Credit Reporting Agencies and Fiji's Ratings

Introduction

Credit Reporting Agencies (CRA) evaluate the credit risk of prospective debtors and predict their ability to repay the debt (principal plus interest). In other words, CRA assess credit worthiness or the probability of debt being defaulted.

The most common type of securities that are rated by CRA include government bonds, corporate bonds, local government or public enterprise bonds, stocks and other collateralised securities. Globally, the three large CRAs cover almost 95.0 percent of the market. These include Moody's Investors Service (Moody's) and Standard & Poor's (S&P), which together control 80.0 percent of the global market, while Fitch Ratings controls the remaining 15.0 percent.

CRA play a key role in global financial and capital markets by providing supplementary credit analysis for investors when deciding which financial instruments to invest in. The credit evaluation is done using a rating scale, which provides investors the degree of risk involved with a particular debtor and type of debt instrument.

Debtors with a better credit rating can access cheaper and easier credit terms; therefore, credit rating becomes a motivation to either improve their credit rating position or maintain their existing position if the rating is already high.

Fiji Government Bonds

The Fijian Government issues a variety of debt instruments to finance its budget and the main ones include the Fiji Infrastructure Bonds (maturity is over 1 year) and Treasury Bills (maturity is less than a year). In addition, Fiji also issues Viti Bonds which have a fixed interest security and suitable for small or retail investors.

Fiji issued its first foreign currency denominated bond in September 2006 worth US$150 million. This was then refinanced in 2011 and 2015.

In 2017, Fiji became the first emerging market economy and only the third in the world to issue a sovereign Green Bond. This F$100 million Green Bond is a fixed income financial instrument to raise funds dedicated to climate mitigation and adaptation and other environmentally friendly projects.

Fiji Government Credit Ratings

When investors, especially foreigners decide to invest in Fiji Government Bonds, they usually have the following questions in mind:

1. Is it worthwhile to invest in Fiji Government Bonds?
2. What interest rate/coupon rate should I charge?

3. What is the likelihood that Fiji will repay its debt and not default?
4. Are there other countries offering similar bonds where I can get a better return with lower risk?

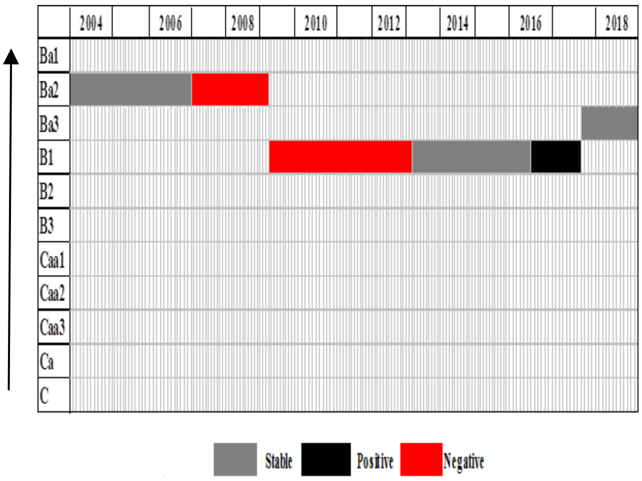
Supplementary to their own research, investors refer to the robust analysis and credit rating provided by the CRA to answer the above questions and help them make informed decisions on potential investment. Moody's and S&P provide an annual evaluation of the Fiji Government's credit rating by assessing the macroeconomic conditions[1] and associated risks.

Fiji's credit rating reflects domestic macroeconomic conditions along with changes in global financial markets especially escalating global risks post the 2008 Global Financial Crisis (GFC) and the 2010 European debt crisis.

Moody's

The latest Moody's rating for the Fiji Government Bond is "Ba3 Stable", based on four rating factors: economic strength, institutional strength, fiscal strength and susceptibility to event risk.

Table 1: Moody's Fiji Government Ratings



Source: IECONOMICS

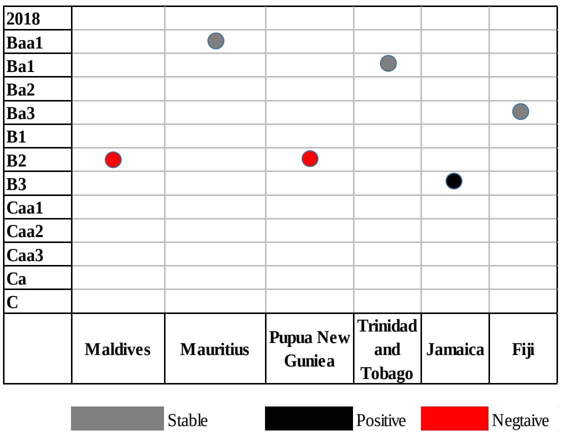
[1] Institutional assessment, economic assessment, external assessment, fiscal assessment (flexibility, performance and debt burden) and monetary assessment.

According to Moody's, the stable credit profile of Fiji is supported by improvements in the country's economic and institutional strength, aided by political stability and ongoing reforms. Going forward, the agency expects Fiji's economic growth to remain robust, underpinned by the country's expanding tourism sector and expects political stability to be maintained.

However, credit challenges for Fiji include a small, open and narrowly diversified economy that is vulnerable to climate change related shocks and low levels of economic competitiveness which affect diversification prospects beyond tourism and agriculture.

Moody's will upgrade the credit rating if economic growth is more robust and leads to improvement in business climate and swift fiscal debt consolidation; and if there is significant economic diversification that enhances resilience to shocks. However, the rating can also be downgraded if there is a large domestic or external shock such as natural disaster, re-emergence of political risks and balance of payments stress.

Table 2: Moody's Peer Country Comparison



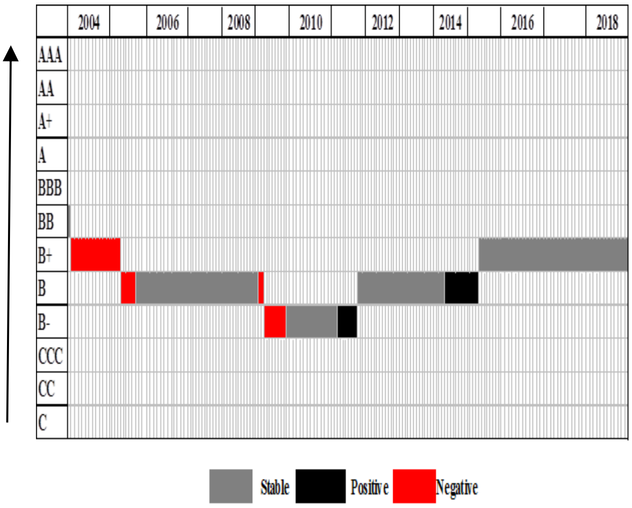
Source: IECONOMICS

In terms of peer countries[2] comparison for Moody's ratings, Fiji rated higher than Maldives, Papua New Guinea (PNG) and Jamaica while it scored a lower rating than Mauritius and Trinidad & Tobago.

Standard & Poor's

S&P's current rating for Fiji Government debt is B+ Stable for long term and B Stable for short term debt.

Table 3: S&P's Fiji Government Ratings



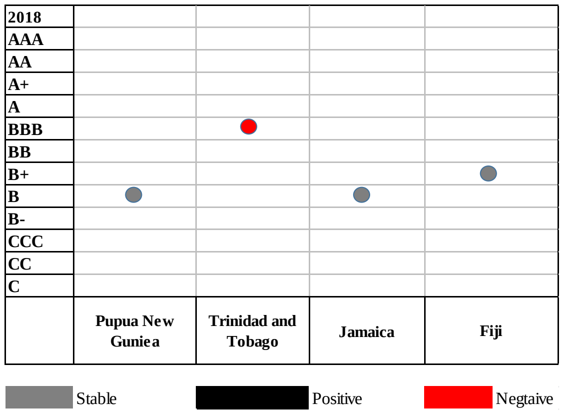
Source: IECONOMICS

Similar to Moody's, S&P expects the Fijian economy to continue to strengthen and help stabilise debt levels. These will be supported by falling interest rate costs, sound external performance and strong medium term growth prospects.

S&P will upgrade the rating if Fiji's institutional settings improve, and foreign exchange restrictions are loosened further whilst maintaining a healthy level of foreign reserves. However, ratings can be downgraded if government's fiscal position weakens and if political and policy environment becomes unpredictable leading to a decline in foreign investor confidence and withdrawal of donor and multilateral support.

When compared to some peer countries S&P rating, Fiji obtained a better rating than PNG and Jamaica but lower than T&T.[3]

Table 4: S&P Peer Country Comparison



Source: IECONOMICS

Conclusion

CRA are important because they assist investors in assessing credit risks of their current and future investments and suggest potential areas of improvement to debtors which would enhance their credit rating and ultimately provide them access to cheaper credit.

However, the ratings given by the CRA are not always accurate. For instance, all the big three rating agencies did not foresee the 2008 GFC. Ironically, the agencies' ratings played a critical role in the marketing of risky mortgage-backed securities, such as collateralized debt obligations, which brought the US financial system to its knees. Therefore, the ratings should not be the only source of information when making an investment decision. These ratings must be used with the investors own analysis, reports by multilateral institutions such as IMF, central banks and government departments and value judgement.

[2] Small developing economies with similar GDP per capita

[3] S&P ratings for Maldives and Mauritius are not available.

For Fiji, CRA play a key role in independently verifying the economic, fiscal and institutional strengths against those reported by the government and central bank and other multilateral agencies such as the International Monetary Fund and the World Bank.

A higher credit rating will help Fiji lower its borrowing costs and reduce her debt servicing burden. It is therefore prudent that Government and the private sector work towards ensuring that economic growth remains robust, resilience is improved and domestic and external risks are contained.

Reserve Bank of Fiji
December 2018

Appendix

Table 1: Moody’s Rating Scale

<table>
<tr><th colspan="3">Moody's credit ratings</th></tr>
<tr><th colspan="3">Investment grade</th></tr>
<tr><th>Rating</th><th>Long-term ratings</th><th>Short-term ratings</th></tr>
<tr><td>Aaa</td><td>Rated as the highest quality and lowest credit risk.</td><td rowspan="5">Prime-1 Best ability to repay short-term debt</td></tr>
<tr><td>Aa1</td><td rowspan="3">Rated as high quality and very low credit risk.</td></tr>
<tr><td>Aa2</td></tr>
<tr><td>Aa3</td></tr>
<tr><td>A1</td><td rowspan="3">Rated as upper-medium grade and low credit risk.</td></tr>
<tr><td>A2</td><td rowspan="2">Prime-1/Prime-2 Best ability or high ability to repay short term debt</td></tr>
<tr><td>A3</td></tr>
<tr><td>Baa1</td><td rowspan="3">Rated as medium grade, with some speculative elements and moderate credit risk.</td><td>Prime-2 High ability to repay short term debt</td></tr>
<tr><td>Baa2</td><td>Prime-2/Prime-3 High ability or acceptable ability to repay short term debt</td></tr>
<tr><td>Baa3</td><td>Prime-3 Acceptable ability to repay short term debt</td></tr>
<tr><th colspan="3">Speculative grade</th></tr>
<tr><th>Rating</th><th>Long-term ratings</th><th>Short-term ratings</th></tr>
<tr><td>Ba1</td><td rowspan="3">Judged to have speculative elements and a significant credit risk.</td><td rowspan="11">Not Prime, Do not fall within any of the prime categories</td></tr>
<tr><td>Ba2</td></tr>
<tr><td>Ba3</td></tr>
<tr><td>B1</td><td rowspan="3">Judged as being speculative and a high credit risk.</td></tr>
<tr><td>B2</td></tr>
<tr><td>B3</td></tr>
<tr><td>Caa1</td><td rowspan="3">Rated as poor quality and very high credit risk.</td></tr>
<tr><td>Caa2</td></tr>
<tr><td>Caa3</td></tr>
<tr><td>Ca</td><td>Judged to be highly speculative and with likelihood of being near or in default, but some possibility of recovering principal and interest.</td></tr>
<tr><td>C</td><td>Rated as the lowest quality, usually in default and low likelihood of recovering principal or interest.</td></tr>
</table>

Source: Moody’s

Table 2: S&P Rating Scale

Standard & Poor's (S&P) Long-Term Issue Credit Ratings*	
Category	**Definition**
AAA	An obligation rated 'AAA' has the highest rating assigned by S&P Global Ratings. The obligor's capacity to meet its financial commitments on the obligation is extremely strong.
AA	An obligation rated 'AA' differs from the highest-rated obligations only to a small degree. The obligor's capacity to meet its financial commitments on the obligation is very strong.
A	An obligation rated 'A' is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories. However, the obligor's capacity to meet its financial commitments on the obligation is still strong.
BBB	An obligation rated 'BBB' exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to weaken the obligor's capacity to meet its financial commitments on the obligation.
BB, B, CCC, CC, and C	Obligations rated 'BB', 'B', 'CCC', 'CC', and 'C' are regarded as having significant speculative characteristics. 'BB' indicates the least degree of speculation and 'C' the highest. While such obligations will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposure to adverse conditions.
BB	An obligation rated 'BB' is less vulnerable to non-payment than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions that could lead to the obligor's inadequate capacity to meet its financial commitments on the obligation.
B	An obligation rated 'B' is more vulnerable to non-payment than obligations rated 'BB', but the obligor currently has the capacity to meet its financial commitments on the obligation. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitments on the obligation.
CCC	An obligation rated 'CCC' is currently vulnerable to non-payment and is dependent upon favourable business, financial, and economic conditions for the obligor to meet its financial commitments on the obligation. In the event of adverse business, financial, or economic conditions, the obligor is not likely to have the capacity to meet its financial commitments on the obligation.
CC	An obligation rated 'CC' is currently highly vulnerable to non-payment. The 'CC' rating is used when a default has not yet occurred but S&P Global Ratings expects default to be a virtual certainty, regardless of the anticipated time to default.
C	An obligation rated 'C' is currently highly vulnerable to non-payment, and the obligation is expected to have lower relative seniority or lower ultimate recovery compared with obligations that are rated higher.
D	An obligation rated 'D' is in default or in breach of an imputed promise. For non-hybrid capital instruments, the 'D' rating category is used when payments on an obligation are not made on the date due, unless S&P Global Ratings believes that such payments will be made within five business days in the absence of a stated grace period or within the earlier of the stated grace period or 30 calendar days. The 'D' rating also will be used upon the filing of a bankruptcy petition or the taking of similar action and where default on an obligation is a virtual certainty, for example due to automatic stay provisions. An obligation's rating is lowered to 'D' if it is subject to a distressed exchange offer.

Source: S&P