weakening of the exchange rate should be accommodated.

10. **The pandemic led to a weakening in the value of the Fijian dollar relative to the US dollar—a fall of 9 percent between the beginning of 2020 and the third week of March.** However, this largely reflected appreciation of the U.S. dollar vis-à-vis other currencies in the basket. In real effective terms, the Fijian dollar has depreciated by 2.4 percent in the 9 months to September 2020. Looking ahead, continued monitoring will be needed with respect to currency movements and the stability of the peg to the basket.

11. **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

12. **The banking sector appears 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. The most recent stress tests suggest existing buffers and provisioning for classified loans are sufficient to cover all losses under a worst-case scenario (30 percent of classified loans become non-performing). However, vulnerabilities in banks' balance sheets will become clearer after the end of loan repayment holidays in early 2021. Vigilance to risk and close monitoring of developments will be needed given the unusual nature of the COVID shock, and the possibility that even severe stress tests might prove to be too benign.

13. **Pockets of vulnerability are evident 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, and even 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.

14. **Transparency in the implementation of prudential rules is of paramount importance to safeguard financial stability going forward**. If capital and liquidity buffers fall below regulatory minima, the RBF should agree with banks on plans to restore them above the minimums required, while showing some flexibility on the timing in light 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

15. **Enhancing the business environment and strengthened governance are essential to foster private investment and potential growth.** Reducing impediments to doing business would boost competitiveness, enhance productivity and catalyze private sector development. More frequent consultation of policy changes with the private sector would also contribute favorably to the business environment. Another priority is to tackle the labor force gender gap in order to boost potential growth and make it more inclusive.

Debt Sustainability

16. **Under the baseline scenario, the public debt-to-GDP ratio is expected to peak in FY20-21 at 82.1 percent, and then to fall gradually.** This projection is subject to significant risks. It assumes the authorities fully implement revenue and expenditure reforms as envisaged and that tourism flows rebound as envisaged in the macroeconomic framework. Under this scenario, the overall fiscal deficit should decline to 3 percent of GDP by FY22-23 (equivalent to a small primary surplus), and the ratio of public debt to GDP should fall to 71.8 percent by FY24-25. As noted above, this scenario is subject to wide degrees of uncertainty and risk, and close monitoring of economic outcomes and policies is warranted. Risks to this projection include policy implementation risks; a slower economic recovery (which could be contingent on border reopening); materialization of contingent liabilities from state-owned enterprises; and natural disaster risk. Particularly important to mitigate these risks is the development of a detailed medium-term fiscal framework to guide policy making, rebuild fiscal buffers in a growth-friendly way, and create space to respond to future natural disasters and ensure public debt sustainability.

IMF Relations

17. **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).

18. **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.

Table 1. Fiji: Selected Economic Indicators, 2018-25

	2018	2019	2020	2021	2022	2023	2024	2025
		Est.			Proj.			
Output and prices (percent change)								
Real GDP	3.8	-0.4	-19.0	5.0	9.0	6.5	4.8	3.7
GDP deflator	3.0	2.4	-1.3	-1.1	2.5	2.5	2.5	2.5
Consumer prices (average)	4.1	1.8	-1.3	-1.1	2.0	2.0	2.0	2.0
Consumer prices (end of period)	4.8	-0.9	-3.0	1.5	2.0	2.0	2.0	2.0
Central government budget (percent of GDP)								
Revenue	26.9	25.5	20.2	18.5	24.9	24.9	24.9	24.9
Tax revenue	23.8	22.5	16.9	16.5	22.9	22.9	22.9	22.9
Other revenue	3.1	3.0	3.3	2.0	2.0	2.0	2.0	2.0
Expenditure	32.4	29.9	34.6	31.2	28.2	27.8	27.9	27.9
Current	18.0	17.6	20.8	18.3	16.0	15.5	15.5	15.5
Capital	11.7	9.5	10.0	9.5	9.0	9.0	9.0	9.0
Overall balance	-5.5	-4.4	-14.4	-12.7	-3.3	-2.9	-3.0	-3.0
Primary balance	-2.8	-1.6	-10.6	-9.3	-0.1	0.4	0.4	0.4
Central government debt	46.4	48.9	75.3	85.3	79.6	75.8	73.6	72.2
External sector (in percent of GDP)								
Current account balance	-8.4	-12.7	-16.8	-11.7	-7.4	-6.0	-5.3	-4.8
Trade balance	-24.2	-25.2	-18.8	-18.5	-18.5	-19.5	-19.5	-19.5
Services balance	16.6	14.9	2.5	9.2	12.8	15.0	15.5	15.8
Primary Income balance	-6.4	-8.2	-6.2	-7.9	-7.2	-7.0	-6.8	-6.6
Secondary Income balance	5.6	5.8	5.7	5.5	5.5	5.5	5.5	5.5
Capital account balance	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Financial account balance (-= inflows)	-12.0	-11.8	-6.0	-8.8	-8.1	-8.0	-7.9	-7.7
FDI	-8.5	-6.5	-4.7	-6.0	-6.7	-6.9	-6.8	-6.7
Portfolio investment	0.6	-0.3	2.1	-0.7	0.4	0.4	0.4	0.4
Other investment	-4.2	-5.0	-3.5	-2.1	-1.8	-1.5	-1.5	-1.4
Errors and omissions	-6.0	2.5	0.0	0.0	0.0	0.0	0.0	0.0
Change in reserve assets (-=increase)	2.2	-1.7	0.8	2.9	-0.7	-2.1	-2.7	-3.0
Gross official reserves (in months of prospective imports)	4.0	7.9	6.7	4.6	4.2	4.3	4.6	...
External central government debt	13.1	12.7	20.2	22.8	21.3	20.3	19.7	19.3
Money and credit (percent change)								
Net domestic credit depository corporations	9.7	4.9	-5.0	5.0	7.0	6.0	5.0	4.0
Private sector credit	7.3	4.6	-7.0	6.0	8.0	6.0	5.0	4.0
Broad money (M3)	2.7	2.8	-4.0	5.0	8.0	5.0	4.5	4.0
Monetary base	-9.9	15.2	-6.0	6.0	9.0	7.0	6.0	5.0
Central Bank Policy rate	0.5	0.5	0.3					
Commercial banks deposits rate	3.4	4.1	3.9					
Commercial banks lending rate	5.7	6.3	6.1					
Memorandum items								
Exchange rate (Fiji dollars per U.S. dollar; Jan-Sep average)	2.07	2.15	2.19					
Real effective exchange rate (Jan-Sep average)	111.9	113.8	109.4					
GDP at current market prices (in millions of Fiji dollars)	11,651	11,874	9,493	9,858	11,014	12,023	12,915	13,728
GDP per capita (in U.S. dollars)	6,273	6,144	4,861	5,137	5,707	6,196	6,619	6,997

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