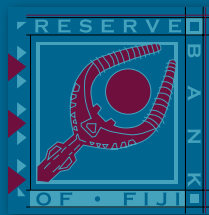


FINANCIAL

STABILITY REVIEW

OCTOBER 2019





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Abbreviations

ANZ	Australia New Zealand Bank	TC	Tropical Cyclone
APRA	Australian Prudential Regulation Authority	UMI	Uncommitted Monthly Income
BES	Business Expectation Survey	USA	United States of America
BIS	Bank for International Settlements	WBC	Westpac Banking Corporation
BSP	Bank South Pacific	WEO	World Economic Outlook
CAR	Capital Adequacy Ratio	WRHR	Wholesale, Retail, Hotels & Restaurants
CBs	Commercial Banks	WALR	Weighted Average Lending Rates
CCB	Consolidated Commercial Banks		
CCS	Credit Conditions Survey		
CL	Crown Lease		
DC	Debt Consolidation		
DSR	Debt Serviceability Ratio		
ELGI	Excess Loan Guarantee Insurance		
ESA	Exchange Settlement Account		
FBOS	Fiji Bureau of Statistics		
FNPF	Fiji National Provident Fund		
FSI	Financial Soundness Indicators		
FSR	Financial Stability Report		
FSSR	Financial Sector Stability Review		
GDP	Gross Domestic Product		
HL	Housing Authority Lease		
HP	Hodrick-Prescott		
HQLA	High Quality Liquid Assets		
IMF	International Monetary Fund		
LHS	Left Hand Side		
LVR	Loan to Value Ratio		
N/A	Not Available		
NL	Native Lease		
NPLs	Non-Performing Loans		
PSBE	Private Sector Business Entities		
RBF	Reserve Bank of Fiji		
RHS	Right Hand Side		
SIB	Systemically Important Bank		
SIFI	Systemically Important Financial Institution		
SME	Small Medium Enterprise		



Preface

The Reserve Bank of Fiji is mandated with the responsibility of promoting a sound financial structure. A sound financial structure safeguards the stability of individual financial institutions and the overall financial system.

The Reserve Bank of Fiji defines financial stability as the ability of the financial system to adequately fulfil its key economic functions of efficient allocation of financial resources and effective mitigation of risks, through the provision of a well-functioning financial structure at all times. The risks to the Fijian financial system are monitored by considering the following key areas: global environment, capital and profitability, risk appetite and risks

relating to the macro-economy, credit, market, liquidity, and systemically important financial institutions (SIFI).

While the Fijian financial system is dominated by the commercial banking industry and the Fiji National Provident Fund, ongoing assessment of the stability of the financial sector is also focused on other lending institutions and the insurance industry, with the assessments aimed at identifying key industry developments and emerging risks to the financial system.



Executive Summary

The global economic growth forecast for 2019 has been revised downwards from 3.2 percent to 3.0 percent¹, underpinned by broad-based weakening in both advanced and emerging market and developing economies. Risks however continue to hover over global economic performance and these relate to tightening global financial conditions, increased repricing risk, higher commodity prices and escalation of trade tensions between US and China.

Domestically, economic activity remain supportive of overall financial stability. The Fijian economy is expected to record its tenth consecutive year of growth of 1.0 percent in 2019, down from 3.5 percent in 2018. Notwithstanding the projection, an uptick in credit risk has been noted, but an assessment on the quality of the commercial banks' loan book indicate that non-performing loans (NPLs) remain within manageable levels and do not pose a cause for concern on the financial system at this time.

Ratings on the macro prudential areas remained relatively unchanged compared to 2018, however downside risk persist, in light of the continued economic moderation, together with the implementation of Government's fiscal consolidation for the 2019/2020 financial year.

Results from the bi-annual survey indicate that, credit underwriting practices remain at a tightening phase, yet a slight increase in demand for credit is expected. However, risks from exogenous factors such as adverse weather conditions remain a challenge or risk for the financial system and the economy.

Stress tests conducted on licensed commercial banks, imply that they are well capitalised to withstand plausible shocks in the short to medium term, however, there are specific areas at institutional and industry level that will continue to be closely monitored by the Reserve Bank.

¹ International Monetary Fund. 2019. World Economic Outlook: Global Manufacturing Downturn, Rising Trade Barriers. Washington, DC, October



RBF Financial System Policy Committee Discussion Summary

The Reserve Bank's Financial System Policy Committee meeting on 24 October 2019 discussed the report on Financial Stability. The Governor of the Reserve Bank and Chair of the Committee made the following remarks during the meeting:

- No change on the ratings to that of 2018 for the broad macro prudential areas, were confirmed, considering the moderation in economic conditions, the assessment for credit risk of corporates and households, the continued expectation of tightened credit conditions, risk appetite and growth.
- The assessment on global environment risk and macroeconomic risk was noted, including the directional sentiments for system credit, risk appetite, market and liquidity risks.

Notwithstanding the ratings, the Committee highlighted the need to keep a close eye

on developments given the continued moderation in economic activity especially its impact on financial system stability in the medium to long term. On sectorial assessments, the Committee noted that while the credit growth trend for households and corporates are not of systemic concern at this time, the level of non-performing loans (NPLs) continue to rise, hence continuous closer monitoring is needed.

In terms of systemically important financial institutions, the Committee concluded that these entities posed low to moderate risk, as their collective balance sheets remained buoyant, which did not point toward a need for capital buffers. Finally, the Committee agreed that the Reserve Bank's twin objectives of a comfortable level of foreign reserves and stable inflation were met during the review period, including the mandate of safeguarding financial stability.

Overview

Global growth momentum slowed in the second half of 2018 and into 2019 as asset prices remain high with uncertainty surrounding weaker growth for major economies. Fiji's foreign reserves coverage remains adequate to cushion effects of any immediate external shock.

Global Economy

Since the last WEO publication of October 2018, the global economic growth forecast for 2019 has been revised downwards from 3.2 percent to 3.0 percent in October 2019, largely due to weaker performances of major economies. Risks relating to tightening global financial conditions, increased repricing risk, higher commodity prices, climate change risk, Brexit fallout, and the escalation of trade tensions between US and China continue to hover over global economic performance.

Key risks for Fiji's major trading partners generally revolve around high aggregate debt levels, deteriorating credit quality, increased sectoral indebtedness for households and overpriced housing market.

However, these developments do not at present, have direct impact on foreign reserve levels as such global environment risk remains at low to moderate (see International Developments, Pg.10).

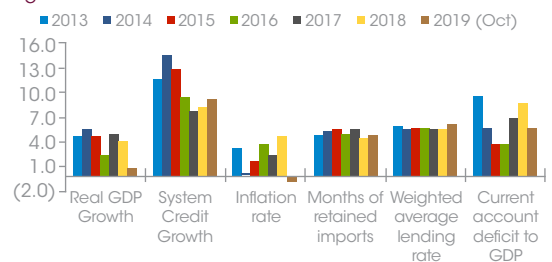
Domestic Economy

Developments in the domestic economy remain relatively supportive of overall financial stability. The Fijian economy is expected to record its tenth consecutive year of expansion of 1.0 percent in 2019 down from 3.5 percent in 2018.

The slower growth forecast for this year mainly reflects the moderation in both domestic and global economic activity, weak business

confidence, spillover from fiscal consolidation and generally weak sectoral performances. Sectoral performance have been generally weak during the year, with the exception of the tourism and electricity sectors. On the demand side, aggregate demand has also slowed, largely owing to subdued consumption activity and contraction in investment. While the economy is envisaged to achieve a broad based growth in 2019, risks to growth remain, mostly from weak business confidence, adverse weather conditions and fiscal consolidation spillovers.

Figure 1: Macroeconomic Indicators



Source: Fiji Bureau of Statistics and The Reserve Bank of Fiji

The Reserve Bank continues to meet its twin objectives of maintaining price stability and adequate level of foreign reserves amidst weaker global and domestic economic outlook.

The annual inflation rate in October 2019 fell to -0.9 percent (deflation), lower than the 0.4 percent in September and the 5.2 percent registered in October 2018. The lower inflation outcome was due to the decline in prices



of communication, alcoholic beverages, tobacco & narcotics; housing, water, electricity, gas & other fuels and transport categories. The year-end inflation forecast for 2019 is 2.0 percent.

Fiji's trade deficit had narrowed by 11.6 percent in the year to August 2019, as total exports increased by 4.5 percent attributed to the higher domestic exports of mineral water, sugar, mahogany, kava, garments and machinery & transport equipment, while total imports fell by 5.6 percent, largely on account of lower imports of machinery & transport equipment, chemicals, manufactured goods, food & live animals, crude material and animal & vegetable oil & fats.

Subsequently, the level of foreign reserves has increased to \$2.2 billion (as at 31 October 2019) from \$2.1 billion in October 2018 sufficient to cover 5.0 months of retained imports of goods and non-factor services.

While improvement is noted in terms of foreign reserves, risk to outlook remain as Fiji heads towards its cyclone season. Additionally, inflationary pressures could be expected should there be material supply-side impact of adverse weather conditions in the near term.

Risks emanating from the domestic economy has the potential to weaken the financial system, mainly if the risks lead to a significant deterioration in asset quality. An assessment of the credit quality of commercial banks

showed that their NPLs remain within manageable levels (see Annex 3) and do not pose a major concern for the financial system at this time.

Soundness of Financial System

The Reserve Bank continues to supervise the Fijian financial system comprising of commercial banks, credit institutions, the Fiji National Provident Fund (FNPf), insurance companies and foreign exchange dealers, as sound and resilient.

Although risks in terms of increasing household and corporate sector debt together with the gradual increase in non-performing loans remain under closer watch of the Reserve Bank, positive improvements have been noted, particularly in the assessment of commercial banks' balance sheet.

Albeit the moderation of the economic activity, the banking industry remained strong to maintain credit to various sectors of the economy. Aggregate credit grew by 9.3 percent as at June 2019, compared to 7.7 percent in the same period in 2018.

The resurgence in system credit has been a combination of growth in commercial banks and other credit providers' loan portfolios. Commercial banks' credit growth accelerated to 7.0 percent (6.6% - March 2019) in June 2019 compared to 4.7 percent the same period in 2018.



Private sector credit remains high, however improvement has been noted in the private sector to GDP gap.

Although the private sector credit to GDP gap is positive and is above the intervention point of 2.0 percent and closer to the historical high of 4.0 percent, it however, does not necessitate a macro prudential intervention. This is attributed to the fact that the positive gap is largely due to subdued performance of production in the economy, and credit growth is also assessed to be moderate and is expected to remain at similar levels in the short term.

Moreover, as at June 2019, the annual growth rate of NPLs was reported at 13.9 percent compared to 34.5 percent in June 2018, while commercial banks' provisioning levels also increased in the past six months signalling increased resilience of the banking industry. (see Buoyancy of the Financial System for further discussion on credit risk, Pg. 25).

Strong capital position of commercial banks does not necessitate additional capital buffers at this stage.

The banking industry continued to maintain a solid capital base with commercial banks' capital adequacy well above the minimum requirement of 12.0 percent. The banks' aggregate capital adequacy ratio stood at 17.9 percent as at June 2019.

Market & Liquidity Risk continues to be under closer monitoring as interest rate risk concerns remain.

Pressure on liquidity risk has somewhat eased as the banks' funding profiles and liquidity conditions improved, however the interest rate risk on negative short-term mismatches in terms of roll-over funding costs continue to rise as banks seek to manage their balance sheet positions.

Essentially, the commercial banks' level of liquid assets took an upward turn in the June 2019 quarter, from its decreasing trend since September 2017. The high quality liquid assets (HQLA) holdings of commercial banks increased by \$126.9 million in June 2019 to \$610.0 million, largely due to increases in ESA balances, underpinned by the increase in foreign reserves.

Risks arising from Systemically Important Financial Institutions (SIFIs) are rated as low to moderate, in light of positive micro prudential assessment rating.

The four systemically important financial institutions: FCPF, ANZ, BSP and WBC do not pose direct risk to the financial system as most assets held are "safe" in the context of liquid assets such as cash balances and Government securities.



Section 1: Financial Stability in 2019

Key Risks on the Horizon

The growth momentum of the Fijian economy moderated this year largely on the back of weak production levels in some of the key sectors such as forestry, mining, and manufacturing coupled with low business and investor sentiments. This moderation could be prolonged with the approaching 2019-2020 cyclone season, thus amplifying risks of wider trade account deficits and heightened fiscal pressure. While the financial soundness indicators remain broadly in support of the overall stability of the domestic financial system, the direct negative effect of increasing global commodity prices on the foreign reserves position remain under close monitoring.

International Developments

Vulnerabilities in the global market including Fiji's major trading partners remain elevated.

As a net importing economy, Fiji is vulnerable to increasing global commodity prices and also susceptible to the spillover effects of significant developments in its major trading partners' economic conditions.

The uncertainty surrounding weaker global economic conditions resulted in a downward revision of the global growth forecast for 2019 to 3.0 percent from 3.2 percent forecast in October 2018, with downside risks remaining elevated. Risks relating to tightening global financial conditions, increased repricing risk, higher commodity prices, climate change

risk, Brexit fallout, and the escalation of trade tensions between US and China continue to dangerously hover over the global economic performance.

Additionally, the expectation of an increase in inflation and rising interest rates materialising in the near future could potentially result in a sharp correction of high global asset prices.

Risks for Fiji's major trading partners:

Australia and New Zealand are one of Fiji's closest trading partners with two of Fiji's systemically important banks (D-SIBs) domiciled in Australia. While the Australian economy has grown modestly over the years supported by low unemployment and inflation rate, risks relating to household indebtedness and high house prices remain a major vulnerability for its financial system.

Similar to Fiji, New Zealand's largest banks are Australian owned. Financial stability concerns in New Zealand revolve around two key challenges of household and agriculture sector indebtedness, as both sectors comprise of relatively high number of risky borrowers.

In their latest Financial Stability Reports, the Reserve Banks of Australia and New Zealand highlighted that the pace of annual economic growth has moderated for both economies.

The United States corporate debt levels have increased over the years with certain indications of a decline in the quality of credit with easing lending standards. While the debt servicing capacity of the US firms has improved post 2008 financial crisis, the downward spiral of risks can swiftly escalate if the economic situation deteriorates.

Aggregate debt level lingers as one of the key areas of concern for financial stability in China which is further amplified by trade tensions between US and China. Albeit, the fiscal and



monetary stimulus which proved to be an impetus for credit and GDP growth, financial stability risks remain high in China.

As one of the major contributors to global economic growth, any adverse change in the Chinese economy could have a detrimental effect on the global performance with spillover effects on several economies, including Fiji's trading partners.

Although the risks highlighted above are external to the Fijian economy, any potential external shock could have a direct impact on Fiji's foreign reserves. It is therefore important to ensure that the Fijian economy and in turn the Fijian financial system remain strong and resilient to these shocks.

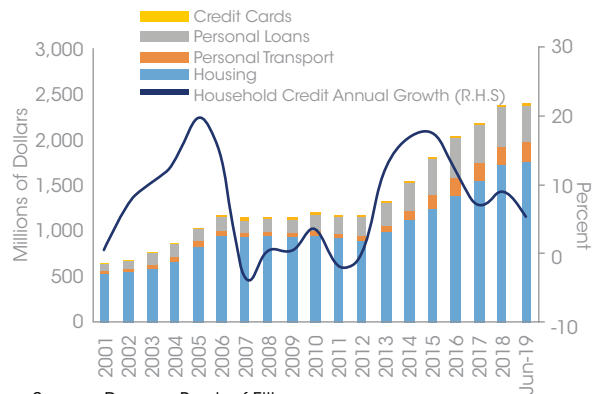
While Fiji's foreign reserves level as at end of October 2019 of \$2.2 billion is adequate and at a comfortable level, it is important to assess some of the risk trends developing in the domestic economy (refer Section 2 for further assessment of domestic and global risks).

Household Sector Developments

Risks to the household sector has slightly moderated over the year, as housing credit slowed however high aggregate household debt level remain under closer monitoring.

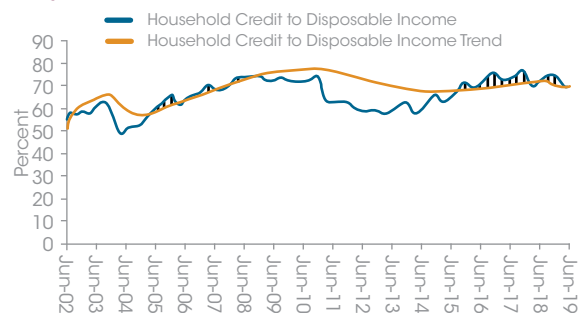
The aggregate household credit² as at June 2019 was recorded at \$2.4 billion, a slight decrease in annual growth to 5.6 percent from 9.4 percent reported in the same period in 2018 (Figure 2). The moderation of credit can be attributed to the decrease in consumption spending and tighter household credit conditions.

Figure 2: Household Credit



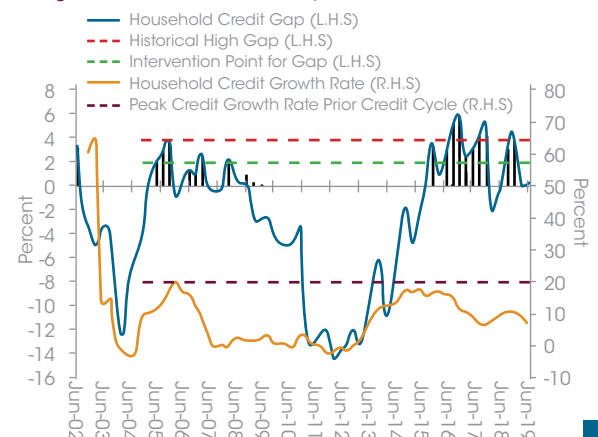
Source: Reserve Bank of Fiji

Figure 3: Household Credit to Disposable Income - Level & Trend



Source: Reserve Bank of Fiji, FBOS

Figure 4: Household Credit Gap & Growth Rate



Source: Reserve Bank of Fiji, FBOS

² Excludes debt with financiers outside the Reserve Bank's supervisory ambit.



With credit to households slowing, vulnerabilities relating to aggregate household credit have somewhat been confined as the ratio of household credit to disposable income remain just above its long-term trend (Figure 3), resulting in a positive credit gap of 0.3 percent in June 2019 (Figure 4).

The current positive credit gap showing for the household sector does not signify overheating of the sector as credit growth is on a downward trend and remains below historical high (Figure 4) level, but is owed to a slower growth in GDP (compared to credit) due to weak production and demand levels.

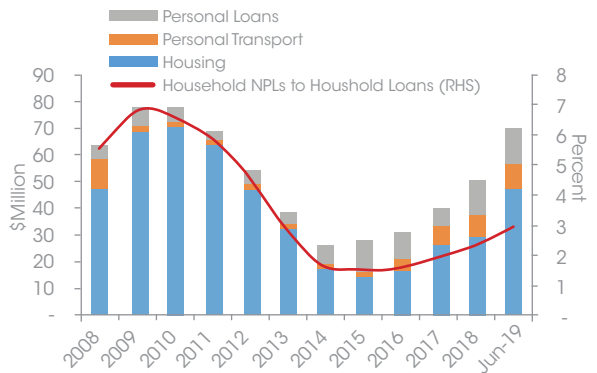
Though the growth in household credit is not excessive compared to historical periods, the high credit level with majority concentrated in housing loans remains a concern. Thus, any further weakening of economic conditions could result in lower housing prices which would adversely affect the household sector.

As discussed in Annex 2, the stress test assessment on households indicate that the sector is still able to service its debt obligations to the banking industry, post an economic stress scenario.

Credit underwriting conditions in the banking sector have been relatively accommodative for growth over the years. However, in line with the changing economic conditions domestically and to some extent internationally, majority of the financial institutions in Fiji have somewhat tightened their credit controls recently, assisting in the overall restraint of increasing household indebtedness.

Additionally, the recommendations of the 2018 thematic credit risk review conducted by the Reserve Bank highlighting some of the key risks at institutional level, have been

Figure 5: Household Non - Performing Loans



Source: Reserve Bank of Fiji

taken positively by the industry as change towards responsible lending is being generally observed across institutions.

However, vulnerabilities in the household sector are recognised with the continued gradual growth of household NPLs over the past five years (Figure 5). Although the household NPLs accounted for less than 3 percent of total household loans as at June 2019, downside risks remain arising from further economic slowdown and increase in interest rates.

Nevertheless financial institutions' credit risk from households remain at manageable level as majority of the households' NPLs are for housing loans, which is understood to be adequately secured by properties.

Corporate Sector Developments

The credit momentum of the corporate sector is gradually picking up in spite of subdued economic activity. However, the overall increase in aggregate debt levels remain a concern for the sector.

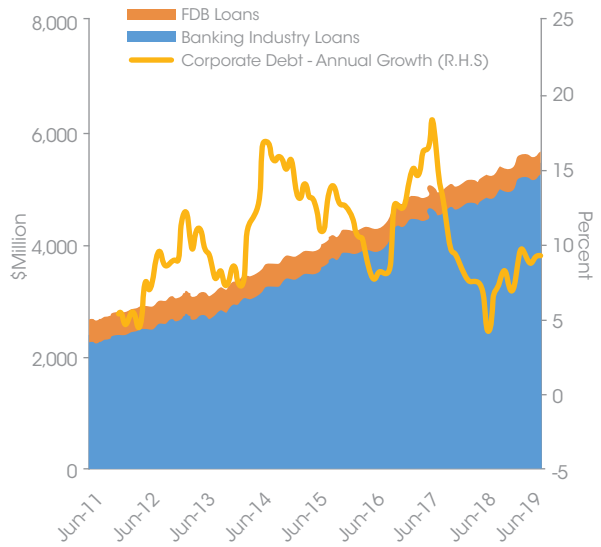
Over the past ten years, corporate sector credit has increased by \$3.3 billion (133.6%) to \$5.7 billion as at June 2019, signifying the strong growth of the corporate sector. While the growth is somewhat in line with the economic growth trajectory, certain vulnerabilities remain for the sector, particularly in terms of credit risk (Figure 6).

Despite the subdued economic performance and tighter market conditions, credit growth of the corporate sector has picked up from 6.3 percent in June 2018 (Figure 6) to 9.4 percent in June 2019, largely attributed to prevailing low interest rate environment (though an increase in lending rates was noted, they remain below historical high levels) which continues to support debt-servicing costs.

The recent June 2019 Credit Conditions Survey indicates that demand for credit will remain positive in the second half of 2019, in spite of the tighter credit conditions.

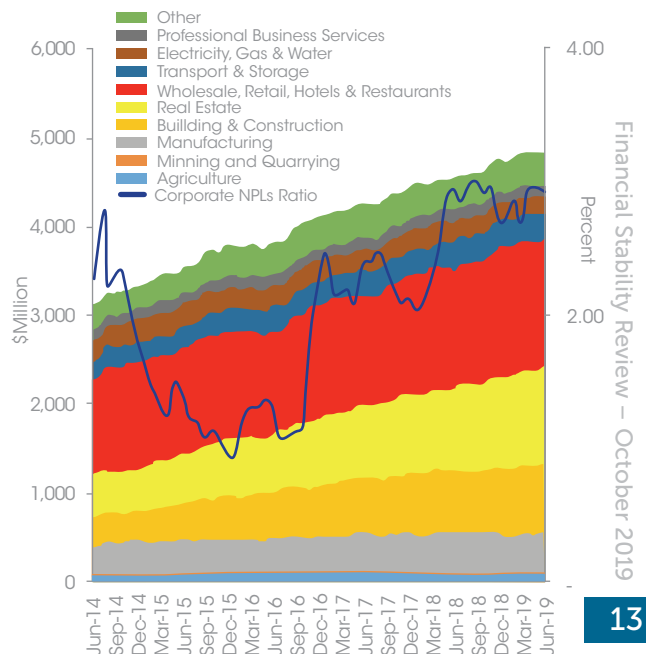
The distribution of credit in specific sectors among corporates is important in monitoring developing risks to Fiji's financial system. The share of corporate credit is distributed among various sectors (Figure 7), with the largest share concentrated within the wholesale, retail, hotels and restaurants (WRHR) sector (30.1%), followed by the real estate (22.8%)

Figure 6: Corporate Credit



Source: Reserve Bank of Fiji

Figure 7: Corporate Credit Concentration and Credit Worthiness



Source: Reserve Bank of Fiji



and building and construction (16.3%) sector, while the other sectors represent less than 10 percent concentration.

Concentration risk is further amplified for sectors such as agriculture and WRHR, as they are considered to be directly vulnerable to adverse weather conditions, which ultimately affect the performance of corporates within these sectors. Other sectors such as building and construction, real estate and transport and storage are also vulnerable to the effects of natural disasters, though indirectly.

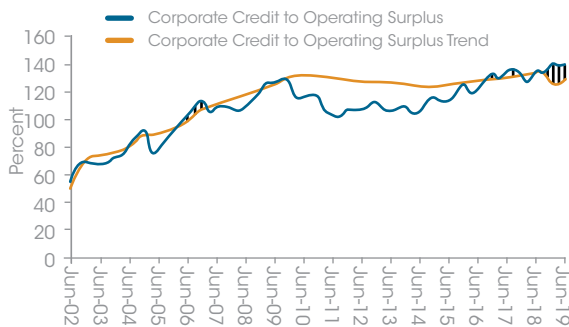
In therefore seeking to mitigate the level of credit losses from recent natural disasters, the banking industry was noted to have implemented measures to ensure corporates impacted by adverse weather conditions are provided structured packages which assist in servicing debt obligations, and easing pressures on their business operations.

With credit being extended to certain vulnerable sectors of the economy, it becomes important to assess the quality of such credit. As at June 2019, the corporate sector's NPLs were reported at \$142.2 million, accounting for only 3.0 percent of the corporate credit portfolio, however as noted for the household sector, the corporates NPL ratio has been gradually increasing, but remains below prudential levels of concern.

The corporate sector's indebtedness level has somewhat increased since June 2018 as the ratio of corporate credit to operating surplus moved above its long-term trend (Figure 8) resulting in a positive credit gap of 7.5 percent (Figure 9) as at June 2019. This currently is not an indication of a build-up in credit in the corporate sector as credit growth

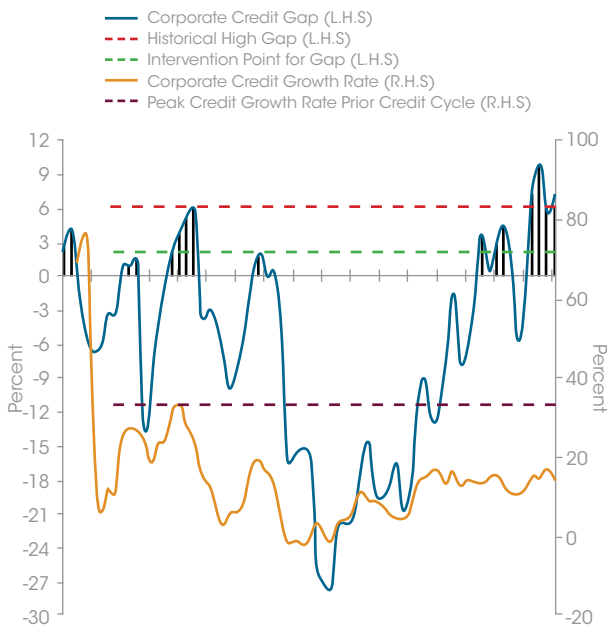
remains below the historical level, but is rather an indication of slowed economic conditions which affect the aggregate income level of corporates.

Figure 8: Corporate Credit to Operating Surplus – Level & Trend



Source: Reserve Bank of Fiji, FBOS

Figure 9: Corporate Credit Gap & Growth Rate



Source: Reserve Bank of Fiji, FBOS



Box A: Stress Testing – June 2019

INTRODUCTION

Stress testing is a risk management tool that may be used to assess the banks' ability to weather very severe shocks, to monitor and intercede to remove or reduce systemic risks, and to support the overall objective of promoting a sound financial structure.

In this Box, we report on the interest rate stress test conducted on banks and the household sector for the period June 2019. The paper concludes that given the assumptions and limitations used in the stress test scenarios, banks are generally assessed as resilient to natural disaster shocks, and the household sector is able to withstand interest rate shocks when stressed to the levels of the 2007 interest rate hike.

Methodology

The methodology uses off-site supervisory data, mainly monthly prudential returns on credit and lending rates as at June 2019 as well as social and economic statistics by Fiji Bureau of Statistics (FBOS). The main variable (baseline) used to measure the impacts of the stress tests, for the banking industry is solvency (capital to risk-weighted assets), referred to as the capital adequacy ratio (CAR), while for the household sector, the debt to financial asset ratio and the debt to income ratio. The coverage of the stress tests includes all the commercial banks, credit institutions and the household sector.

Stress Test Scenario

The stress testing methodology includes shocks to credit, and interest rate risks. Credit risk was assessed at both sectorial and overall levels. The shocks applied included a natural

catastrophe scenario assuming standard loans becoming non-performing in major sectors of the economy, and the interest rate shocks applied was the proportional increase in NPLs to increase in interest rates (2007 interest rate hike; between 170-488 basis points); the same was applied for the household sector.

Results

The Credit Risk Test: This test assesses the impact of a plausible scenario of a natural catastrophe. Given the history of natural disasters in Fiji, the financial system is exposed to certain risks arising from the deterioration of loans granted to major sectors by banks. The test assumes that standard loans in the affected sectors become non-performing and therefore assesses the impacts of the following shocks:

- increase in NPLs by 20 percent for the agriculture, forestry & fisheries and hotels & restaurants sector;
- increase in NPLs by 15 percent to other wholesale and retail trade; and
- increase in NPLS by 10 percent to the manufacturing sector, transport sector and household sector.

A natural disaster will affect a bank's loan book should the sectoral counterparties affected by the natural disaster default on their repayments. The spillover effects may also trigger movements in liquidity levels within the system as large depositors may wish to withdraw their deposits for rehabilitation/reconstruction, resulting in banks' becoming distressed with inadequate capital to withstand the related risks.



The test conducted revealed results on the aggregate post shock CAR for the banking industry stood at 14.6 percent for commercial banks (Baseline CAR - 17.9%), and 17.8 percent for credit institutions (Baseline CAR - 21.0%).

Interest Rate Risk: In a rising interest rate environment, monitoring interest rate risk is essential, as the increase in interest rates adds financial pressures on borrowers, which may result in default of loan payments. Through stress testing, we may to an extent test the household and banking sectors' resilience to an interest rate shock.

Interest Rate Risk Test 1 & 2: The household sector has over the years become increasingly indebted as household credit increased further by 5.6 percent to \$2.4 billion as at June 2019. Given the gradual growth in the household non-performing loans (refer Household Sector Developments section) and the anticipated increase in lending rates by the CCS respondents, a stress test was conducted to determine if the sector is well placed to service its debt obligations given the expected increase in repayment obligations, as a result of the increase in interest rates.

The test shows the impact of applying the 2007 interest rate hike on the household sector's financial assets and disposable income. The test uses aggregate household data, household income and expenditure information from the 2008-2009 Household Income and Expenditure Survey (as the latest survey available).

The household sector's financial assets, comprising of its deposit balances with commercial banks and credit institutions and FNPf member balances, stood at around

\$3.3 billion as at June 2019, while total debt is reported at \$2.6 billion. However given that FNPf balances are retirement savings and access to such funds is strictly controlled, the FNPf balance would be regarded as an illiquid asset for the sector. Therefore for this test, 30 percent of the FNPf balance was considered, which reduced the household assets to \$2.8 billion and a debt to financial asset ratio of 92.6 percent

In stressing the households' debt servicing ability, an interest rate shock using adverse scenario of increasing the lending interest rate by 270 basis points was utilised. This resulted in the application of a new interest rate of 9.9 percent to the household exposure which increased the post-shock debt to \$2.7 billion and their post-shock debt to financial asset ratio to 95.1 percent.

A second test was conducted on the household sector's debt repayment to income ratio, where the sector's total income excluding PAYE, FNPf and household expenditure was calibrated. Using the same increase in the initial test, the results show an increase in the debt repayment to income ratio to 94.0 percent from the baseline ratio of 74.2 percent.

While the resulting ratios from both tests are significantly high, the results nonetheless show that the household sector is just able to meet its debt obligations, given a rise in repayments from an increase in interest rates.

A third test was conducted; given that around 86.0 percent of the household sector is with commercial banks; with the focus on commercial banks' capital adequacy ratio.

Interest Rate Risk Test 3: This test was conducted on commercial banks and it assumes that 100 percent of the increase in



loan repayments from an interest rate hike, would become non-performing. Furthermore, banks will book an additional 20 percent provisioning against new non-performing loans, and 60 percent provisioning against existing NPLs.

The magnitude of the test was drawn from the 2007 interest rate hike experience which saw interest rates increased between 170 basis points and 488 basis points.

The aggregate banks' post shock CAR indicate that banks have sufficient capital to withstand losses arising from the increase in non-performing loans, given the increase in interest rates. The post shock capital adequacy ratio fell slightly by 0.3 percentage points to 17.7 percent from the baseline CAR of 17.9 percent.

CONCLUSION

The impact of the stress scenarios vary across individual banks, due to the different sizes of their exposures and the types of risks they are most exposed to. However the overall results revealed that the current level of capital held by commercial banks are adequate to withstand a range of financial shocks.

Similarly, the household sector is able to weather the impact of the increase in interest rates, however a continuous increase in household debt and further rise in rates may elevate risk to the banking sector, and subsequently systemic stability.



Box B: June 2019 Credit Conditions Survey Results³

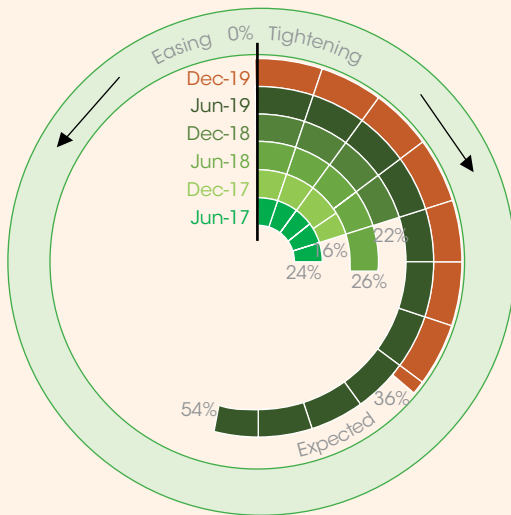
ENTERPRISES

The overall responses indicate tightening of credit standards and increase in demand for loans.

Development in Credit Standards and Terms of Conditions

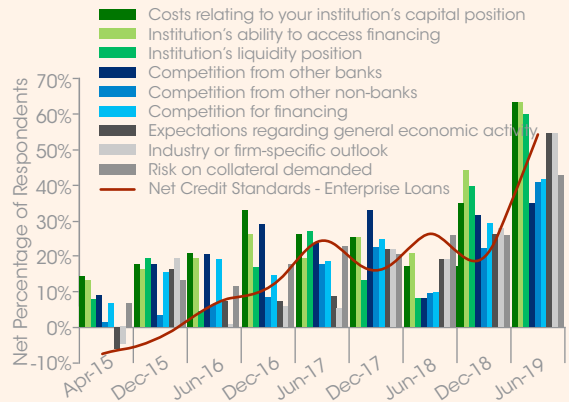
Respondents reported that credit standards continue to be in tightening stage. A net 54 percent of respondents recognised a continued tightening of credit standards in the past 6 months compared to a net 20 percent in the previous survey (Figure B1).

Figure B1: Net Credit Standards Enterprise Loans



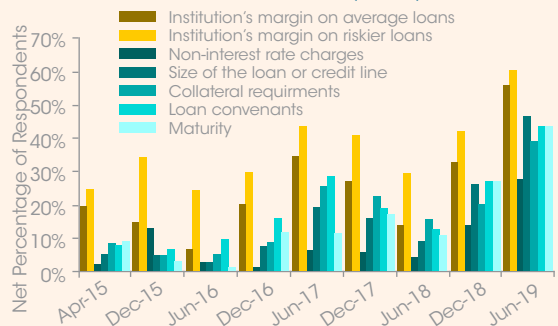
The continued tightening has been largely prompted by the institutions' capital and liquidity positions, and the ability to access financing; as well as the institutions' risk perceptions regarding the general economic activity and industry outlook (Figure B2). Respondents however, anticipate reduced tightening of credit standards in the next six months (Figure B1).

Figure B2: Factors Affecting Credit Standards as Applied to the Approval of Loans or Credit Lines to Enterprises



With regard to the conditions and terms of credit, a net 58 percent of respondents indicated that price components contributed to the tightening of credit standards for the approval of loans, compared to 37 percent in the previous survey. A net 40 percent of respondents indicated that tightening was contributed by other conditions and terms such as non-interest rate charges, size of loan, collateral requirements, loan covenants and maturity (Figure B3).

Figure B3: Conditions and Terms for Approving Loans or Credit Lines to Enterprises (overall)

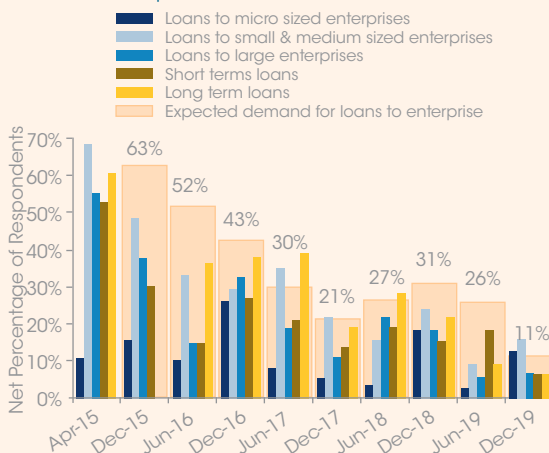


³ Refer to Annex 3 for the CCS Results

Development in Demand for Loans and Expected Lending Rates

The demand for enterprise loans continue to remain positive in the past 6 months. However contrary to the expectation from the last survey (Figure B5), the demand for enterprise loans slowed across all firm sizes and for long term loans (Figure B4).

Figure B4: Changes in Demand for Loans or Credit lines to Enterprises

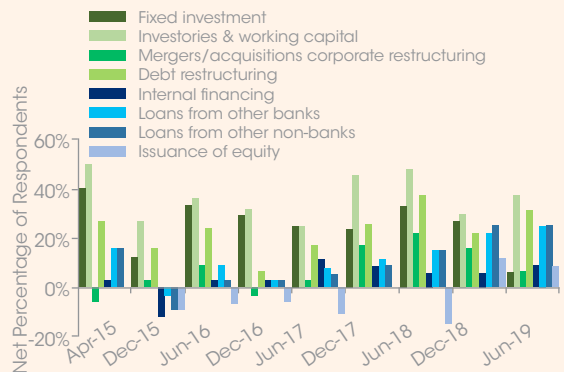


A net 6 percent of respondents indicated an increase in demand compared to a net 18 percent of respondents in the last survey. The major factors behind the decrease were the reduction in the demand for fixed investment and mergers/acquisitions corporate restructuring (Figure B5).

However, in the next 6 months to December 2019, demand is anticipated to increase, with the net percentage of respondents reporting a positive loan demand across all firm sizes (Figure B4).

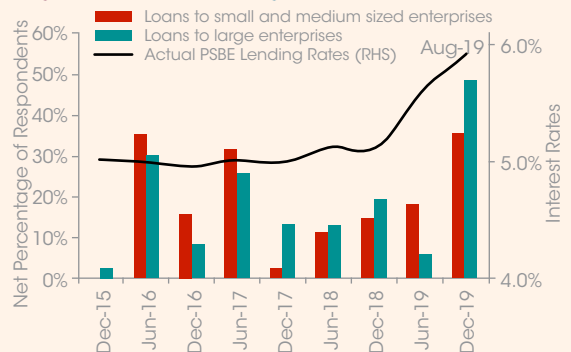
Coincidentally, a net 40 percent of respondents anticipate an increase in lending rate for the next 6 months to December 2019, compared to a net 10 percent of respondents in the previous survey (Figure B6).

Figure B5: Factors Affecting the Demand for Loans or Credit Lines to Enterprises



The actual lending rates to enterprises confirm the increase in the rates over the 6 months to June 2019, as the enterprises' interest rates stood at 5.1 percent as at December 2018 compared to 5.6 percent in June 2019 (Figure B6).

Figure B6: Expected Lending Rates - Enterprise Loans



Rejection of Loans

A slight decline in the number of rejected loans was noted by the respondents, mostly from small and medium and large sized enterprises. In terms of loan maturity; there were no changes to the number of rejected applications for long-term loans, however respondents indicated a rise in the number of declined loan applications for short-term loans (Figure B7).



Expected Non-Performing Loans

In the next 6 months, 23 percent of the respondents expect an increase in non-performing loans for enterprise loans, while 55 percent assumed no changes, and 22 percent anticipate a decrease (Figure B8). Respondents expect the increase to be from the micro, small and medium sized enterprises.

Figure B7: Change in the Number of Rejected Enterprise Loans over the Past 6 Months

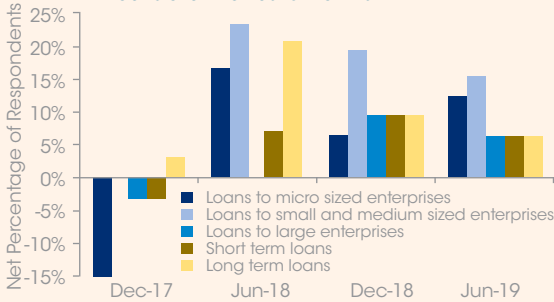
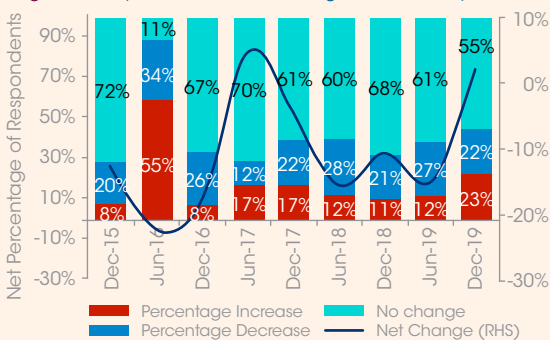


Figure B8: Expected Non-Performing Loans – Enterprises



HOUSEHOLDS

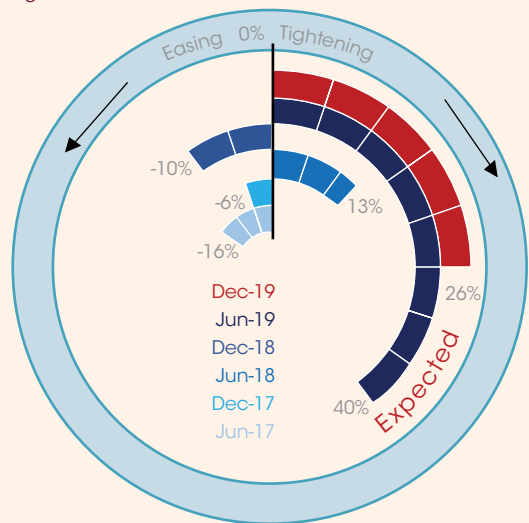
The consolidated responses indicate a continued tightening of credit standards and increases in demand for vehicle and housing loans.

Developments in Credit Standards and Terms of Conditions

Housing Loans

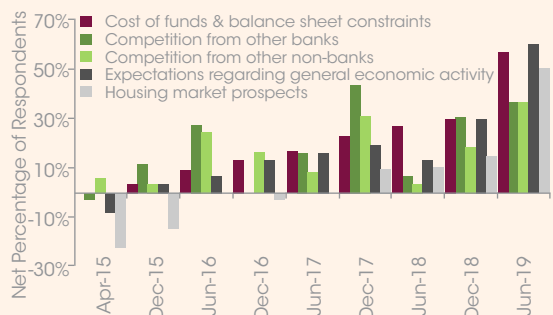
In the first half of 2019, respondents had recognised a move from an easing to tightening phase in the credit standards applied for the approval of loans for house purchases (Figure B9).

Figure B9: Net Credit Standards - Loans for House Purchase



The move has been attributed to the institutions' risk perception regarding the general economic activity and housing market prospects; as well as their cost of funds and balance sheet constraints (Figure B10).

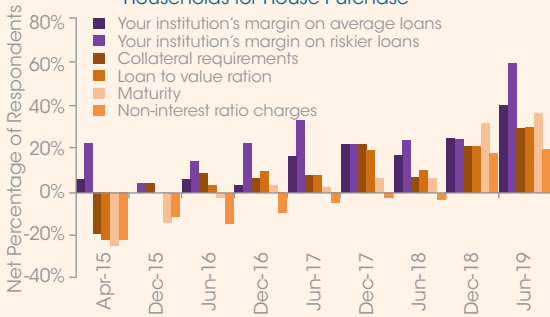
Figure B10: Factors Affecting Credit Standards as Applied to the Approval of Loans to Households for House Purchase.





On the terms and conditions in the approval of loans for house purchase, a net 60 percent of respondents responded that the institutions' margin on riskier loans contributed to the tightening in credit standards; compared to a net 25 percent of respondents in the previous survey (Figure B11). Respondents anticipate the tightening phase to remain in the next 6 months to December 2019 (Figure B9).

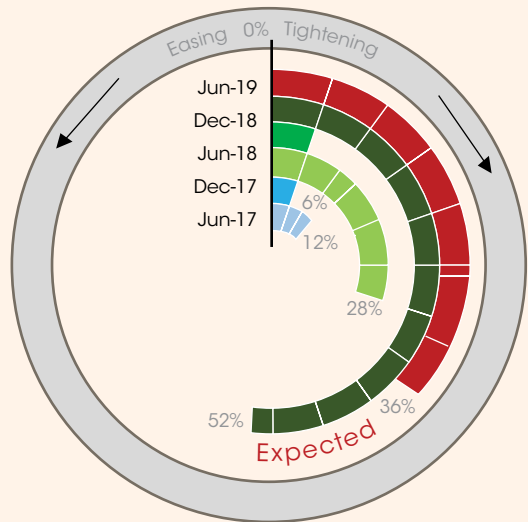
Figure B11: Conditions and Terms for Approving Loans to Households for House Purchase



Consumer Credit, Vehicle Loans and Other Lending

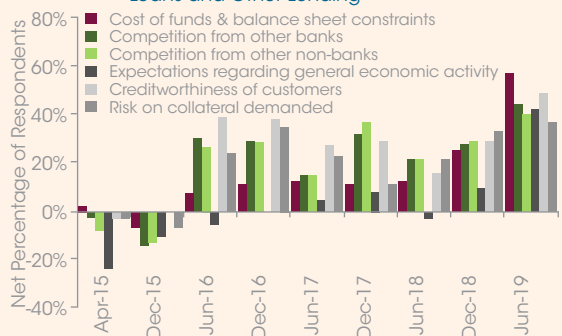
The credit standards applied to the approval of consumer credit, motor vehicle loans and other loans tightened further in the first half of 2019, as indicated by a net 52 percent of respondents (Figure B12) from a net 10 percent of respondents in the previous survey.

Figure B12: Net Credit Standards - Loans for Consumer Credit & Motor Vehicle Loans



The further tightening in the past 6 months was contributed by the institutions' cost of funds and balance sheet constraints, expectation regarding general economic activity, and credit worthiness of customers as well as pressure from competition (Figure B13).

Figure B13: Factors Affecting Credit Standards as Applied to the Approval of Consumer Credit, Vehicle Loans and Other Lending

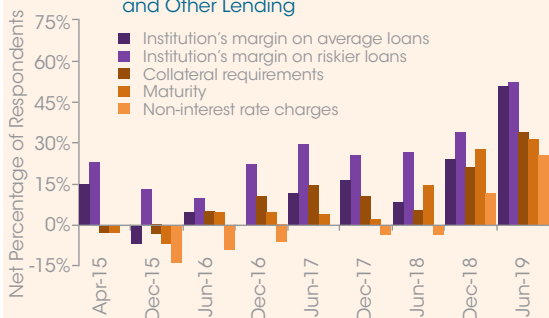


With regards to the conditions and terms of credit, the current survey results are noted to be similar to the previous survey, whereby respondents indicated that all components of price continue to be the major contributor



to the tightening in credit standards for the approval of loans; specifically on the institutions' margin on riskier loans (Figure B14). Respondents anticipate the tightening phase of credit standards to remain in the next 6 months (Figure B12).

Figure B14: Conditions and Terms for Approving Loans to Households for Consumer Credit, Vehicle Loans and Other Lending



Development in Demand for Loans and Expected Lending Rates

In the first half of 2019, respondents indicated a decline in demand for loans from the household sector for vehicle purchase, consumer credit and other lending, the demand for loans for house purchase however, remained positive (Figure B15).

Figure B15: Changes in Demand for Housing Loans, Vehicle Purchase and Consumer Credit & Other Lending

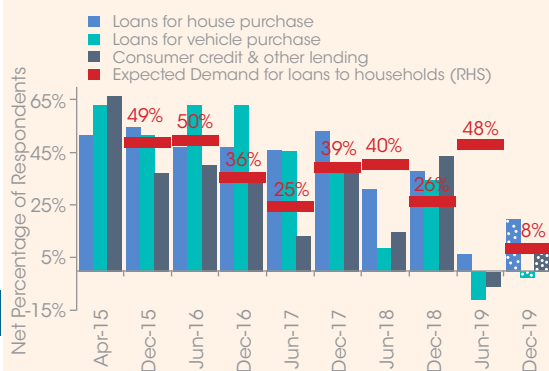
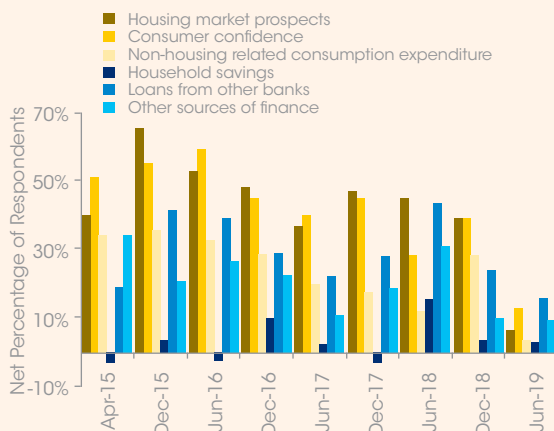


Figure B16: Factors Affecting the Demand for Loans or Credit Lines to Household for House Purchase



Consumer Credit, Vehicle Loans and Other Lending

Similar to the demand for housing loans, the demand for consumer credit, vehicle loans and other lending from households declined in the first half of 2019, as indicated by the negative net 17 percent of respondents; compared to a net 39 percent of respondents in the previous survey (Figure B15).

Major factors contributing to the decrease were the low level of consumer confidence, financing needs for spending on durable goods and household savings. (Figure B17). Respondents anticipate the demand for credit for vehicle purchase to remain negative in the next 6 months; while demand for consumer credit and other lending will rise from the negative net 11 percent to a net 9 percent (Figure B15).

In terms of lending rates to households, respondents anticipate a rise in the next 6 months to December 2019. The actual lending rates to the household sector confirms the increase in the enterprises lending rates over the 6 months to June 2019 (Figure B18).



Figure B17: Factors Affecting the Demand for Loans or Credit Lines to Households for Vehicle Purchase & Other Lending

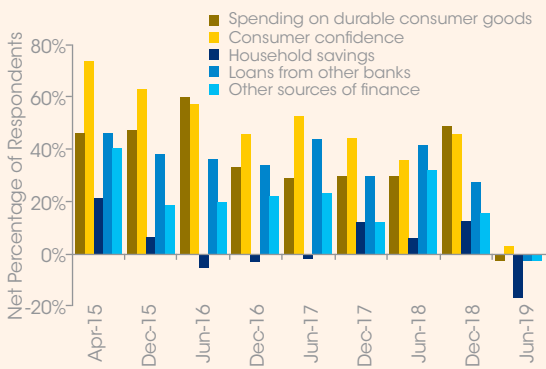
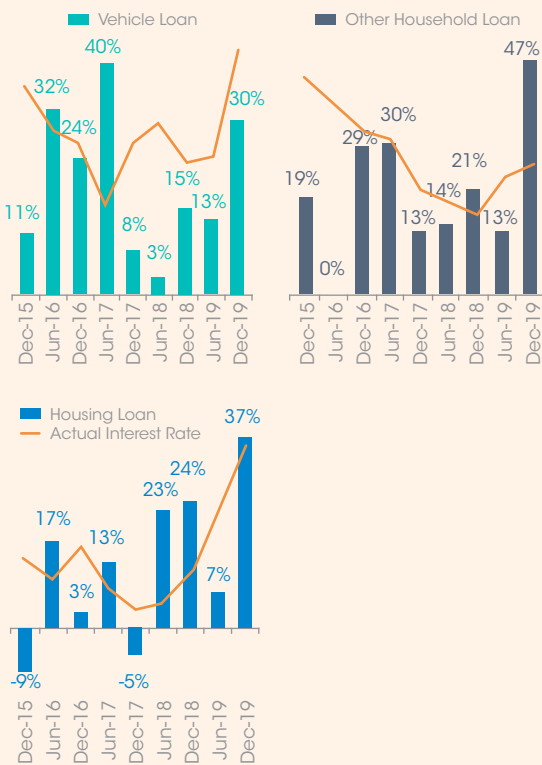


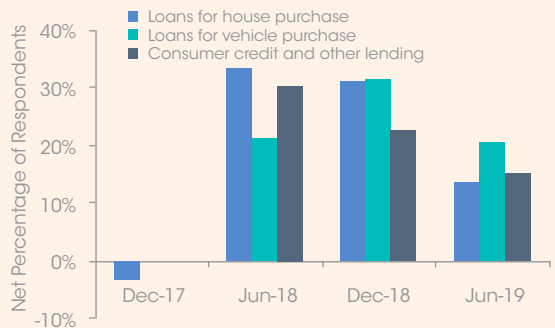
Figure B18: Expected Lending Rates – Household Loans (Net percentage of respondents reporting an increase in lending rates)



Rejection of Loans

Similar to enterprise loans, respondents noted a decline in the number of rejected loans. A net 16 percent of respondents noted a decline in the rejection of loans to households for all purposes compared to a net 29 percent of respondents in the previous survey (Figure B19).

Figure B19: Change in the Number of Rejected Household Loans over the Past 6 Months



Expected Non-Performing Loans

With regard to non-performing loans in the next 6 months to December 2019, 17 percent of respondents expect an increase in non-performing loans for households, while 62 percent assumed no changes, and 21 percent anticipate a decrease (Figure B20). Respondents expect the increase to be from loans for consumer credit, vehicle loans and other lending to households

Availability of Household Secured Credit

On the question of the institutions' willingness and ability to supply credit, respondents indicated a decrease in the past 6 months, for borrowers with either high or low loan to value ratios and this is expected to decrease further in the next 6 months (Figure B21).



Open-Ended Question

The survey questionnaire closed with an open-ended question, requesting respondents to identify any other issues of importance on the institutions' lending behaviour that has not been covered in the questionnaire. Respondents had highlighted matters of delayed or no repayments, tight liquidity environment in the first quarter of 2019, higher interest rates, the impact of the new taxes introduced on vehicles, market prices for home purchases, and a change in the customer contribution requirement by the institutions.

Figure B20: Expected Non-Performing Loans - Household

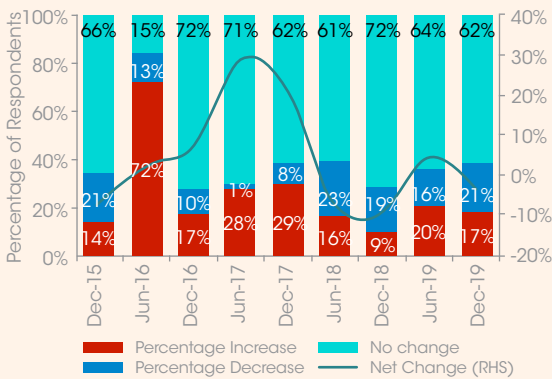
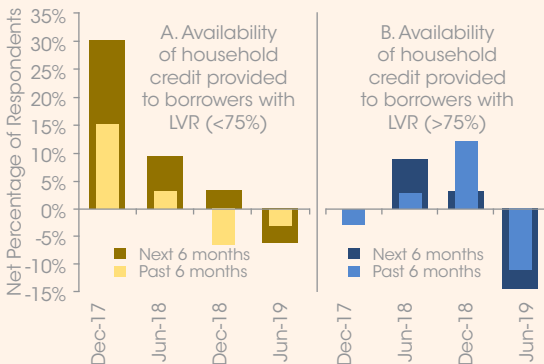


Figure B21: Changes in the Availability of Household Secured Credit



Buoyancy of the Fijian Financial System

Despite global and domestic challenges, the Fijian financial system remained resilient as the banking industry's ability to withstand shocks strengthened in the first half of 2019. The improved capital ratios continue to be facilitated by healthy levels of profits reported by commercial banks, as well as capital injections.

Fiji's financial system is dominated by commercial banks and the FNPF (Table 1). The three major commercial banks; Australia & New Zealand Bank (ANZ), Bank of South Pacific (BSP) and Westpac Banking Corporation (WBC) account for 77.7 percent of overall commercial banks' lending, distributed over various classes of loans. The other lending institutions remain relatively small when compared to the commercial banks and focus more on lending to special niche markets and products

Similarly, the capital markets remain reasonably small in comparison to the banking industry, however, recent listing of some major corporates should provide an added investment opportunity for Fijians and boost the development and growth of the capital markets.

The total gross assets of the Fijian financial system stood at \$24.8 billion as at September 2019, of which FNPF represented 31.0 percent, while the three largest commercial banks represented 32.7 percent.

While commercial banks accounted for 74.7 percent of the overall credit market share.

(Figure 10), the lending market share of other credit providers has increased steadily and as at June 2019, stood at 25.3 percent compared to 23.7 percent in 2018.

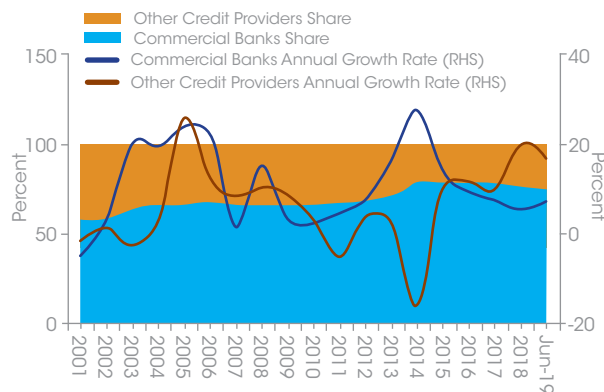
Sectoral credit risk lies predominantly with the private non-financial corporations which account for the largest share of commercial bank lending of 66.6 percent, followed by the household sector at 28.5 percent (Figure 11).

Table 1: Composition of Financial System as at September 2019

Category	Composition (%)
Reserve Bank of Fiji	11.4
Commercial Banks	42.3
Credit Institutions	3.0
Fiji Development Bank	2.6
Housing Authority	0.8
Insurance Companies	7.0
Fiji National Provident Fund	31.0
Unit trusts	1.6
Insurance Brokers	0.2

Source: Reserve Bank of Fiji

Figure 10: Credit Intermediation - Bank vs Non-Bank Lending



Source: Reserve Bank of Fiji



The Fijian banking system continues to effectively contain credit risk despite the slight increase in non-performing loans and prevailing subdued economic performance.

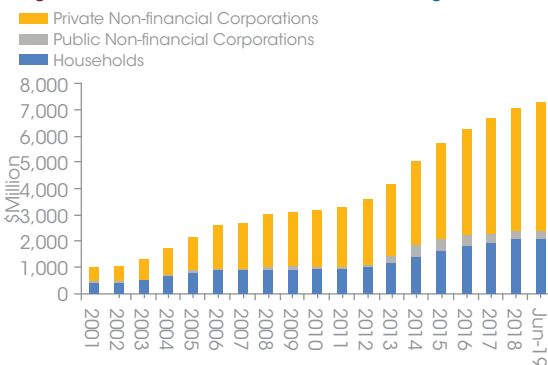
A slight pick-up in aggregate credit was noted in the first half of 2019 with credit growing by 9.3 percent as at June 2019, compared to 7.7 percent in the same period in 2018 (Figure 12). The resurgence in system credit has been a combination of growth in commercial banks' and other credit providers' loan portfolios.

Despite the continued tightening of credit standards, as applied to the approval of loans in the banking industry (see Box B: June 2019 CCS Results, Pg. 18) commercial banks' credit growth accelerated to 7.0 percent in the current period compared to 4.7 percent the same period in 2018. Similarly, other credit providers' credit growth has been increasing since 2014, with an annual credit growth of 16.8 percent (23.0% - Mar 2018) as at June 2019 (Figure 13).

For the current credit cycle, private sector credit to GDP⁴ has been above its long term trend since June 2018 (Figure 14). Although the private sector credit gap is above the intervention point of 2.0 percent and closer to the historical high of 4.0 percent (Figure 15), this does not necessitate macro prudential intervention at this stage, as the positive gap is largely due to the lower economic growth.

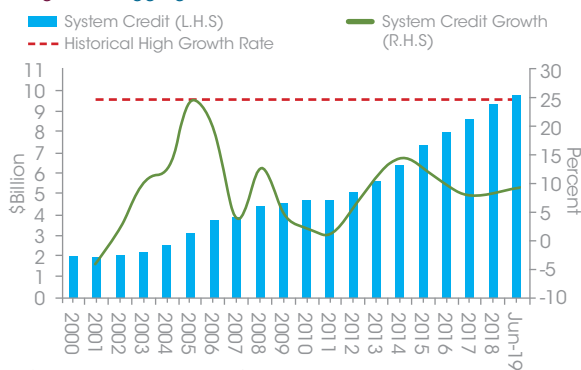
Additionally, credit growth is not considered excessive as it remains well below historical high levels and is assessed to remain at similar levels in the short term (Figure 15). Closer monitoring of any potential downside risk to the aggregate private-sector credit levels will continue.

Figure 11: Commercial Banks' Sectoral Lending



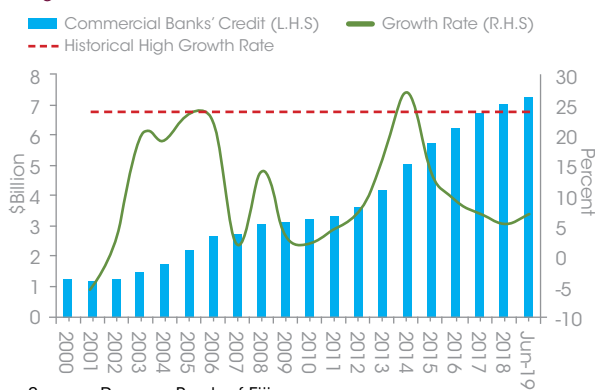
Source: Reserve Bank of Fiji

Figure 12: Aggregate Credit Growth



Source: Reserve Bank of Fiji

Figure 13: Commercial Banks' Credit Growth

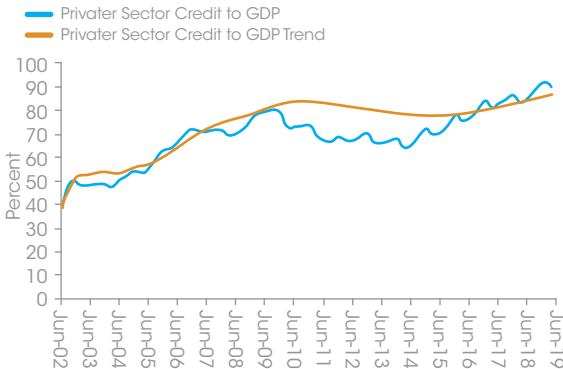


Source: Reserve Bank of Fiji

⁴ The credit-to-GDP gap assessment was based on the GDP projection of 2.7 percent.

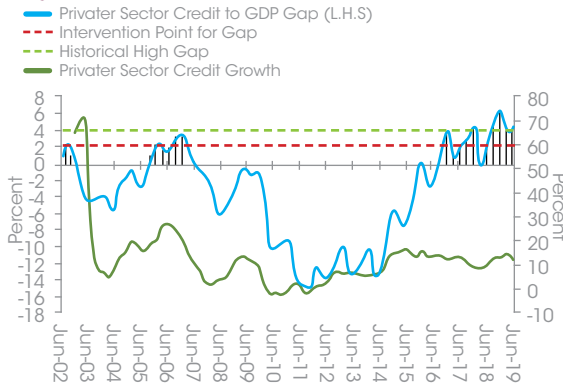


Figure 14: Private Sector Credit to GDP Level & Trend



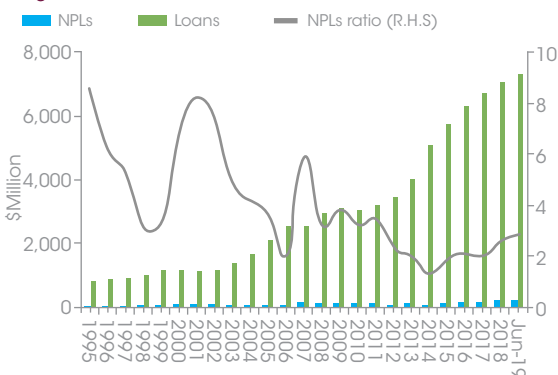
Source: Reserve Bank of Fiji, FBOS

Figure 15: Private Sector Credit Gap



Source: Reserve Bank of Fiji, FBOS

Figure 16: Commercial Banks' NPLs Ratio



Source: Reserve Bank of Fiji

Commercial banks' asset performance has been relatively strong over the years, despite the gradual increase in non-performing loans since 2014. Generally, the deterioration noted in asset quality remain significantly lower than historical high levels.

In comparison to historical data, the current NPL ratio of 2.8 percent remain well below the historical high of 8.5 percent experienced in 1995 (refer Figure 16). The concentration of NPLs is mainly with the non-financial sector followed by the households sector.

Both sectors have noted gradual increases in NPLs in recent years, and as at June 2019, the non-financial sector's non-performing loans was reported at \$142.1million, and the households non-performing loans at \$59.6million (Figure 17).

Although, the relative levels of NPLs remain below historical levels, the potential risk of further deterioration in asset quality remain. This is due to the slowdown in the domestic economy and the potential adverse effects of the upcoming cyclone season which could have significant bearing on the financial strength of households and the non-financial sector.

These risks are somewhat contained in the commercial banks' books underpinned by the increasing level of provisions. Specific provisions cover almost 40 percent of NPLs as at June 2019 (refer Figure 18), signalling increasing safety net for commercial banks.

The commercial banks' total regulatory capital increased by 10.8 percent (\$123.3m) over the last six months to June 2019, increasing the banking sector resilience to solvency shocks (Figure 20). Tier one capital accounted for 80 percent of the overall regulatory capital of the



Figure 17: Sectoral Distribution of NPLs

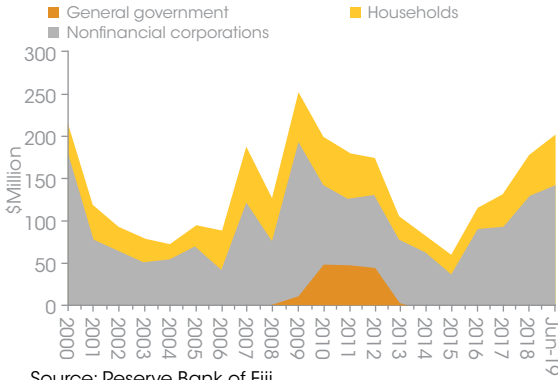


Figure 18: Commercial Banks Provisioning Levels

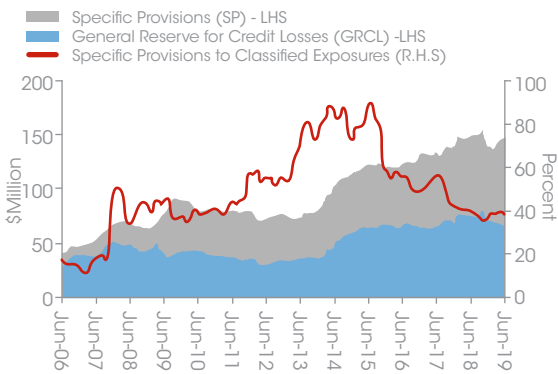


Figure 19: Credit Concentration by Sectors (June 2019) - \$7.013b

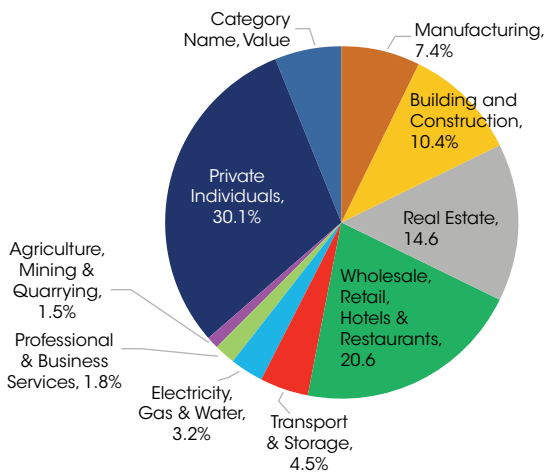


Figure 20: Commercial Banks' Capital Adequacy Components

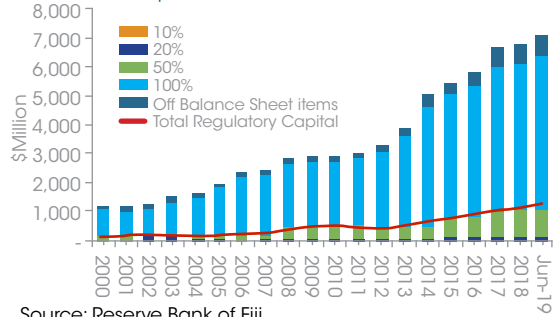


Figure 21: Commercial Banks' Capital Adequacy Ratio

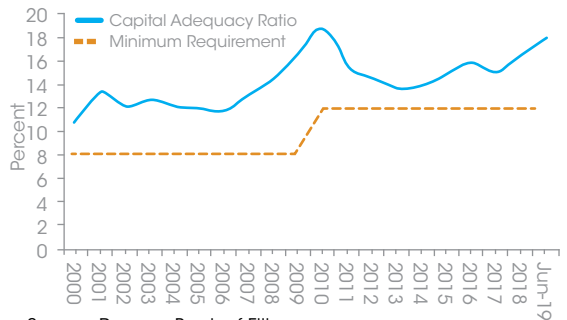
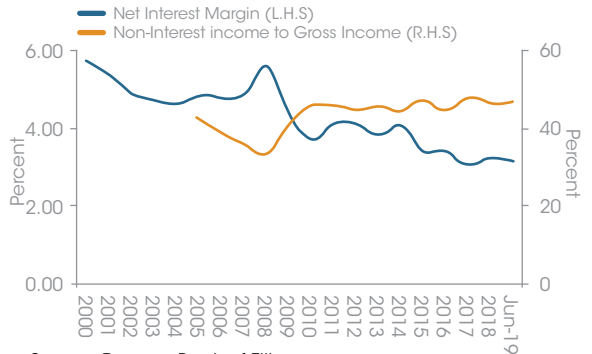


Figure 22: Commercial Banks' Net Interest Margin

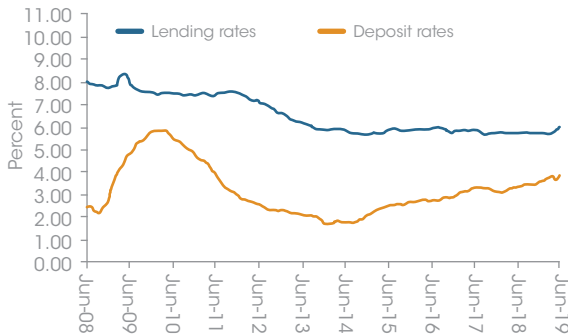


commercial banks, signifying a strong position of banks to withstand stress events.

Additionally, with the banking industry maintaining a solid capital base, the resulting capital adequacy ratio remained well above



Figure 23: Weighted Average Lending & Deposit Rates



Source: Reserve Bank of Fiji

the minimum requirement of 12 percent as reflected in Figure 21. The banks’ aggregate capital adequacy ratio strengthened to 17.9 percent in June 2019, from 16.6 percent in December 2018.

Net interest margin has remained relatively stable since June 2018 (refer Figure 22) which indicates competition on pricing has not been aggressive, however the lending rate has picked up in June 2019. Similarly, interest rate on deposits has progressively increased indicative of competition in funding (refer Figure 23).

Table 2: Summary of Market and Liquidity Indicators

Indicators	Historically Stress Points/ Slump Period	Best or “Boom” Period	Current Performances
Short-Term Wholesale Funding Mix	57 percent (Dec07)	44 percent (Jun-09, Mar-10-Sep 10)	44 percent (48% - Jun 18)
High Quality Liquid Asset	\$131m (Dec08)	\$821m - \$829m (Sep13, Jun-15-Sep-15)	\$610m (\$658m - Jun18)
Core Liquidity Ratio	7 percent (Dec08)	35 percent (Sep -13)	11.4 percent (11.9% - June18)
Foreign Reserves Position	\$409m (Sep06)	\$2,409m(Oct17)	\$2,143m (13/08/19) (\$2,139 - June18)
Broad Level Liquid Assets	\$353m(Sep06)	\$1,340m (Oct17)	\$1,037.8m (\$1,119m - June18)
Net Open Position to Capital Ratio	23.7 percent (June 13)	0.2 percent (Mar-10)	4.65 percent (3.53% - June 18)

Source: Reserve Bank of Fiji

The current performance of the liquidity indicators noted in Table 2 below, show an eased pressure on liquidity as banks’ funding profiles, and liquidity conditions improved in the second half of 2019; however the interest rate risk on negative short-term mismatches in terms of roll-over funding costs continues to rise.

In assessing market and liquidity risk, the major indicators in the following table analyses the stress points, the “good” and current level of performance. Their levels during historically stressed times against their current performance are also provided.

Overall, liquidity indicators improved in the second half of 2019, as the short-term wholesale funding mix continued to deviate from the historical stress point. Earlier in the year, there were noted reductions in the banks’ funding mix which was due to an outflow of funds from the banking system.

The June 2019 quarter however showed a shift in reliance from short-term wholesale funding to long-term wholesale funding as the latter had increased by \$81.6 million to \$1.5 billion, reporting an annual growth of 7.1 percent.



As at June 2019, banks' short-term wholesale funding decreased by \$242.4 million to \$3.7 billion, consequently reducing their funding mix to 44.0 percent from 48.0 percent in June 2018 (refer Figures 24 and 25).

Additionally, the commercial banks' level of liquid assets took an upward turn in the June 2019 quarter, from its decreasing trend since September 2017.

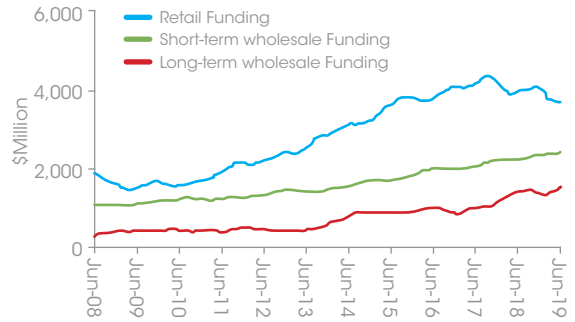
The high quality liquid assets (HQLA) holdings of commercial banks increased by \$126.9 million in June 2019 to \$610.0 million from March 2019, largely due to increases in the commercial banks' ESA balances, underpinned by the increase in foreign reserves.

As a result, commercial banks' core liquid assets was able to meet 11.4 percent run-offs of short term wholesale funds, compared to 9.1 percent in March 2019 and 11.9 percent in the prior year (refer Figures 26 and 27).

On the other hand, the interest rate risk component of market risk continue to show concerning trends. Historical analysis conclude that commercial banks have become susceptible to interest rate risk on negative short-term mismatches in terms of roll-over funding (Figure 28), whereby interest rates on short-term funds' responsiveness towards negative short-term mismatches has led to its gradual rise in the last 5 years.

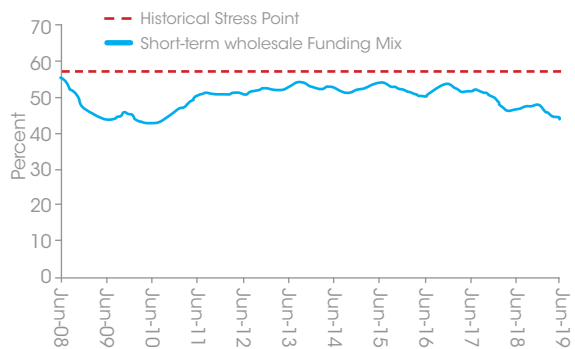
The decrease in liquidity in the first quarter of 2019, resulted in competition for funds in the banking industry, subsequently leading to

Figure 24: Commercial Banks' Funding Profile



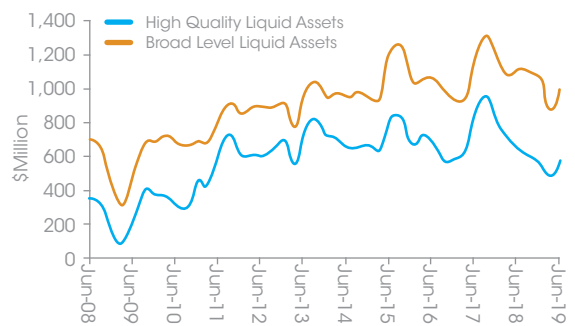
Source: Reserve Bank of Fiji

Figure 25: Ratio of Short-term Wholesale Funding



Source: Reserve Bank of Fiji

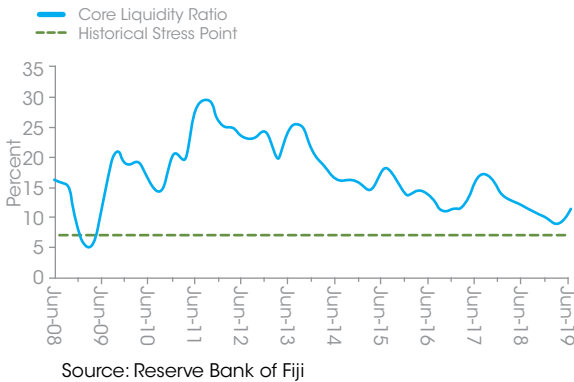
Figure 26: Commercial Banks' Liquid Assets



Source: Reserve Bank of Fiji



Figure 27: Core Liquidity Ratio

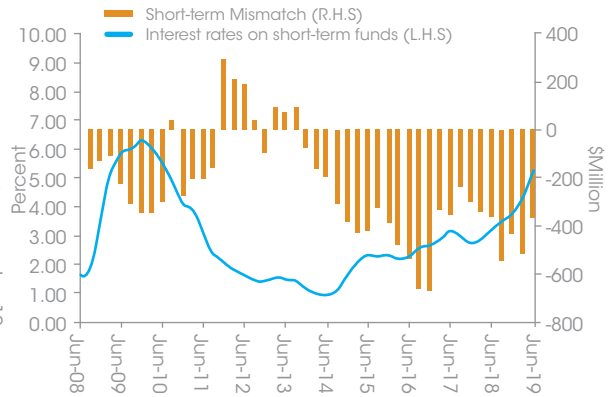


Source: Reserve Bank of Fiji

an increase in the interest rates on short-term funds. Interest rates on short term funds rose to 5.3 percent from 4.3 percent in March 2019, and 3.3 percent in June 2018 (refer Figure 28). In minimizing the effects on the net interest margin, commercial banks have started to increase their lending rates (refer Figure 23).

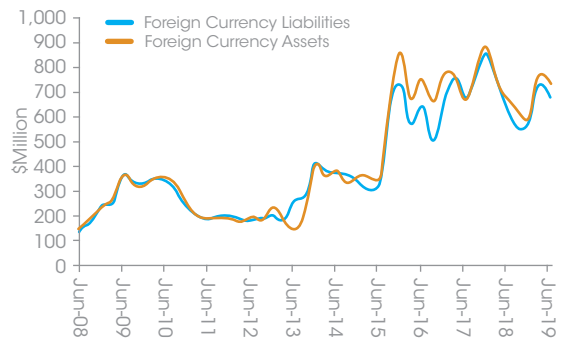
Finally, on foreign exchange risk (FX), the net open position to capital as at June 2019 stood at 4.7 percent. Commercial banks have been satisfactorily protecting their positions to limit losses (refer Figure 29).

Figure 28: Commercial Banks' Maturity Profile & Interest Rate Risk



Source: Reserve Bank of Fiji

Figure 29: Commercial Banks' FX Risk



Source: Reserve Bank of Fiji



Box C: Assessment of the Impact of the Economic Slowdown on Non-Performing Loans

The stability of the banking sector depends in a large part on the size of non-performing loans (NPLs). In 1995, the collapse of the National Bank of Fiji (NBF) was largely due to poor governance and management of risks which led to sustained accumulation of NPLs. The bank had amounted bad and doubtful debts of at least \$90.0 million, with the final debt figure rising to \$220.0 million (Grynberg et al., 2002). Today, it remains as an example of a bank failure in a small developing country and resonates the importance of effectively managing and mitigating problem loans.

Previous studies have identified two sets of factors that affect NPLs over time: Internal factors, which are considered bank specific variables such as return on assets, solvency, interest rates on deposits and loans, among others; and external factors such as macroeconomic conditions which affect a borrower's capacity to repay.

This Box will focus specifically on the macroeconomic indicators such as growth rate, inflation and unemployment rate, all of which can influence NPLs.

Domestic Economic Growth

Empirical evidence found an inverse relationship exists between economic growth and non-performing loans (Farhan et al. 2012). Kemraj and Pasha (2009) suggest that economic growth usually increases the income and capacity of the borrower to make loan repayment, contributing to lower arrears. Similarly, in times of extreme economic slowdown, the quality of assets usually deteriorates to uncontrollable levels for institutions, which may lead to systemic concerns.

Fiji's economic growth was revised down to 1.0 percent in 2019, from the earlier projection of 2.7 percent largely underpinned by moderation in

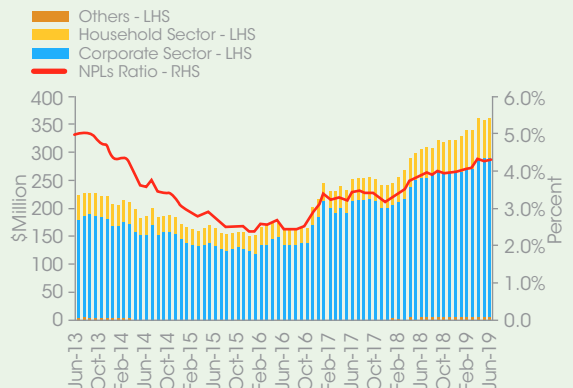
domestic economic activity as a result of weak business and investor sentiments.

Aggregate credit has been on an increasing trend and stood at \$9.8 billion as at June 2019, with annual growth registered at 9.3 percent, an increase from 7.7 percent for the same period last year (Figure 12, Pg. 26). Commercial banks continue to account for the largest portion of the lending market share (Figure 10, Pg. 25), while sectoral credit remains concentrated with the private non-financial corporations, followed by households.

Aggregate non-performing loans has been on an increasing trend and stood at \$361.0 million as at June 2019 with the NPLs ratio registered at 4.3 percent, compared to 3.9 percent for the same period in 2018 (Figure C1). In terms of sector concentration, problem loans remain concentrated with the building and construction sector, followed by private individuals and transport and storage sector (Figure C2).

In terms of households, there has been a gradual increase in non-performing loans due to the economic slowdown with household NPLs registered at 3.0 percent as at June 2019,

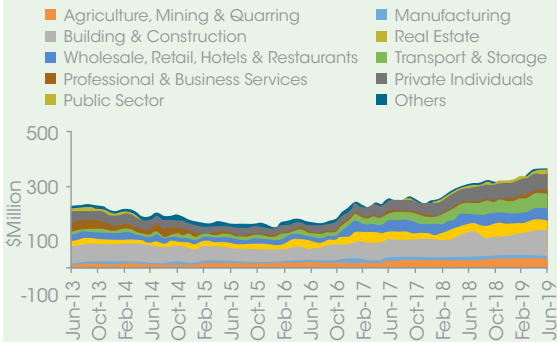
Figure C1: Aggregate Non-Performing Loans



Source: Reserve Bank of Fiji

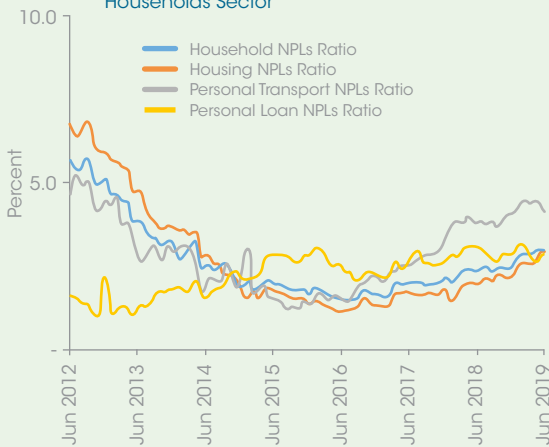


Figure C2: Aggregate Non-Performing Loans by Sector



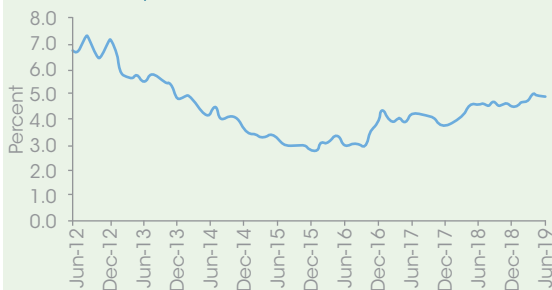
Source: Reserve Bank of Fiji

Figure C3: Aggregate Non-Performing Loans of the Households Sector



Source: Reserve Bank of Fiji

Figure C4: Aggregate Non-Performing Loans of the Corporates Sector



Source: Reserve Bank of Fiji

compared to 2.3 percent for the same period last year. As depicted in Figure C3 below, there has been an increasing trend from all the components of the household sector.

A similar trend is observed when assessing the corporate sector. Private sector business NPLs ratio has been on an increasing trend since October 2016, registering at 4.9 percent as at June 2019.

During an economic downturn, the probability of loan default also increases, and this affects loan collection, lessens banks' ability to lend and increases the cost of borrowing (Burrios, 2013). Consequently, financial institutions tend to tighten their lending policies irrespective of the condition of the loan applicant. This is in line with the results of the recent credit conditions survey (refer Box B: June 2019 CCS Results, Pg. 18)

When assessing loan collections, commercial banks' loan repayments (Figure C5) fluctuated over the years in terms of value. However in terms of annual growth, it has been on a decreasing trend since January 2018, indicative of a slowdown in collection and loan repayments. Noting this trend, there may be a need for an in-depth assessment to identify key drivers.

Whilst the results of the June 2019 credit conditions survey point towards a continued tightening of credit standards, majority of the respondents anticipate demand for credit to increase for both households and enterprises in the next six months.

Inflation

Studies have found a positive relationship between inflation and non-performing loans. When inflation is low, the financial conditions of households is likely to improve, enabling them to make prompt and regular loan repayments and vice versa (Demirguc-Kunt and Detragiache, 1998). Annual inflation stood at 2.8 percent



in June, from 4.0 percent in March 2019, and lower than 4.6 percent registered in June 2018. However, key risks to the outlook that could impact probability of loan default include higher commodity prices, adverse domestic weather conditions and certain tax policy measures included in the 2019/2020 National Budget.

Unemployment

Unemployment creates income constraints and has a positive correlation with NPLs, i.e. the level of NPLs tends to increase when unemployment rises. However, with Fiji's unemployment rate trajectory on a decline (Figure 34), the outlook for the domestic economy is positive in the wake of moderating economic performance.

Provisioning for credit losses

The Reserve Bank of Fiji requires each licensed financial institution to maintain a prudent level of general reserves for credit losses, against losses not certain to arise on the good part of the portfolio, as well as specific provisions against reasonably anticipated losses on impaired assets.

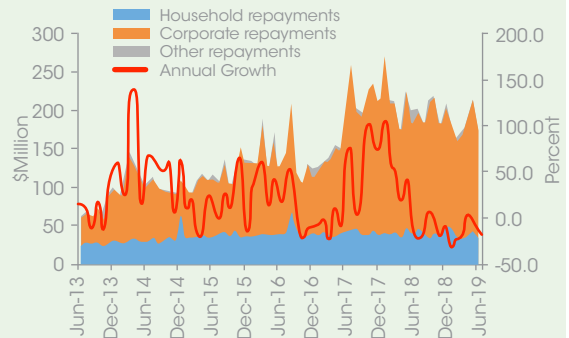
Understatement of required provisions may result in the overstatement of an institution's capital and profits and certainty of its on-going solvency. In terms of coverage, commercial banks' specific provisions cover 39.3 percent of classified exposures, which is deemed sufficient.

Notwithstanding the increase in aggregate past due levels since 2016 (Figure C6), total provisions is at adequate levels to counter anticipated losses from impaired assets.

The introduction of IFRS 9 in January 2018 has also impacted on provisioning levels for most of the licensed financial institutions in Fiji as reflected in Figure 18, Pg. 23.

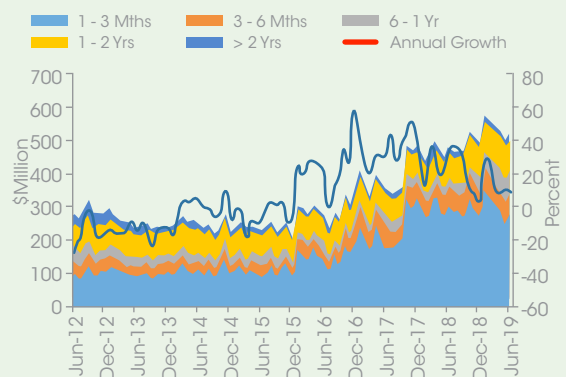
The standard that preceded IFRS 9 required banks to recognize credit losses only when evidence of a loss was apparent. Under IFRS

Figure C5: Commercial Banks' Loan Repayments



Source: Reserve Bank of Fiji

Figure C6: Aggregate Past Due Levels



Source: Reserve Bank of Fiji

9, banks are required to recognize all expected credit loss (ECLs) at all times, taking into account past events, current conditions and forecast information, and to update the amount of ECLs recognized at each reporting date to reflect changes in an asset's credit risk.

In terms of financial stability, while the economic slowdown has seen a gradual increase in NPLs for both the household and corporate sectors, it is still considered within manageable levels as NPLs ratio is still well below historical high of 11.3 percent and does not pose a systemic concern at this time. However, it is important that the credit cycle is closely monitored, particularly developments in the household sector.



Box E: An Embryonic Focus on Market Conduct through Risk Based-Supervision (RBS)

Risk-based supervision (RBS) has been traditionally used by many developing economies including Fiji as an intrinsically focused mechanism of prudential supervision in ensuring a safe and sound financial system.

While RBS has generally been targeted at prudential supervision of commercial banks, insurance companies and pension funds, in recent years the RBS approach is being considered for market conduct supervision. Market conduct of financial institutions can be defined as the institution's behavior in developing, designing, disclosing information on financial products and services, along with its dispute resolution and complaints handling systems.

The importance of market conduct broadly aims at safeguarding economic and financial stability by empowering consumers and maintaining a sustainable financial sector as greater consumer protection, high level of financial inclusion and financial literacy enhance the trust and confidence in financial services providers.

There are three common types of market and regulatory structures across different jurisdictions:

- 1. Internal Twin Peak Structure** – one supervisory agency in charge of prudential and market conduct supervision. Such a structure can be observed in Thailand, Malaysia and Singapore have this in practice this structure.
- 2. Twin Peak Structure** – a specialized financial consumer protection and market conduct agency. The USA, France, Australia and Canada have this institutional arrangement
- 3. General Protection structure** – a general consumer protection agency dealing with

financial products and services. Cayman Islands has such structure for market conduct regulation.

Fiji's market and regulatory arrangement is similar to the twin peak structure, with the prudential supervision of licensed financial institutions being undertaken by the Reserve Bank of Fiji while the mandate for consumer protection and market conduct is with the Fijian Competition and Consumer Commission (FCCC).

In an ideal situation, market conduct supervision should fully capture all the major financial institutions and industries such as banking, capital markets, and non-bank financial institutions and financial sector supervision should have a clear demarcation between prudential supervision and market conduct without any overlapping functions.

Currently for Fiji, the prudential supervision of some industries seems to be overlapping into certain aspects of market conduct supervision, this is largely due to the limitations of powers as well as resources of the Reserve Bank to fully regulate a particular industry or institutions such as micro-finance institutions, the Fiji Development Bank and the Housing Authority of Fiji, and other non-bank financial institutions. However, it should be noted that the Reserve Bank has a dedicated function focusing on handling complaints from financial services consumers in relation to the supervised financial institutions.

While prudential supervision policies mainly for the banking and insurance industries in Fiji aim to address certain aspects of market conduct such as disclosure, reporting and dispute resolution, the Reserve Bank recognises the need to continue to work on developing additional policies to address gaps related to market conduct.



The Reserve Bank plans to carry out a thematic risk based conduct and culture review of major financial services sectors under its supervisory ambit to identify areas which may require strengthening of regulation and enforcement, in consumer protection, financial literacy and financial inclusion.

The Reserve Bank would continue to strengthen its coordination with the market conduct regulator to ensure effective results for the overall benefit of Fijian consumers, the financial services industry, and the economy as a whole.



Section 2: Assessment of Current Financial Cycle against Economic Performance

As the regulator of the Fijian financial system, the Reserve Bank of Fiji monitors the changes in the financial cycle and seeks to mitigate the effects of any major downward spiral of risks to the economy through its prudential policies, and if required necessary intervention. This section aims to identify potential risks emanating from the current financial cycle which may have a negative bearing on the economic performance of the Fijian economy.

The Global Financial Crisis (GFC) of 2007-2008 prompted the need to consider the changes in the financial cycle along with the assessment of fluctuations in the economic performance to better predict and lower the probability of a build-up of systemic risk which could trigger the next financial crisis.

Following the GFC, assessment of financial variables such as asset prices, mortgage lending, credit growth and the understanding of the cyclical behaviour of bank lending grew in prominence as it was evident that business and/or financial crises tend to be preceded by periods of strong credit growth and high asset prices.

Even if a financial boom may not necessarily result in a crisis, it tends to weaken aggregate growth, thus the behaviour of financial cycles could be helpful in measuring risks relating to recessions, particularly when financial peaks

display structured patterns over a certain period of time.

Generally, it has been suggested that financial cycles tend to be longer than business cycles and they should be managed separately from business cycles. The notion of “what goes up must come down”, is very much true in the assessment of financial and business cycles as fluctuations in these cycles are inevitable.

Global Macroeconomic Variables vs Domestic Trends

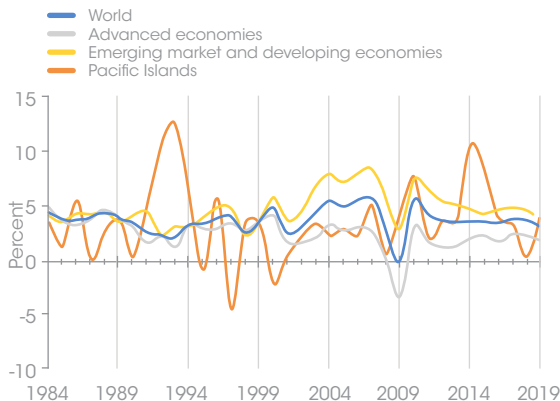
Given the strong integration of international financial systems, it is important to look at the developments in the business cycle focusing on key macroeconomic variables such as Real GDP growth, inflation and unemployment rates of major economies which could potentially have a direct or indirect effect on the Fijian economy.

The global economic performance has remained subdued since the second half of 2018, attributed to the slowed investment and lower consumer demand across advanced and emerging economies (Figure 30) with the private sector holding back on long term investment. Risks to the projections remain largely due to escalating trade and technology tensions as well as global commodity prices (including crude oil prices).

Subsequently, after years of low interest rates and high global asset prices, financial vulnerabilities could rise as increasing pressure related to inflation (Figure 31) could amplify debt servicing difficulties, thereby limiting the

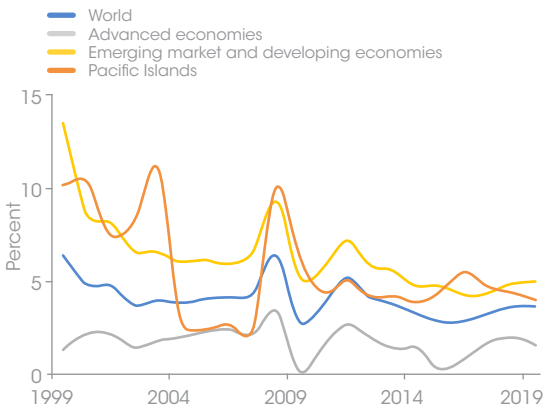


Figure 30: Global Economic Growth



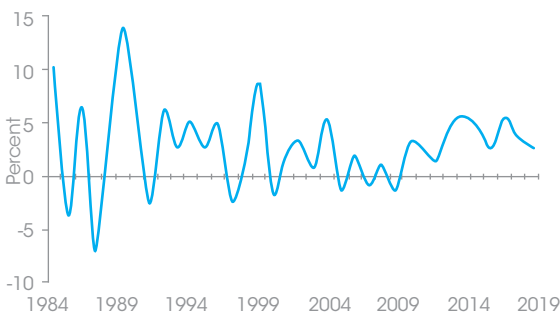
Source: IMF, WEO - October 2019

Figure 31: Global Inflation



Source: IMF, WEO - October 2019

Figure 32: Domestic Economic Growth



Source: IMF, WEO - October 2019

ability of monetary policy to counteract the effects of an economic slowdown.

The Pacific Islands⁵ business cycle over the years has witnessed a lot of fluctuations largely due to external factors such as adverse weather conditions and political instabilities. Certain optimism is anticipated as economic performance of the region is expected to gradually pick up in the second half of 2019.

Similarly, the Fijian economy has gone through a lot of fluctuations historically, however in the last decade some stability has been noted in Fiji's economic performance, as the economy is poised to achieve its 10th consecutive year of economic growth this year (Figure 32). It is also noted that the momentum of growth is slowly moderating similar to the moderation seen in the global economic growth trend.

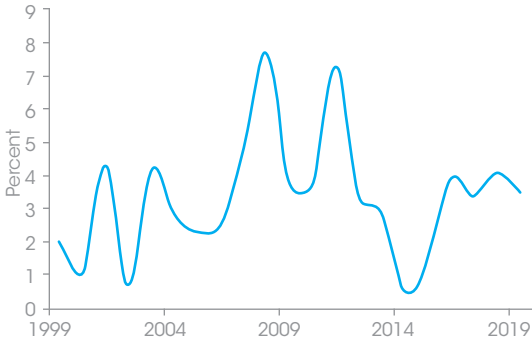
Domestic sectors such as sugar, gold and timber noted a decline in production due to a combination of technical and weather related issues, however, visitor arrivals and electricity production have been positive. Additionally, partial indicators for domestic consumption and investment reflect a slowdown, particularly, the annual contractions noted in new lending for consumption and investment purposes in the year to date.

While Fiji's current economic growth momentum is slower than the last peak of 2017, the pace is expected to pick up going into 2020. This is on the backdrop of anticipated increased private sector confidence and the expected rebound global economic outcomes.

⁵ Pacific Island countries include Fiji, Kiribati, Marshall Islands, Micronesia, Fed. States of, Nauru, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu. These countries are also part of emerging market and developing economies.

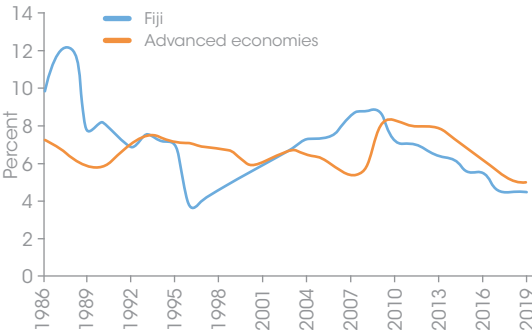


Figure 33: Domestic Inflation



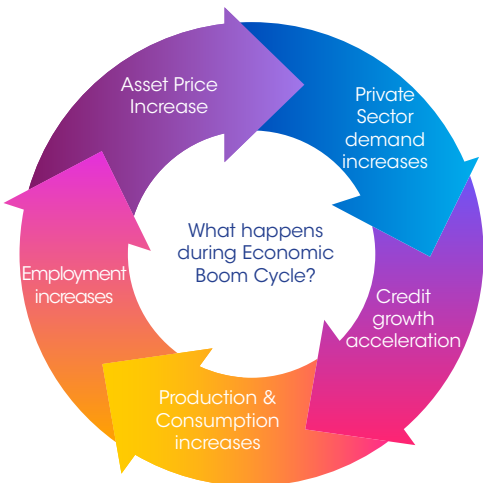
Source: IMF, WEO - October 2019

Figure 34: Unemployment Rate



Source: IMF, WEO - October 2019

Figure 35: Economic Boom Cycle



Though the global risk related to debt servicing issues remain elevated due to high asset prices, financial stress among households in the Fijian banking sector revealed that households remain well placed to service their debt obligations albeit the gradual increasing interest rate in the banking sector (Refer section on stress test analysis) and inflationary pressures (Figure 33).

Moreover, the unemployment rate trajectory for advanced economies and for Fiji is improving (Figure 34).

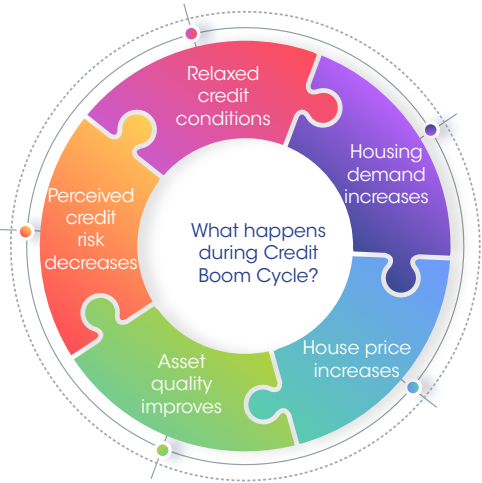
Though the global risks may not be directly influencing the Fijian economy, monitoring of global commodity price changes and global financial conditions is essential.

Fijian Financial Cycle and Economic Cycle

Figures 35 and 36 provide a snapshot of what happens during an economic and financial boom. For central bankers, the difficult task of maintaining price stability as well as ensuring financial stability during and post these cycles is critical.

During boom periods, risks become difficult

Figure 36: Financial Boom Cycle





to identify as all indicators are likely to be on the positive side, however, these are periods which breed the ultimate dangers of financial vulnerabilities. Moreover, it also becomes difficult to tame a booming financial cycle which is ultimately resulting in high economic activity for an economy.

Excessive growth in housing prices and over indebtedness of the real sector is the significant challenge which regulators have to continuously monitor and control. The challenge of controlling such risks amplifies when the booming period ends and the economy slows down.

Similar to the business cycle, the Fijian financial cycle as measured by the aggregate credit growth in the Fijian financial system has been on a downward trajectory since the peak of 2014, however, the growth momentum is steadily picking up (refer Figure 12; Pg. 26) which may provide an impetus for economic growth.

In times of extreme slowdown of an economy, the quality of assets usually deteriorates to a level which often becomes uncontrollable for institutions resulting in systemic concerns.

For Fiji, while the slowdown of the economy has seen a gradual increase in non-performing loans, it is not substantial to cause any systemic concerns as it remains well below the historical high levels (see Box C: for detailed analysis on NPLs).

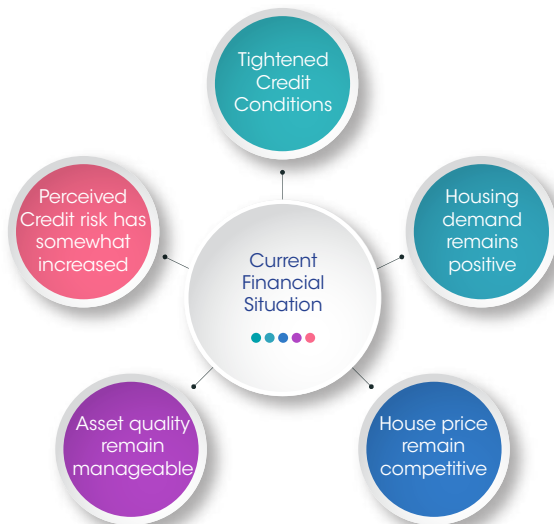
Additionally, the risk relating to the over indebtedness of the private sector, particularly for the household sector has somewhat reduced as the household credit gap decreased in the second half of 2019 mainly due to the decrease in credit growth of households (refer Figure 2). However,

developments will be closely monitored for the private sector as a whole.

Due to data and legislative constraints, the RBF is unable to gauge the real-time changes in housing prices in Fiji. However, through prudential policies and ongoing consultations with the banking industry, the RBF ensures banks are well capitalized to withstand sudden shocks to their loan portfolios due to any negative movements in the housing market.

In a nutshell as depicted in Figure 37 below, the current financial situation does not indicate any major concerns stemming from the economic moderation to the stability of the overall financial system.

Figure 37: Current Financial Situation





Conclusion and Way Forward

The current economic moderation in Fiji is largely due to the reduced production in some of the key sectors of the economy. While external demand for tourism remains resilient, changes in global commodity and financial conditions need to be monitored.

In terms of systemic risks emanating from within the financial cycle, the assessment notes that risks related to the gradual increase in NPLs is not significant to cause any systemic concerns, however, closer monitoring of developments in the credit cycle with the assessment of indebtedness levels of the private sector is intrinsic to ensure stability within the financial system.



Annexures

Annex 1: Fiji Financial Soundness Indicators

	2015	2016	2017	2018	2019 Q2
Core FSIs for Deposit takers	%	%	%	%	%
Regulatory capital to risk-weighted assets	15.56	16.43	15.26	16.94	18.17
Regulatory Tier 1 capital to risk-weighted assets	13.17	13.80	12.85	13.81	14.71
Non-performing loans net of provisions to capital	2.59	7.01	8.03	12.11	12.27
Non-performing loans to total gross loans	1.45	2.24	2.42	3.09	3.49
Sectoral distribution of loans					
Residents	99.17	99.38	99.44	99.51	99.42
Sectoral distribution of total loans: Deposit-takers	-	0.15	0.14	0.40	0.06
Sectoral distribution of total loans: Central bank	-	-	-	-	-
Sectoral distribution of total loans: Other financial corporations	0.11	0.04	0.08	0.07	0.07
Sectoral distribution of total loans: General government	8.04	5.83	5.22	4.34	4.17
Sectoral distribution of total loans: Non-financial corporations	63.00	64.63	65.36	65.17	66.22
Sectoral distribution of total loans: Other domestic sectors	28.02	28.73	28.65	29.52	28.90
Non-residents	0.83	0.62	0.56	0.49	0.58
Return on assets	2.62	2.54	2.53	2.78	1.57
Return on equity	24.35	23.47	23.02	24.12	12.31
Interest margin to gross income	55.14	58.74	56.41	57.95	58.62
Non-interest expenses to gross income	52.73	50.16	49.34	48.82	46.79
Liquid assets to total assets	20.13	16.82	18.90	15.10	14.86
Liquid assets to short-term liabilities	82.22	60.67	66.37	61.61	62.29
Encouraged FSIs	%	%	%	%	%
Deposit takers					
Capital to assets	8.52	9.17	8.86	9.94	10.68
Large exposures to capital	205.23	177.55	186.28	163.22	162.44
Trading income to total income	12.53	11.37	10.82	11.06	11.24
Personnel expenses to non-interest expenses	44.99	44.47	44.29	46.45	48.06
Customer deposits to total (non-interbank) loans	90.26	90.67	92.42	89.19	87.11
Foreign-currency-denominated loans to total loans	2.67	2.75	1.92	1.37	2.59
Foreign-currency-denominated liabilities to total liabilities	9.92	8.02	9.61	6.17	7.64
Residential real estate loans to total gross loans	18.71	18.91	19.73	20.90	20.85
Commercial real estate loans to total gross loans	10.45	11.41	12.26	13.72	14.03

Annex 2: Composition of the Financial System

September 2019	Millions of Fiji Dollars	Percent in Subsector	Percent in Sector
Financial Corporations	24,963		100.00
Reserve Bank of Fiji	2,717		10.88
Other Depository Corporations	12,294	100.00	49.25
Commercial Banks	10,513	85.52	42.11
Credit Institutions	755	6.14	3.02
Fiji Development Bank	649	5.28	2.60
Housing Authority	197	1.60	0.79
Credit Unions ¹	173	1.41	0.69
Microfinance Institutions ²	7	0.06	0.03
Other Financial Corporations	9,953	100.00	39.87
Insurance Companies	1,745	17.53	6.99
Fiji National Provident Fund	7,695	77.32	30.83
Asset Management Bank ³	1.5	0.02	0.01
Unit Trusts	387	3.89	1.55
Finance Companies ⁴	32	0.32	0.13
Private Money Lenders	Not Available	Not Available	Not Available
Pawn Shops	Not Available	Not Available	Not Available
Insurance Brokers ⁵	61	0.61	0.24
Restricted Foreign Exchange Dealers ⁶	28	0.28	0.11
Money Changers ⁷	0.2	0.00	0.00
South Pacific Stock Exchange ⁸	2.7	0.03	0.01

Notes:

¹ As at December 2016. 21 out of 24

² As at March 2011. 5 out of 24

³ As at June 2018

⁴ As at December 2010. 4 out of 8

⁵ As at December 2018

⁶ As at September 2018

⁷ As at June 2017

⁸ As at December 2018

Annex 3: Credit Conditions Survey Results

		Net Percentage Balance									
		2015		2016		2017		2018		2019	
		Apr	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	
1.	Over the past six months, how have your institution's credit standards as applied to the approval of loans or credit lines to enterprises changed?										
a.	Loans to micro sized enterprises	0%	0%	6%	15%	19%	22%	23%	22%	44%	
b.	Loans to small & medium sized enterprises	-16%	-10%	5%	9%	25%	14%	30%	22%	53%	
c.	Loans to large enterprises	-5%	0%	8%	9%	28%	11%	25%	16%	65%	
d.	Short term loans	-18%	-3%	5%	12%	14%	11%	28%	16%	48%	
e.	Long term loans	-8%	13%	8%	13%	19%	14%	19%	23%	55%	
2.	Over the past six months, how have the following factors affected your institution's credit standards as applied to the approval of loans or credit lines to Small & Medium sized enterprises?										
A.	Cost of funds & balance sheet constraints	10%	11%	17%	19%	20%	18%	14%	34%	56%	
i.	Costs relating to your institution's capital position	11%	16%	22%	29%	22%	29%	16%	29%	58%	
ii.	Your institution's ability to access financing	11%	0%	17%	18%	11%	17%	16%	39%	55%	
iii.	Your institution's liquidity position	8%	16%	11%	9%	28%	9%	10%	35%	56%	
B.	Pressure from competition	4%	14%	17%	17%	21%	29%	11%	35%	36%	
i.	Competition from other banks	11%	19%	19%	26%	22%	31%	10%	35%	30%	
ii.	Competition from other non-banks	-3%	3%	6%	9%	19%	23%	10%	29%	39%	
iii.	Competition for financing	5%	19%	25%	17%	22%	31%	13%	42%	39%	
C.	Perceptions of risk	-3%	18%	0%	5%	11%	25%	23%	36%	49%	
i.	Expectations regarding general economic activity	-5%	13%	0%	3%	9%	26%	19%	34%	55%	
ii.	Industry or firm-specific outlook	-4%	23%	-6%	-3%	3%	26%	19%	41%	55%	
iii.	Risk on collateral demanded	0%	17%	6%	15%	21%	24%	30%	34%	38%	
3.	Over the past six months, how have the following factors affected your institution's credit standards as applied to the approval of loans or credit lines to large enterprises?										
A.	Cost of funds & balance sheet constraints	14%	25%	13%	32%	28%	24%	17%	45%	69%	
i.	Costs relating to your institution's capital position	18%	19%	19%	36%	31%	21%	19%	41%	70%	
ii.	Your institution's ability to access financing	16%	32%	22%	35%	28%	34%	25%	50%	73%	
iii.	Your institution's liquidity position	8%	23%	-3%	24%	26%	17%	6%	44%	64%	
B.	Pressure from competition	7%	10%	15%	18%	19%	25%	7%	20%	42%	
i.	Competition from other banks	8%	16%	22%	32%	25%	34%	6%	28%	39%	
ii.	Competition from other non-banks	5%	3%	8%	9%	17%	23%	9%	16%	42%	



		Net Percentage Balance									
		2015		2016		2017		2018		2019	
		Apr	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	
iii.	Competition for financing	8%	12%	13%	13%	14%	18%	6%	16%	44%	
C.	Perceptions of risk	0%	15%	13%	16%	14%	17%	20%	17%	53%	
i.	Expectations regarding general economic activity	-8%	19%	17%	12%	8%	17%	19%	19%	55%	
ii.	Industry or firm-specific outlook	-5%	16%	6%	15%	8%	17%	19%	16%	55%	
iii.	Risk on collateral demanded	13%	10%	17%	21%	25%	17%	22%	16%	48%	
4.	Over the past six months, how have your institution's conditions and terms for approving loans or credit lines to small and medium enterprises changed?										
A.	Price	24%	23%	15%	25%	34%	35%	20%	39%	53%	
i.	Your institution's margin on average loans	13%	13%	3%	15%	29%	26%	16%	30%	48%	
ii.	Your institution's margin on riskier loans	34%	34%	28%	35%	39%	44%	25%	48%	58%	
B.	Other conditions & terms	6%	6%	4%	11%	17%	16%	9%	23%	39%	
i.	Non-interest rate charges	5%	13%	3%	3%	3%	3%	3%	15%	24%	
ii.	Size of the loan or credit line	3%	6%	0%	9%	16%	9%	6%	27%	45%	
iii.	Collateral requirements	7%	3%	6%	18%	26%	26%	13%	18%	42%	
iv.	Loan covenants	5%	7%	8%	12%	31%	21%	13%	29%	42%	
v.	Maturity	11%	3%	3%	12%	7%	20%	9%	26%	42%	
5.	Over the past six months, how have your institution's conditions and terms for approving loans or credit lines to large enterprises changed?										
A.	Price	21%	26%	17%	26%	44%	33%	23%	35%	64%	
i.	Your institution's margin on average loans	26%	17%	11%	26%	41%	29%	13%	35%	64%	
ii.	Your institution's margin on riskier loans	16%	34%	22%	25%	48%	37%	34%	35%	64%	
B.	Other conditions & terms	7%	7%	5%	8%	20%	17%	13%	23%	41%	
i.	Non-interest rate charges	0%	14%	3%	0%	10%	9%	6%	13%	31%	
ii.	Size of the loan or credit line	8%	3%	6%	6%	23%	24%	13%	26%	48%	
iii.	Collateral requirements	11%	7%	6%	0%	26%	19%	19%	23%	36%	
iv.	Loan covenants	11%	7%	11%	21%	27%	18%	13%	26%	45%	
v.	Maturity	8%	3%	0%	12%	16%	15%	13%	29%	45%	
6.	Please indicate how you expect your institution's credit standards as applied to the approval of loans or credit lines to enterprises to change over the next six months.										
a.	Loans to micro sized enterprises	-22%	-17%	-6%	12%	8%	3%	3%	19%	29%	
b.	Loans to small & medium sized enterprises	-26%	-20%	-16%	12%	3%	-6%	9%	13%	32%	
c.	Loans to large enterprises	-5%	10%	3%	21%	14%	9%	9%	32%	47%	
d.	Short term loans	-28%	0%	5%	21%	16%	9%	9%	19%	40%	



		Net Percentage Balance								
		2015		2016		2017		2018		2019
		Apr	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun
e.	Long term loans	-14%	20%	5%	15%	19%	6%	9%	28%	43%
7.	Over the past six months, how have your institution's credit standards as applied to the approval of loans to households changed?									
a.	Loans for house purchase	-33%	-37%	-9%	-16%	-16%	-6%	13%	-10%	40%
b.	Loans for vehicle purchase	-43%	-47%	-8%	-6%	3%	0%	24%	0%	54%
c.	Consumer credit & other lending	-38%	-28%	25%	34%	21%	11%	33%	10%	50%
8.	Over the past six months, how have the following factors affected your institution's credit standards as applied to the approval of loans to households for house purchase?									
A.	Cost of funds & balance sheet constraints	0%	4%	9%	13%	17%	23%	27%	30%	57%
B.	Pressure from competition	1%	7%	26%	29%	12%	38%	5%	25%	37%
i.	Competition from other banks	-3%	11%	27%	0%	16%	44%	7%	31%	37%
ii.	Competition from other non-banks	6%	4%	24%	16%	8%	31%	3%	19%	37%
C.	Perceptions of risk	-16%	-6%	3%	7%	8%	15%	12%	22%	55%
i.	Expectations regarding general economic activity	-9%	4%	6%	13%	16%	19%	13%	30%	60%
ii.	Housing market prospects	-23%	-15%	0%	-3%	0%	10%	10%	15%	50%
9.	Over the past six months, how have your institution's conditions and terms for approving loans to households for house purchase changed?									
A.	Price	14%	2%	10%	13%	25%	22%	21%	25%	50%
i.	Your institution's margin on average loans	6%	0%	6%	3%	17%	22%	17%	25%	40%
ii.	Your institution's margin on riskier loans	23%	4%	15%	23%	33%	22%	24%	25%	60%
B.	Other conditions & terms	-23%	-6%	-1%	2%	3%	11%	5%	23%	29%
i.	Collateral requirements	-20%	4%	9%	6%	8%	22%	7%	21%	30%
ii.	Loan to value ratio	-23%	0%	3%	10%	8%	19%	10%	21%	30%
iii.	Maturity	-26%	-15%	-3%	3%	3%	7%	7%	32%	37%
iv.	Non-interest rate charges	-23%	-11%	-15%	-10%	-5%	-3%	-3%	18%	20%
10.	Over the past six months, how have the following factors affected your institution's credit standards as applied to the approval of consumer credit, vehicle loans to households and other lending to households?									
A.	Cost of funds & balance sheet constraints	3%	-6%	8%	11%	13%	12%	13%	26%	57%
B.	Pressure from competition	-5%	-13%	29%	33%	15%	35%	22%	29%	43%
i.	Competition from other banks	-8%	-13%	27%	29%	15%	37%	22%	29%	40%
ii.	Competition from other non-banks	-3%	-14%	31%	29%	15%	32%	22%	28%	44%
C.	Perceptions of risk	-11%	-6%	19%	25%	18%	17%	11%	24%	43%
i.	Expectations regarding general economic activity	-24%	-10%	-6%	0%	5%	9%	-3%	10%	43%
ii.	Creditworthiness of customers	-3%	0%	39%	38%	28%	29%	16%	29%	49%



		Net Percentage Balance								
		2015		2016		2017		2018		2019
		Apr	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun
iii.	Risk on collateral demanded	-3%	-7%	24%	35%	23%	11%	22%	33%	37%
11.	Over the past six months, how have your institution's conditions and terms for approving consumer credit, vehicle loans to households and other lending to households changed?									
A.	Price	20%	3%	8%	11%	21%	21%	18%	30%	52%
i.	Your institution's margin on average loans	16%	-7%	5%	0%	13%	17%	9%	25%	51%
ii.	Your institution's margin on riskier loans	24%	13%	11%	23%	30%	26%	27%	34%	53%
B.	Other conditions & terms	-2%	-8%	1%	4%	7%	4%	6%	21%	30%
i.	Collateral requirements	-3%	-3%	5%	11%	15%	11%	6%	22%	34%
ii.	Maturity	-3%	-7%	5%	6%	5%	3%	15%	28%	31%
iii.	Non-interest rate charges	0%	-13%	-8%	-6%	0%	-3%	-3%	13%	26%
12.	How has the availability of household secured credit (defined as willingness and ability to supply credit) provided to the following types of borrower changed over the past six months?									
	Past six months	n/a	n/a	n/a	n/a	n/a	6%	3%	3%	-7%
a.	Borrowers with low Loan to value ratio (75% or less)	n/a	n/a	n/a	n/a	n/a	16%	3%	-6%	-3%
b.	Borrowers with high Loan to value ratio (more than 75%)	n/a	n/a	n/a	n/a	n/a	-3%	3%	13%	-12%
	Next six months	n/a	n/a	n/a	n/a	n/a	17%	9%	3%	-14%
a.	Borrowers with low Loan to value ratio (75% or less)	n/a	n/a	n/a	n/a	n/a	31%	9%	3%	-6%
b.	Borrowers with high Loan to value ratio (more than 75%)	n/a	n/a	n/a	n/a	n/a	3%	9%	3%	-21%
13.	Please indicate how you expect your institution's credit standards as applied to the approval of loans to households to change over the next six months.									
a.	Loans for house purchase	-26%	-17%	-9%	-13%	-18%	-3%	-10%	10%	26%
b.	Loans for vehicle purchase	0%	-16%	8%	12%	-5%	-6%	6%	18%	37%
c.	Consumer credit & other lending	0%	-13%	16%	30%	5%	-6%	12%	16%	34%
14.	Over the next 6 months, how do you expect lending rates for the following to change?									
a.	Loans to small and medium sized enterprises	0%	35%	16%	31%	3%	11%	15%	18%	35%
b.	Loans to large enterprises	3%	30%	8%	26%	13%	13%	19%	6%	48%
c.	Loans for house purchase to households	-9%	17%	3%	13%	-5%	23%	24%	7%	37%
d.	Loans for vehicle purchase to households	11%	32%	24%	40%	8%	3%	15%	13%	30%
e.	Consumer credit & other lending to households	19%	0%	30%	30%	13%	14%	21%	13%	47%
15.	Over the past six months, how has the demand for loans or credit lines to enterprises changed at your institution, apart from normal seasonal fluctuations?									
a.	Loans to micro sized enterprises	11%	16%	11%	26%	8%	6%	3%	18%	3%
b.	Loans to small & medium sized enterprises	68%	48%	33%	29%	35%	22%	16%	24%	9%



		Net Percentage Balance									
		2015		2016		2017		2018		2019	
		Apr	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	
c.	Loans to large enterprises	55%	38%	17%	32%	19%	11%	22%	18%	6%	
d.	Short term loans	53%	30%	17%	27%	21%	14%	19%	15%	18%	
e.	Long term loans	61%	0%	36%	38%	39%	19%	28%	22%	9%	
16.	Over the past six months, how have the following factors affected the demand for loans or credit lines to enterprises?										
A.	Financing needs	28%	15%	26%	17%	17%	28%	35%	24%	20%	
i.	Fixed investment	41%	12%	33%	29%	25%	24%	33%	27%	6%	
ii.	Inventories & working capital	50%	27%	36%	32%	25%	46%	48%	30%	38%	
iii.	Mergers/acquisitions & corporate restructuring	-6%	3%	9%	-3%	3%	17%	22%	16%	6%	
iv.	Debt restructuring	27%	16%	24%	7%	17%	26%	38%	22%	31%	
B.	Use of alternative finance	7%	-10%	2%	1%	3%	7%	5%	16%	17%	
i.	Internal financing	3%	-12%	3%	3%	11%	9%	6%	6%	9%	
ii.	Loans from other banks	16%	-3%	9%	3%	8%	11%	15%	22%	25%	
iii.	Loans from other non-banks	8%	-9%	3%	3%	6%	9%	15%	25%	25%	
iv.	Issuance of equity	0%	-12%	-6%	-6%	-11%	0%	-15%	13%	9%	
17.	Over the past six months, how has the number of rejected enterprise loan applications changed?										
a.	Loans to micro sized enterprises	n/a	n/a	n/a	n/a	n/a	-13%	17%	6%	16%	
b.	Loans to small & medium sized enterprises	n/a	n/a	n/a	n/a	n/a	0%	23%	19%	16%	
c.	Loans to large enterprises	n/a	n/a	n/a	n/a	n/a	-3%	0%	10%	23%	
d.	Short term loans	n/a	n/a	n/a	n/a	n/a	-3%	7%	3%	15%	
e.	Long term loans	n/a	n/a	n/a	n/a	n/a	3%	21%	7%	20%	
18.	Please indicate how you expect demand for loans or credit lines to enterprises to change at your institution over the next six months (apart from normal seasonal fluctuations).										
f.	Loans to micro sized enterprises	51%	48%	43%	29%	22%	23%	22%	19%	13%	
g.	Loans to small & medium sized enterprises	74%	61%	47%	35%	25%	34%	28%	34%	16%	
h.	Loans to large enterprises	65%	47%	39%	26%	17%	23%	44%	25%	6%	
i.	Short term loans	63%	36%	33%	15%	5%	17%	31%	31%	6%	
j.	Long term loans	61%	38%	31%	24%	27%	31%	25%	30%	6%	
19.	Over the past six months, how has the demand for loans to households changed at your institution, apart from normal seasonal fluctuations?										
a.	Loans for house purchase	51%	55%	47%	47%	46%	53%	31%	38%	6%	
b.	Loans for vehicle purchase	63%	52%	63%	63%	46%	38%	9%	34%	-11%	
c.	Consumer credit & other lending	67%	38%	40%	36%	13%	37%	15%	44%	-6%	
20.	Over the past six months, how have the following factors affected the demand for loans to households for house purchase?										



		Net Percentage Balance								
		2015		2016		2017		2018		2019
		Apr	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun
A.	Financing needs	42%	52%	48%	41%	32%	36%	28%	36%	7%
i.	Housing market prospects	40%	66%	53%	48%	37%	47%	45%	39%	6%
ii.	Consumer confidence	51%	55%	59%	45%	40%	45%	28%	39%	13%
iii.	Non-housing related consumption expenditure	34%	36%	32%	29%	20%	18%	12%	29%	0%
B.	Use of alternative finance	17%	22%	21%	20%	12%	15%	30%	13%	15%
i.	Household savings	-3%	3%	-3%	10%	3%	-3%	16%	3%	6%
ii.	Loans from other banks	19%	41%	39%	29%	22%	28%	44%	24%	23%
iii.	Other sources of finance	34%	21%	26%	23%	11%	19%	31%	10%	16%
21.	Over the past six months, how have the following factors affected the demand for consumer credit, vehicle loans to households and other lending to households?									
A.	Financing needs	59%	55%	58%	41%	41%	37%	32%	47%	0%
i.	Spending on durable consumer goods	46%	47%	59%	33%	29%	29%	29%	48%	-3%
ii.	Consumer confidence	73%	63%	57%	46%	53%	44%	35%	45%	3%
B.	Use of alternative finance	36%	21%	17%	20%	21%	18%	26%	18%	-8%
i.	Household savings	22%	6%	-6%	-3%	-3%	12%	6%	13%	-17%
ii.	Loans from other banks	46%	38%	36%	34%	44%	29%	41%	27%	-3%
iii.	Other sources of finance	41%	19%	19%	22%	23%	12%	32%	15%	-3%
22.	Over the past six months, how has the number of rejected household loan applications changed?									
a.	Loans for house purchase	n/a	n/a	n/a	n/a	n/a	0%	33%	31%	13%
b.	Loans for vehicle purchase	n/a	n/a	n/a	n/a	n/a	0%	21%	31%	21%
c.	Consumer credit and other lending	n/a	n/a	n/a	n/a	n/a	0%	30%	23%	15%
23.	Please indicate how you expect demand for loans to households to change at your institution over the next six months (apart from normal seasonal fluctuations).									
d.	Loans for house purchase	49%	47%	36%	28%	50%	42%	32%	52%	19%
e.	Loans for vehicle purchase	42%	44%	35%	20%	34%	44%	18%	38%	-3%
f.	Consumer credit and other lending	56%	59%	35%	26%	34%	35%	29%	55%	9%
24.	Over the next 6 months how do you expect non-performing loans to change in your institution's lending portfolio?									
a.	Loans to micro sized enterprises	-8%	-21%	-14%	11%	-3%	-14%	-3%	-15%	9%
b.	Loans to small and medium sized enterprises	-11%	-18%	-20%	3%	0%	-11%	-13%	-12%	3%
c.	Loans to large enterprises	-18%	-28%	-20%	0%	-11%	-20%	-16%	-18%	-6%
d.	Loans for house purchase to households	-14%	-10%	-3%	18%	15%	-15%	-19%	-3%	-10%
e.	Consumer credit, vehicle loans to households & other lending to households	0%	15%	17%	40%	27%	0%	0%	12%	3%

Annex 4: Systemic Risk Indicators

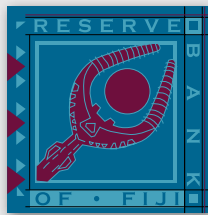
Indicator	Definition and usefulness
System and commercial banks credit growth rate	Annual percentage change in total financial system's and commercial banks' outstanding credit. It is a lead indicator of growing financial imbalances from excessive credit growth.
Debt to GDP, level and trend	Ratio of total system credit to annual nominal GDP. The trend is calculated using Hodrick-Prescott (HP) filter with a lambda of 400,000. Increasing ratios, particularly level above trend, indicates increased vulnerability to financial imbalance from increasing procyclical behaviour.
Credit Gap	Difference between debt to GDP level and its trend. A large positive gap is a globally proven indicator of providing a 3 year ahead signal of financial system stress.
Commercial banks' lending standards and loan to value ratios (LVRs)	Credit growth and associated risks may be amplified by excessively easing credit standards and higher LVRs.
Commercial banks capital adequacy ratio	Ratio of capital to risk weighted assets. Shows level of buffer against potential losses.
Commercial banks stable/core funding ratio	Retail funding, long-term wholesale funding and equity as a share of total loans and advances. Shows vulnerability to liquidity mismatches by determining whether credit is increasingly financed by volatile funds.
Commercial banks non-performing loans level and ratio	Ratio of non-performing loans to total loans and advances. Although a lagged indicator, increasing trend indicates deteriorating ability of borrowers to repay debt.

Source: Reserve Bank of Fiji

Indicators used to measure cross-sectional dimension of systemic risk

Indicator	Definition and usefulness
Interconnectedness of financial institutions	Level of net financial obligation amongst the financial system to study degree of contagion risk arising from financial system interconnectedness
Common exposures within & amongst financial system	Shows degree of contagion risk arising from common financial system exposures
Sectoral non-performing loans	Ratio of non-performing loans in each sector to total loans in that sector. Indicator of concentration of credit risk.
Assessment of SIFI's	Micro-prudential stances on SIFIs

Source: Reserve Bank of Fiji



Reserve Bank of Fiji

The great double-hulled, ocean-going canoes (drua) of the ancient Fijians were remarkable craft capable of long voyages. The tagaga (pronounced "tangaga") or masthead, was crucial for holding in place the sails, woven from the leaves of the pandanus tree. It was the tagaga which enabled the navigators to keep their drua sailing towards their destinations.

For the Reserve Bank of Fiji, a logo based on the tagaga masthead, symbolises the Bank's role in contributing towards a sure and steady course for Fiji's economy.

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