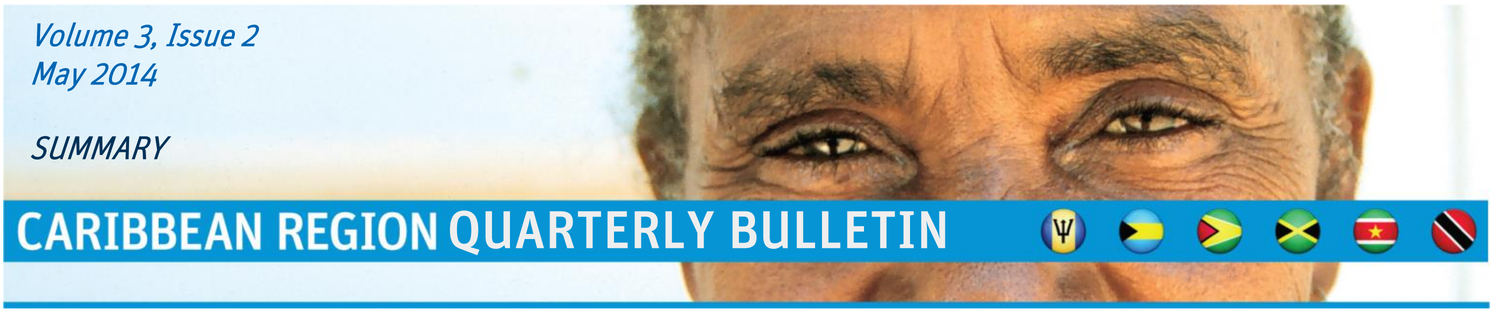


Volume 3, Issue 2
May 2014

SUMMARY

CARIBBEAN REGION QUARTERLY BULLETIN

With the exception of Barbados, all of the Caribbean economies are recovering. External sustainability seems to be strong for Trinidad and Tobago. Jamaica is meeting International Monetary Fund program targets. Guyana's economy remains strong, but debt levels are gradually rising. Suriname's economy is growing, but the current account has now drifted from surplus to deficit.

SELECTED INDICATORS 2013	Real Growth Rate (%)	Annual Inflation (end of period)	General Government Primary Balance	General Government Overall Balance	Current Account Balance	General Government Debt
	(in percent of GDP unless otherwise stated)					
1) High-debt countries						
Jamaica	0.5	9.7	7.7	0.1	-10.4	142.6
Barbados	-0.7	2.2	-4.9	-10.3	-11.4	92.2
2) Medium-debt countries						
The Bahamas	1.9	0.3	-4.2	-6.5	-19.6	55.6
Trinidad & Tobago	1.6	5.6	-0.6	-2.3	10.2	30.3
3) Low-debt or FSO countries						
Suriname	4.7	0.6	-4.5	-6.0	-4.7	29.2
Guyana	4.8	3.5	-2.9	-4.1	-17.9	63.9
Caribbean average	**2.1**	**3.6**	**-1.6**	**-4.9**	**-9.0**	**69.0**

Note: For Guyana, most debt is on concessional terms. FSO = Fund for Special Operations.
Source: World Economic Outlook, April, 2014.

Summary of Recent Developments, by Country

Economic activity in **The Bahamas** remained sluggish through the beginning of 2014. Tourism grew by 3.5 percent, with sea arrivals increasing and air arrivals declining, despite closure of a mid-sized hotel. Private sector credit growth moderated signaling a persistent weakness in the domestic market. The percentage of unemployed individuals persists in the double-digits while inflation abated. Fiscal performance improved with the deficit contracting for the first 6 months. Furthermore, authorities have announced the possibility of adopting fiscal rules.

Barbados' economy contracted in 2013 and is projected to deteriorate further in 2014 by about 0.7 percent. Tourism had a mixed performance with the decline in long-stays outweighing the increase in cruise arrivals. Unemployment remained high while inflation decreased. Fiscal outcome worsened as revenues were below expected levels, which led to higher debt ratios.

Guyana remained on its healthy growth trajectory and registered a remarkable 5.2 percent growth rate in 2013. The 2014 national budget is the largest in Guyanese history and is mostly driven by an expansion in capital projects. The rice, gold, and services sectors served as the primary drivers of growth, while sugar and bauxite underperformed. The AML/CFT bill has not yet been passed and carries serious reputational damage to the financial sector. The current account is expected to remain fully financed through capital flows and earnings.

Jamaica's outlook improved toward the end of 2013, with the economy registering growth of 1.4 percent in Q4. The authorities committed to continue meeting the reform targets under the International Monetary Fund program and completed the third review in March 2014. Also, Fitch upgraded Jamaica's long-term credit rating. Moody's did not upgrade the rating but improved the outlook to positive. The Jamaican dollar's depreciation continued, and reserves approached desirable levels; however, the consistent current account deficit has led to a steady worsening of Jamaica's international investment position.

While **Suriname**'s economy grew around 4.7 percent in 2013, inflation continued to decline. A tight monetary policy supported the external position, but the current account moved into deficit at 4 percent of GDP. However, current and projected levels suggest that the external position should remain sustainable. The third and final volume of the 2012 census was also released.

Growth in **Trinidad and Tobago** is expected to be robust as the energy sector began to recover with the estimates for 2013 at 1.5 percent. Seismic exploration activities reflect promising prospects for the energy sector. Unemployment fell to 3.7 percent in Q1 of 2013, and public spending is expected to increase before the 2014 election. Standard sustainability indicators suggest a sound external position.

After experiencing a moderate expansion, the **Eastern Caribbean Countries** contracted in the first 9 months of 2013 year-on-year. As a result, prices fell and contributed to a narrowing of the merchandise trade deficit. Credit to the private sector expanded by 3.1 percent, while the tourism sector remained largely flat. Externally, the overall balance of payments narrowed and net international reserves increased.

Special Country Reports: External Sustainability

In the special country reports, we consider external sustainability in various ways that are consistent with the economic makeup of each country.

Regional Report: Kundalini Falling: Intertwined Fiscal and External Sustainability

Although the global economy slowly improves and recovery is imminent, some significant risks still loom. Specifically, the risk of unexpected rises in interest rates in the United States and the decline of growth in China are directly relevant to the Caribbean region. The Regional Report explores these risks and assesses whether economies in the Caribbean region are prepared to weather such exogenous shocks.

For questions or comments, please e-mail: cet@iadb.org

Recent Developments

Economic activity in the Bahamian economy remained sluggish in the beginning of 2014. Advances in overall tourism performance were offset by lower air arrivals and reduced room inventory. External borrowing activities in December 2013 boosted external reserves and heightened bank liquidity. Reserves stood at B$912.1 million at end-January 2014.

Tourism activity presented a mixed picture, despite growth of 3.5 percent. In 2013, total arrivals rose by 3.5 percent, to 5.9 million visitors. Data highlighted an increase in the sea arrivals segment of total arrivals amid continued softness in the higher priced air arrivals segment. Sea arrivals grew 6.3 percent versus a 5.7 percent contraction in the air component. Hotel performance exhibited a decline in room stock for the most part as a result of the temporary closure of a mid-sized hotel, and this was reflected in lower room earnings by 1.3 percent, year-on-year. Notwithstanding this, average hotel occupancy rose by 1.4 percent to more than 59 percent, while the average daily room rate also increased marginally to B$241.73.

Double-digit unemployment figures persist across the country, with rates as high as 17 percent in some family islands. For the 6 months to November 2013, the unemployment rate fell by 0.8 of a percentage point to 15.4 percent, which includes 2,600 people from the discouraged workers category. Unemployment rates for New Providence stands at 15.6 percent, while the rate for Grand Bahama fell to almost 17 percent. By gender, unemployment data revealed an almost equal distribution in the labour force and the employed labour force, with female workers just slightly higher than their male counterparts in both groups. Youth unemployment rose to 32.3 percent versus just over 30 percent in the May survey. Participation rates remain in the 70 percent range at 73.7 percent for the period under review.

The current account deficit for the third quarter of 2013—latest information available—advanced to $533.1 million, projected at 19.6 percent of GDP. The widened deficit was owed to a contraction in the surplus on the services account and an increase in the deficit on the income account. Both events offset the reduction in the deficit on the merchandise account. The surplus on the capital and financial account contracted mainly because of a decline in investment inflows.

Consumer price inflation abated for the 12 months to November to 0.4 percent from 2.2 percent. The decline was due to the tapering in the most heavily weighted component of the basket— the housing; water; and gas, electricity, and other fuels component. Slight reductions in costs were noted for the transportation component, while prices increased for most other categories including food and nonalcoholic beverages (by 2.5 percentage points to 0.6 percent); furnishing, household equipment, and maintenance (to 0.7 percent); health (to 1.1 percent); and communications (to 2.9 percent from 1.9 percent). Meanwhile, average energy prices in the domestic market declined: The average prices for diesel fell 4.9 percent, and the cost of gasoline advanced by 0.2 percent to B$5.13.

Highlights

Double-digit unemployment figures persist across the country, with rates as high as 17 percent in some family islands.

Private sector credit growth moderated signaling persistent weakness in the domestic market.

The fiscal deficit contracted for the first 6 months of FY 2013/14.

Private sector credit growth moderated, signaling persistent weakness in the domestic market. For the month of January 2014, reductions in the consumer and commercial segments of the loan portfolio of the banking system underpinned the 1.3 percent slowdown in private sector growth, whereas the mortgage component exhibited a slight increase over the last year. During this period, the government also used credit from the commercial banking system to service its debt, as proceeds from the external bond issue were used to repay short-term borrowings from the banking system. Credit quality improved marginally as the market continues to suffer the effects of high unemployment and weak consumer demand. Nonperforming loans climbed by 1 percent with the corresponding loan ration expanding to 15.8 percent. As a result, provisioning levels increased by 46 basis points to 33.2 percent. Official reports also indicate an estimated B$4.9 million in debt write-offs and $2.8 million in loan recoveries.

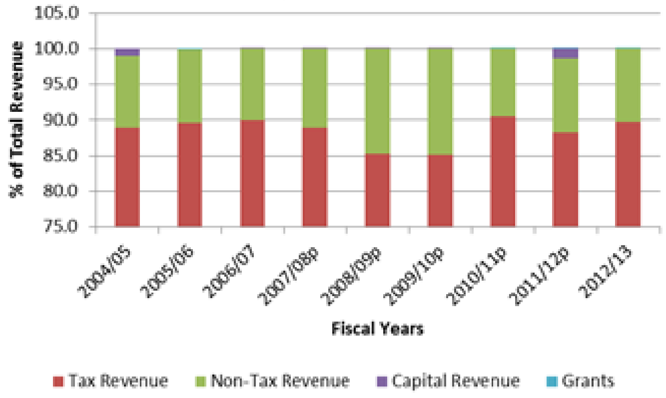
The fiscal deficit contracted for the first 6 months of FY 2013/14.[1] Preliminary data on the fiscal accounts indicated a decline in aggregate expenditure, alongside lower total

[1] This is part of the government's medium-term fiscal consolidation plan, to reach surplus by 2016/16. It targets: (i) a reduction in recurrent outlays by 0.5 percent of GDP each year; (ii) capital expenditures to equal 3 percentage points of GDP each year: and (iii) a 4 percentage points of GDP increase in revenues to FY 2016/17.

revenues. Lower spending was due to a halving in lending to public corporations, while lower tax collections—associated with less international trade and fewer departure taxes—led to a contraction in the deficit. About 77 percent of the US$832 million deficit was financed internally (mostly Bahamian dollar bonds and internal foreign currency loans). In addition, during the period, US$123 million in external borrowing was obtained[2]. Indeed, about 70 percent of the country's debt has been financed from the domestic market over the past 10 years.

Despite the support of the credit ratings agencies for the government's articulated medium term fiscal consolidation plan, they have voiced concern over the lack of substantial implementation of the consolidation process. Slippages in the implementation (delays in implementation, confirmation of the VAT rate, finalization of the tariff rates, etc.) has resulted in warnings of likely downgrades by one-to-two notches in 2014, thereby leading to a loss of the country's investment grade rating. Recent push-backs in the implementation date from July 1, 2014 to later in 2014 or 2015 further worsen the potential for downgrades. At this point, the outlook given by rating agencies remains negative, reflecting *"their expectation that the government will find it difficult to achieve…a sustainable trajectory in the near term" (Moody's, 2014).* Currently, the country's S&P rating is BBB/A2, while Moody's rating is Baa1.

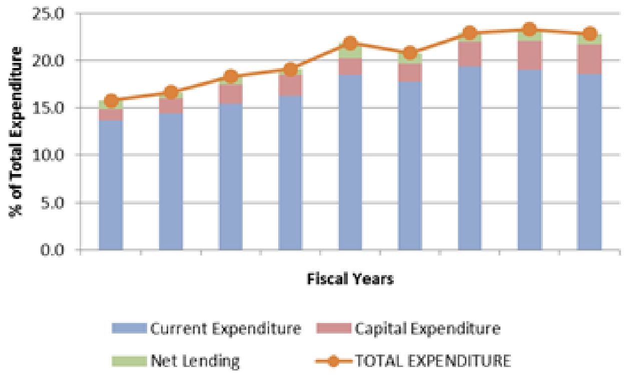
Figure 1. Composition of Total Revenue (FY 2004/05 to FY 2012/13)



Source: Central Bank of The Bahamas.

The concept of fiscal rules has been discussed by the authorities. A recent public debate on the pros and cons of implementing a fiscal rules framework has been escalated. This step, if implemented by the government, could be considered the first toward creating a public debt management legal framework that would rationalize and provide greater structure and transparency to debt management in The Bahamas. Not only would this proposed framework provide greater credibility to the budget process, but it would also improve investor confidence related to future foreign direct investment flows, thereby promoting growth. If this effort gained momentum, future budget processes and policymaking would be backed by a legislative framework and greater accountability. However, authorities have not yet moved towards actual implementation.

Figure 2. Composition of Total Expenditure FY 2004/05 to FY 2012/13)



Source: Central Bank of The Bahamas.

The IDB and The Bahamas

The IDB, along with other development partners, has been working to assist the government with its efforts at fiscal consolidation. In 2012, the IDB funded a technical cooperation called "Conditions for a Sustainable Fiscal Balance in The Bahamas" through the Japan Special Fund. The study will consider an econometric model to measure the impact of the value-added tax on revenue, income distribution, equity, productivity, poverty, and inflation; a fiscal risks analysis; analysis of government expenditure; and public expenditure reviews of the water and electricity sectors. Closer examination of the progress on the implementation of the fiscal rules framework could be useful in providing further support to the government with its fiscal consolidation efforts.

High-Frequency Macroeconomic Indicators	Last data	Period	Prior data	Period
Annual GDP growth (%)	1.8	2012	2.0	2011
Tourism arrivals (annual % change)	3.5	Dec-13	2.3	Sep-13
Exports (12-month growth)	-2.6	Q2 2013	27.3	Q3 2011
Imports (12-month growth)	5.5	Q2 2013	13.9	Q3 2011
Private sector credit growth (%)	-1.3	Jan-14	-1.9	Oct-13
Inflation	2.0	Dec-12	3.3	Nov-12
Exchange rate (end of period)	1.00	Jan-14	1.00	May-13
Unemployment rate (%)	15.4	Nov-13	16.2	May-14

[2] The terms of the bond issue are as follows: fixed rate 4.66 percent interest rate, maturing in 2021 for up to EUR equivalent of $100 million. This compares to the December 2013 $300 million bond, which had a 5.75 percent interest rate with a ten year maturity to 2024.

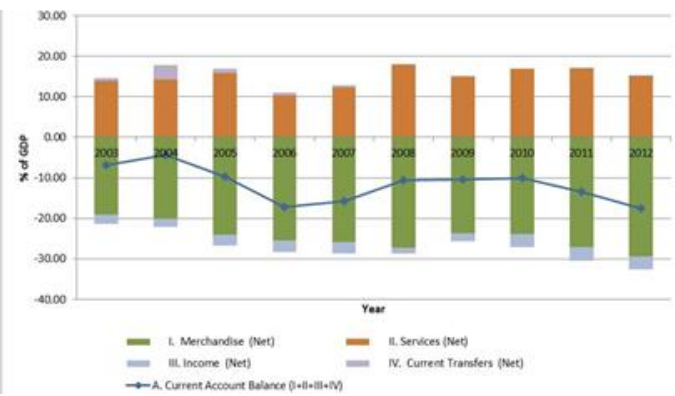
Evolution of the Current Account

The current account deficit in The Bahamas is typically in the double digits, and it further increased in 2013 after consistent expansion over the past 10 years. Changes in the import bill, specifically related to higher oil imports and construction-related imports, and foreign direct investment flows have led to this widened current account deficit. It is estimated at 15 percent of GDP in 2013 (versus 10 percent in the pre-crisis years), with estimates for a moderate reduction to 13 percent in 2014. Integral to this expansion have been the movements in international commodity prices, which would present a risk for the current account, as oil imports account for roughly 21 percent of the goods balance and one third of the current account balance.

Persistent current account deficits may pose a risk to long-term stability. Key to diminishing the risk factors include the reduction of the oil import bill, a more diversified economy that is less reliant on one sector (tourism), reduction of the dependency on imported goods, and higher reserve levels; this could be achieved through a reduction of structural impediments to growth.

One difficulty in understanding the issue is the lack of comprehensive data to fully analyze the impact of the offshore sector in the Bahamian economy. The absence of this information poses a potential risk to external sustainability. Using available data, the following sections look at various aspects of the structure and characteristics of the offshore sector in The Bahamas.

Table 3. The Bahamas Current Account Balance 2003–2012 (% of GDP)



Source: The Central Bank of The Bahamas, the International Monetary Fund.

The Structure of the Offshore Sector

The offshore or international banking sector, a component of the financial services sector[3] in the Bahamian financial economy, focuses on wealth management, trust business, and global financing of operations and fiduciary services. By June 2012, the sector consisted of 249 banks, with total assets equivalent to about 75 percent times GDP (Financial Stability Assessment Report, April 2013), exceeding US$500 billion.

These branches represent branches of subsidiaries of global financial institutions (ibid). To date, more than 100 broker dealers and investment advisory firms provide investment management services, custodial services, corporate services, and registrar and transfer agent services. According to the Bahamas Financial Services Board, more than 50 fund administrators provide fund administration, corporate services, and registrar and transfer agent services, with more than 750 licensed funds in the country.

According to the Central Bank's March 2013 Quarterly Economic Report,[4] the employment base in banks and trust companies grew 0.4 percent to 4,927, reflecting the downturn experienced during the recessionary years. The number of Bahamians and non-Bahamians employed in the sector totaled 4,623 (93.8 percent) and 304 (6.2 percent), respectively. Out of the Bahamians employed in the sector, 69 percent were engaged in local banking activities, while the remaining 31 percent work in trust and offshore banking activities.

To gain a more holistic view of the operations of the offshore sector, the Central Bank has established a center that focuses on Trust & Wealth Management, as a part of the work of the Commercial Banks Unit in the Bank Supervision Department. The Center has the mandate to gain expert knowledge in the areas of trusts and wealth management, specifically in the offshore sector. The Bank Supervision Department has recruited an additional specialist with extensive knowledge of fiduciary risk management, including trust and wealth management experience, to lend assistance with the on-site analysis of businesses. The expert assists the department by providing

[3] For decades, the financial services sector in The Bahamas has been rapidly evolving, currently contributing roughly 10–15 percent to the country's GDP. It also accounts for US$110.4 million in government revenues from financial sector activities versus US$119.1 million in 2008. The asset base of the financial sector is in excess of US$315 billion, employing about 5,000 people in local banking, offshore banking, and trust administration.

[4] This report contains a brief write-up on the "Gross Contribution of the Financial Sector to the Economy," from which these data were extracted.

advice to relationship teams and senior supervision management in the offshore sector.

In November 2011, key amendments were made to improve the regulatory structure for the country's wealth management niche via improvements to the Trustee Act, the Purpose Trust Act, Rule Against Perpetuities Act, and a new Executives Entities Bill of 2011. These were designed to improve the country's competitive position, despite the requirements of international organizations such as the G-20 and the OECD. To date, the legislation has passed through the Senate and is expected to clear the lower House before the end of the year. This new group of legislation brings into line companies such as International Business Companies,[5] by ensuring that records are kept for a minimum of 5 years for the following financial products: segregated accounts companies, investment funds, exempted limited partnerships, foundations, partnerships, and purpose trusts. These amendments would ensure that the country adheres to G-20/OECD requirements.

As a consequence of the challenging global economic environment, the offshore sector has experienced lower rates of return, lower net worth, and lower portfolio values. Moreover, the trend within the offshore sector across the globe has now moved to consolidation of representation of firms throughout the region. As a result, the hub concept or centers of excellence has emerged as a viable option to centralize services and control functions from one jurisdiction for the region.

According to the April 2013 Financial Stability Assessment Report on The Bahamas, there are limited impacts for the offshore sector on the real economy of The Bahamas, because of protective firewalls between onshore and offshore sectors.[6] The interaction between the offshore and domestic banking sectors seems confined to inter-group linkages, with only about 0.5 percent of domestic banking sector assets and liabilities with offshore counterparties. Considering that assets are held by branches of foreign institutions, which are not guided by local solvency regulations, risks in the offshore sector appear to be minimal. However, further studies on the sector would help provide a more comprehensive understanding of any potential risks to this sector and the external sustainability of the country.

[5] An International Business Company is a vehicle for company formation listed under the banner of Other Local Financial Institutions in the Bahamian economy.

[6] The firms that wish to borrow from abroad need to request authorization from the Central Bank, and permission may be granted on the basis of the business proposal's credibility and the possibility to earn the foreign currency required to repay the obligations.

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The Bahamas: Selected Indicators

	2009	2010	2011	2012	2013 (F)
(Annual percentage changes, unless otherwise indicated)					
Real Sector					
Real GDP	-5.4	1.0	2.0	1.8	2.7
Nominal GDP	-5	-1	5	4	3.5
Inflation (end of period) - Central Bank	1.3	1.4	3.2	1.9	2.0
Inflation (end of period) - IFS	1.5	1.5	1.0	n.a.	n.a.
External Sector					
Exports of goods and services	-14.7	-2.6	19.0	9.6	7.2
Imports of goods and services	-18.9	1.1	12.9	7.3	4.6
Current account (percentage of GDP)	-10.5	-10.5	-14.0	-16.0	-13.7
FDI (percentage of GDP)	9.4	12.0	14.9	7.3	8.6
(In percentage of GDP, unless otherwise indicated, on a fiscal year basis)					
Central Government	2009/10	2010/11	2011/12	2012/13	2013/14
Revenue and grants	16.8	18.2	16.2	18.5	18.7
of which: tax revenue	14.3	16.4	16.2	16.7	16.7
Current expenditure	18.0	19.3	19.6	20.1	20
Capital expenditure and net lending	3.2	3.5	4.4	1.5	4.3
Primary balance	-0.9	-1.1	-2.1	-3.6	-2.9
Overall balance	-4.4	-4.7	-5.9	-5.9	-5.9
Debt Indicators					
Central government debt	43.9	43.9	45.7	49.3	53.6
Central government debt over revenues	261.1	247.9	263.0	289.7	290.1
External public debt (end of period)	9.1	11.8	12.9	12.8	14.1
External debt service as percentage of exports of goods and services		11.2	8.1	7.5	5.9

Note: FDI = foreign direct investment; IFS = International Financial Statistics; (F) Forecasts numbers for 2013.

Source: Department of Statistics, Central Bank of The Bahamas and International Monetary Fund World Economic Outlook April 2013.

BARBADOS A FISCAL CAVITY AND ADDITIONAL TIGHTENING MEASURES

Highlights

Barbados' economy is not expected to grow in 2014. However, a gradual improvement in growth is expected if the global economy continues to strengthen.

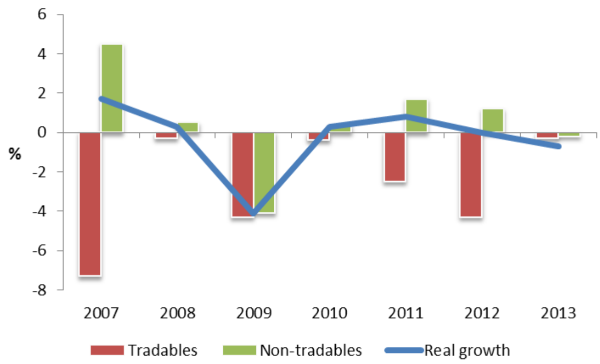
The International Monetary Fund has recommended additional tightening measures to prevent downside risks.

Barbados needs to attract more foreign direct investment and promote exports to achieve a sustainable external balance.

Recent Developments

Barbados' economy contracted in 2013 and is projected to deteriorate further in 2014. The International Monetary Fund's 2013 Article IV reported a decline in domestic output of 0.7 percent in 2013 on account of weak performances in both the traded and nontraded sectors (see Figure 1). Growth in cruise passenger arrivals of 10.2 percent for 2013 fell short of buffering the impact of a 5.2 percent decline in long-stay tourists.[1] Consequently, tourism output, which accounts for almost 60 percent of the traded sector, was estimated by the Central Bank to fall slightly by 1.6 percent in 2013. The International Monetary Fund projects economic growth for 2014 at −1.2 percent, given partially to the government's contractionary fiscal measures and weak international price-competitiveness. A timely start to the investment projects, planned for 2014–2015, would be important in determining the level of economic activity in the medium term. Also, the simplification of the United Kingdom's air passenger duty to two—rather than four—bands from April 1, 2015, should generate some growth benefit for the economy given the reduced travel cost for visitors from its main source market.

Figure 1. Contracting Sectors and Economy



Source: Central Bank of Barbados Press Release (December 2013) and International Monetary Fund's 2013 Article IV.

Weak economic conditions maintained high unemployment rates while inflation continued on a downward path. The unemployment rate has remained persistently in double digits since 2009: the latest available data as of December 2013 was 11.7 percent, up from 7.4 percent before the financial crisis. The unemployment rate is expected to further increase in 2014 given the government's retrenchment measure of laying off more than 3,000 public sector workers. Moreover, the falloff in inflation to 1.8 percent at the end of 2013 compared with 4.5 percent in 2012, 9.4 percent in 2011, and an annual average of 3.5 percent between 1990 and 2010, reflects the decline in international prices of food and fuel.

The fiscal outcome for 2013/14 worsened as revenue receipts were below expected levels. The fiscal deficit for FY2013/14 (ending March) is estimated at 11.3 percent of GDP, an important deterioration compared with 8 percent in the previous year. It compares to the 5.4 percent target presented under the 19-month fiscal adjustment program in the *Growth and Development Strategy 2013–2020*. Government revenue fell by 10 percent year on year while current expenditures increased slightly despite the implementation of some of the fiscal measures in September 2013. The performance of the fiscal position will be critical in determining whether Barbados' credit rating will be downgraded further by the international rating agencies.[2]

Additional Tightening Measures

The Government has announced additional fiscal measures[3] in March 2014 to address the shortfall in its revenue and to remain somewhat in line with the 19-month adjustment program. The measures include the selling off of some assets, in particular the Barbados National Terminal Company Limited for US$35 million, the remittance of the Barbados National Oil Company dividends for 2013 and 2014 to government (US$12 million), the introduction of a 20 cent gasoline tax (US$11.5 million), the extension of the 0.2 percent tax on bank assets to all financial institutions (US$3 million), and the removal of subsidies on diesel. Combined, these measures are anticipated to generate US$72.5 million and allow the government to

[1] Statistics was obtained from the Caribbean Tourism Organisation online statistics.

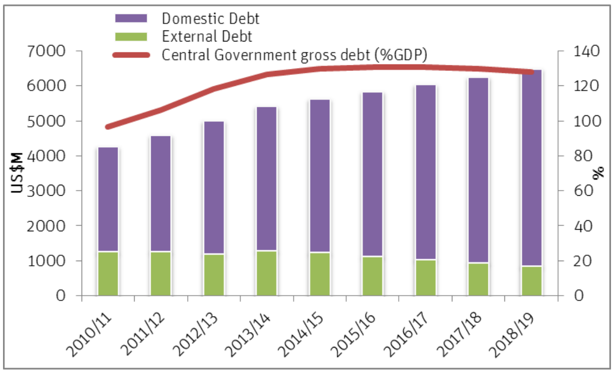
[2] Moody's Investors Service in a recent 27-page report noted that Barbados' rating of Ba1 with a negative outlook can be lowered before the usual 12 to 18 months period is over if the fiscal situation does not improve.

[3] Fiscal consolidation measures were also announced in August and December of 2013.

achieve a fiscal deficit target of 5.5 percent by the end of March 2015, but putting it a year behind its 19-month fiscal targets.

Reduced output levels and deteriorated fiscal outturns drove higher debt ratios. The debt-to-GDP ratio (excluding holdings of the National Insurance Scheme) is estimated to have increased from 53 percent in 2008 to 92 percent in 2013, with average annual growth rates of 7.7 percent in the past 5 years. Most of Barbados' debt is domestic, with the National Insurance Scheme as the largest creditor (27 percent of outstanding government debt). When the National Insurance Scheme is included, central government gross debt is registered at 126.4 percent of GDP in 2013. The International Monetary Fund projects this debt to increase to as much as 130.9 percent of GDP in 2015/16 before following a gentle downward trajectory (see Figure 2). The 2013 Article IV Consultation report states that debt sustainability hinges on "the government's ability to implement timely and vigorous fiscal consolidation …".

Figure 2. Evolution of Gross Central Government Debt



Source: International Monetary Fund's 2013 Article IV.

The International Monetary Fund recommends additional tightening of 1.1 percent of GDP over the next 5 years to reduce downside risks of not achieving fiscal targets. The 2013 Article IV Consultation report recognized the Government of Barbados' fiscal adjustment program but underscored the need for timely implementation of the fiscal consolidation measures as well as additional fiscal effort to place the debt trajectory on a sustainable path. The Fund also recommended reducing tax expenditures (waivers, exemptions, and concessions), strengthening revenue and customs administration, reducing inefficiencies in public enterprises, and reducing business and labor costs.

Financial Sector Developments

The offshore financial sector will be under further scrutiny given new international financial regulations. The Canadian government has changed its tax regulations so as to curb tax evasion by financial companies that set up in low-tax jurisdictions. This comes at a time when the sector is required to comply with the provisions of the Foreign Account Tax Compliance Act. The International Monetary Fund's 2013 *Financial Sector Assessment Program* report recommended improved monitoring of common ownership links and reputational risks in the financial sector, however, the report did not consider the offshore financial sector to be a major source of risk because it does not undertake financial transactions with domestic residents.

A new cooperative solution to settle outstanding CLICO claims in Barbados and the Eastern Caribbean should help reduce financial sector uncertainties[4]. A North American company has offered to purchase CLICO's over US$400 million in assets. Under this agreement, it is expected that policyholders' principal investment of more than US$221 million will be restored.

IDB in Barbados

The IDB is in the process of preparing its new Country Strategy (2014–2018) for Barbados. The Bank's strategic approach focuses on restoring sustainable economic growth through the transformation of the public and private sector while mitigating the risk of external shocks from commodity price spikes, slow recovery of traditional trading partners, natural disasters, and the slow onset of climate change impacts.

The IDB can assist with tax reform and public enterprise restructuring. The Government of Barbados, alongside the International Monetary Fund, is currently reviewing the public sector through tax reform and improving the efficiency of state-owned enterprises. The IDB has already conducted significant research in the area of tax expenditure, pensions, and public enterprises.

High-Frequency Macroeconomic Indicators	Last data	Period	Prior data	Period
Annual GDP growth (%)	-0.7	Dec-13	-0.7	Sep-13
Tourism arrivals (annual % change)	-5.2	Dec-13	-6.2	Sep-13
Exports (12-month growth)	-9.8	Dec-13	-7.1	Sep-13
Imports (12-month growth)	3.5	Dec-13	0.0	Sep-13
Non-performing loans (%)	11.3	Sep-13	12.9	Dec-12
Inflation	2.0	Oct-13	2.1	Jul-13
Exchange Rate (End of Period)	2.0	Apr-14	2.0	Mar-14
Unemployment rate (%)	11.2	Sep-13	11.1	Jun-13

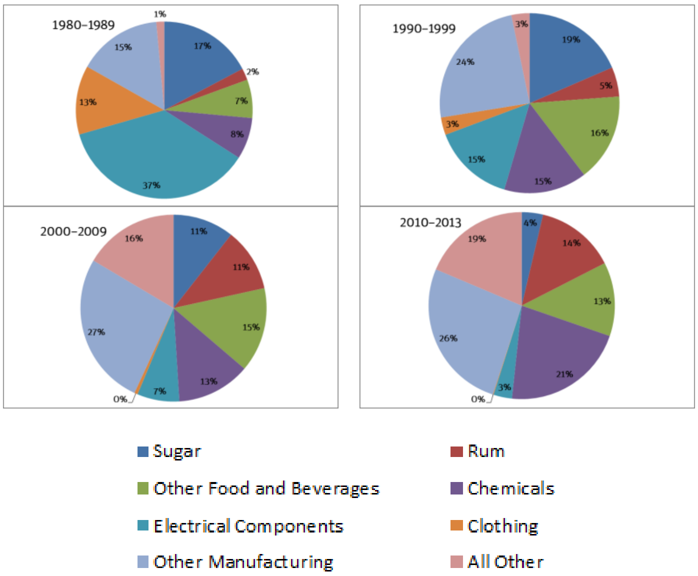
[4] See article: "CLICO Light: Offer from North American Firm 'Good News' for Policyholders". Sunday Sun, March 2, 2014. www.nationnews.com

BARBADOS

PRESERVING EXTERNAL SUSTAINABILITY

Barbados is a highly open economy with exports and imports covering about 120 percent of GDP in the past 5 years, making the country susceptible to terms of trade shocks. Tourism accounted for about 50 percent of export of goods and services and 35 percent of total trade to GDP in 2013. In the past 4 years, Barbados' main merchandise exports were food and beverages (26 percent of exports of goods) and chemicals (21 percent of exports of goods). The export of goods and services has always been significantly smaller than that of imports, with the latter accounting for 60 percent of GDP on average during the past decade. The country's principal trading partners are the United States, the United Kingdom, and Trinidad and Tobago. The degree of openness and the high concentration of trade partners render the economy vulnerable to external shocks such as fluctuations in international commodity prices, a downturn in global demand for tourism, or policy changes abroad. Also, changes in the country's foreign trade have an immediate effect on its GDP.

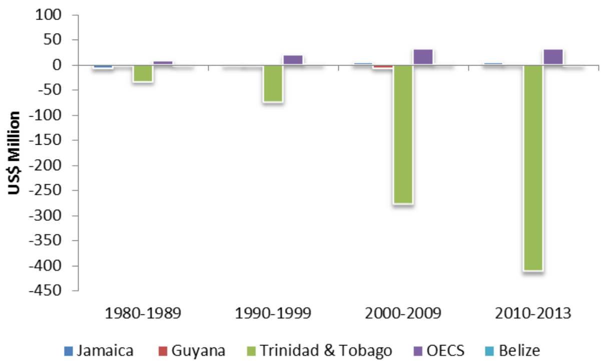
Figure 3. Composition of Exports



Source: Central Bank of Barbados online statistics.

Within CARICOM, Barbados trades most with Trinidad and Tobago. About 36 percent of merchandise goods are exported to Trinidad and Tobago, followed by 15 percent to Jamaica. During the 1980 to 2013 period, around 78 percent of CARICOM imports originated from Trinidad and Tobago, on average; however, this share has increased significantly since 2005 to about 90 percent. The high levels of importation (predominantly fossil fuel and food and beverages) have resulted in Barbados acquiring a trade deficit with Trinidad and Tobago of US$412 million between 2010 and 2013 (see Figure 4). The gap in the trade deficit grew in the 21st century, rising from US$73 million in the 1990s to US$278 million. Barbados' trade balance is somewhat balanced with the other CARICOM countries.

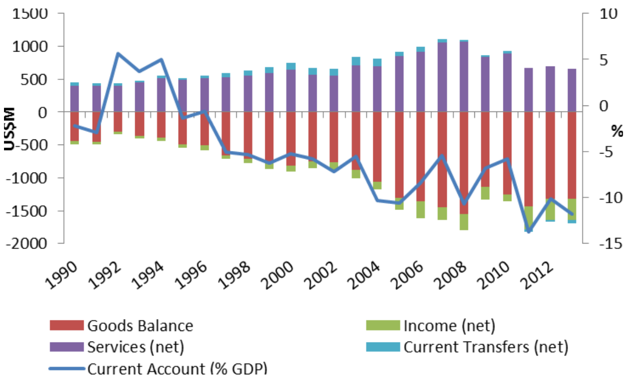
Figure 4. Trade Balance With CARICOM



Source: Central Bank of Barbados online statistics.

Barbados' current account balance is sensitive to changes in international oil prices and has been in deficit since 1995. The current account deficit averaged 10 percent in the past 5 years. At the end of 2013, the external current account balance deteriorated to 10.5 percent, reflecting higher outflows in income (Figure 5). A simple vector autoregression analysis on the current account and international oil prices for 1982 to 2012 showed the current account deficit is highly affected by international oil prices. About 18 percent of the change in the current account deficit is explained by international oil prices in only the first period, while the impulse response function indicated a worsening of the current account balance to a one standard deviation shock of an oil price change.

Figure 5. Current Account Performance



Source: International Monetary Fund's 2013 Article IV.

Keeping the current account deficit within acceptable limits is an important objective for maintaining external stability. The external sustainability assessment estimates the required current account balance that would stabilize the net foreign assets position of the country at a target level. To compare how far the actual is from the target, an estimate of the steady-state long-run growth rate of the country, as well as the expected rate of return on the country's assets (real interest rate), is required. Net foreign asset and the real interest rate were estimated using a 5-year historical average, and long-run growth was assumed to be modest at 1 percent (given historical averages). The minimum current account balance as a share of GDP that stabilizes net foreign assets at current levels was found to be 0.32 percent (see Table 1 for a sensitivity analysis of these results). This will require an adjustment to the current account balance of nearly 9 percent of GDP. The International Monetary Fund's projections in its 2013 Article IV Staff Report suggest some possibility of the country achieving this ratio, but this will have to be supported by strong export promotion and heavy private capital inflows going forward.

Table 1. Current Account Sustainability Sensitivity Results

Required primary surplus (%GDP)

Average real interest rate	Long-Term GDP Growth Rate: -0.6	0.4	1.0	1.4	2.4
1.0	0.26	0.10	0.00	-0.06	-0.22
1.5	0.34	0.18	0.08	0.02	-0.14
2.0	0.42	0.26	0.16	0.10	-0.06
3.0	0.58	0.42	0.32	0.25	0.09
4.0	0.75	0.58	0.48	0.41	0.25
4.5	0.83	0.66	0.56	0.49	0.33
5.0	0.91	0.74	0.64	0.57	0.41

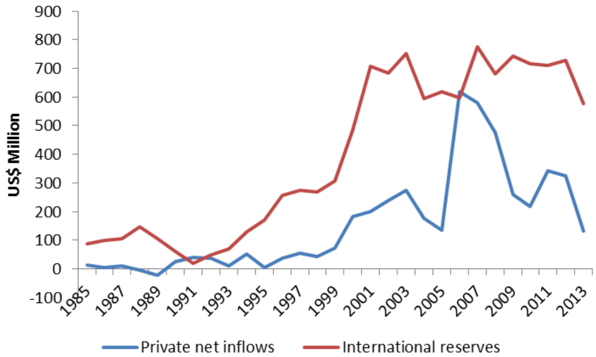
Required adjustment (%GDP)

Average real interest rate	Long-Term GDP Growth Rate: –0.6	0.4	1.0	1.4	2.4
1.0	8.59	8.42	8.33	8.26	8.11
1.5	8.67	8.50	8.41	8.34	8.19
2.0	8.75	8.58	8.49	8.42	8.26
3.0	8.91	8.74	8.65	8.58	8.42
4.0	9.07	8.90	8.80	8.74	8.58
4.5	9.15	8.98	8.88	8.82	8.66
5.0	9.23	9.06	8.96	8.90	8.74

Source: Central Bank of Barbados online statistics and Author's calculation.

International reserve levels are a key element in the Barbadian economy related to private net inflows. International reserves are important to maintain the fixed exchange rate regime, and their level is highly correlated (0.8) to private net flows (see Figure 6). Over the past 5 years, the level of net international reserves was volatile, ranging from as high as US$744.4 million in 2009 (21 weeks of import coverage) to as low as US$578 million at the end of 2013 (15 weeks of import coverage). Moreover, there was a sharp falloff of reserves in 2013: foreign exchange levels that had remained relatively unchanged in the first 3 months of 2013 (US$728.7 million) weakened in the second and third quarters by about US$260 million on account of lower net long-term private capital inflows. However, in December 2013, the government was able to secure a US$225 million loan from Credit Suisse AG Cayman Islands[5] that resulted in the reserve position recording import cover above the benchmark level of about 12 weeks of imports at the end of the year. The issuance of external bonds has also been used to build the reserve position and protect the exchange rate.

Figure 6. Private Net Inflows and International Reserves



Source: Central Bank of Barbados online statistics.

Since 1975, Barbados maintains a fixed exchange rate at US$1 equal to BDS$2. This regime contributed to a reduction in the magnitude of volatility in the external sector, with the Central Bank managing the foreign exchange market in a manner that gives private agents smooth access to foreign exchange for normal business activities. However, since 2008, the country's real effective exchange rate has appreciated against its main tourism competitors and client countries. The International Monetary Fund's 2013 Article IV estimated a real overvaluation of the exchange rate of 6 percent using the external sustainability approach. Although this indicates that the purchasing power of the currency has strengthened, it also implies that the country is disadvantaged in terms of price competitiveness. The impact on the country's most crucial sectors such as tourism could be substantial and begs for greater discourse on an appropriate way forward.

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[5] The interest rate is above 7 percent and is subject to change given any adjustments to the country's foreign currency debt rating. Additional terms and conditions can be found on The Barbados Parliament website. http://barbadosparliament.com/htmlarea/uploaded/File/Resolutions/2013/Resolution%20Credit%20Suisse%20AG%20Cayman%20Islands%20$225%20000%20000.pdf

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Barbados: Selected Indicators

	2009	2010	2011	2012	2013
(Annual percentage changes, unless otherwise indicated)					
Real Sector					
Real GDP	-4.1	0.3	0.8	0.0	-0.2
Nominal GDP	1.1	-3.5	-1.5	-3.3	-0.3
Inflation (end of period)	3.6	5.8	9.4	4.5	2.0
Unemployment	10.0	10.8	11.2	11.6	11.2
External Sector					
Exports of goods and services (% change)	-13.7	14.0	8.7	4.3	-9.8
Imports of goods and services (% change)	-23.4	7.8	16.6	-7.6	3.5
Current account (percent of GDP)	-6.8	-5.8	-13.7	-10.1	-11.8
International reserves (USD mill)	744.4	717.7	711.7	728.7	578.1
International reserves cover (weeks)	21.1	18.4	17.7	19.5	15.1
(In percentage of GDP, unless otherwise indicated, on a fiscal year basis)					
Central Government					
Revenue and grants	26.2	26.1	29.2	27.7	26.4
Current expenditure	30.6	32.9	32.2	34.3	36.8
Capital expenditure and net lending	1.9	1.5	1.4	1.5	1.4
Primary balance	-2.5	-3.0	1.6	-1.4	-4.5
Overall balance	-7.2	-8.7	-4.4	-8.0	-11.8
General government balance	-6.0	-3.9	-4.4	-4.0	n.a.
Debt Indicators					
General government debt	63.2	72.0	77.8	85.7	97.8
Central government debt over revenues	249.6	280.0	266.4	309.1	370.4
External public debt (end of period)	28.6	34.2	35.1	34.9	37.4
External debt service as percentage of exports of goods and services	7.0	16.7	6.6	6.9	6.6

Source: Central Bank of Barbados, International Monetary Fund World Economic Outlook October 2013.

GUYANA

SETTING THE PACE, HURDLES REMAIN

Guyana's growth momentum remains undeterred by downturns in key commodity prices and production conditions. The Guyanese economy grew by a remarkable 5.2 percent in 2013, based on strong performances in the rice, gold, and services sectors. During the year, gold prices fell, the sugar sector missed production targets, and bauxite production contracted 11 percent. Nonetheless, the economy—excluding sugar—grew at 6.3 percent, as foreign direct investment in and public expenditures on capital projects proved to be drivers of continued expansion. Authorities anticipate that the economy will further expand by 5.6 percent in 2014 as several key infrastructural projects begin (See Figure 1).

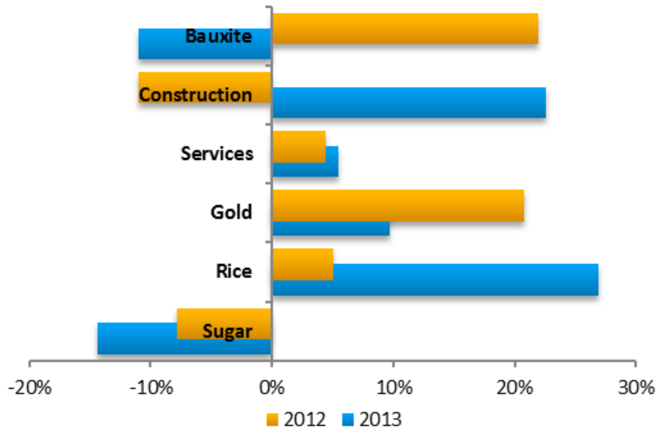
Highlights

Guyana's economy has once again set the pace among its Caribbean counterparts, posting an impressive real growth of 5.2 percent in 2013. The expansion reflects the results of extensive investments in the rice and gold sectors and a vibrant construction sector. Authorities project 2014 real growth of 5.6 percent; however, significant down risks remain.

Concurrently, Guyana's overall macroeconomic stability remained favorable, with declining external debt, inflation below 1 percent, and ample international reserves coverage,

The 2014 National Budget of G$215.8 billion, the largest in Guyana's history, focuses on Guyana's medium-term capital investment needs in energy, transport, and the communication infrastructure, and for structural diversification.

Figure 1. GDP at 2006 Prices, by Industry



Source: Ministry of Finance.

The sugar sector continues to encumber economic growth. Sugar production fell by 14.4 percent to 186,770 tons, underpinning a reoccurring trend of performing well below expectations. The Guyana Sugar Corporation attributed the recent slump to persistent industrial actions and labor shortages within the sector, unfavorable weather conditions, and organizational issues that affect productivity. The sugar industry is Guyana's largest industrial employer, comprising a workforce of 18,000 persons. In terms of economic impact, an estimated 120,000 individuals are affected by the industry; however, sugar accounted for only 3.9 percent of GDP in 2013.

The European Union's withdrawal of support for the sugar industry has raised the urgency of implementing tangible structural reforms in the sector. The year 2014 signals the final year of the European Union's assistance in restructuring Guyana's sugar sector. Moreover, the impending elimination of production quotas in 2017 for European Union beet farmers may reduce import demand for the less competitive Guyanese sugar. However, regional opportunities exist in the form of 70,000 metric tons of sugar that is currently sourced extra-regionally by CARICOM member states. Authorities have taken measures to (a) address structural and technical inefficiencies; and (b) increase production by investing in field conversion, agricultural management, and factory modernization.

In contrast, rice maintains its record-breaking run. In 2013, the sector grew by 27 percent, amounting to 535,439 metric tons. Strong performance in the rice sector is accredited to high preferential prices via the rice compensation agreement with Venezuela, which continues to stimulate production expansion. However, major concerns exist about the continuation of the PetroCaribe agreement and accompanying rice compensation agreement in light of recent political and economic developments in Venezuela.

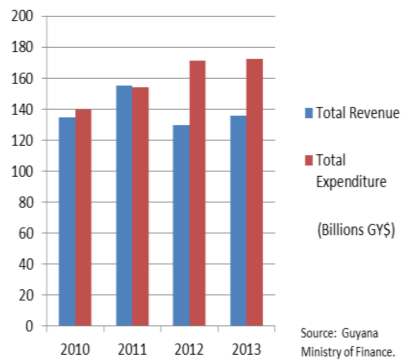
The government is ramping up investment in the rice sector to improve competitiveness. In the 2014 national budget, G$500 million was allocated to the sector to improve competitiveness through investments in research and development, mechanization of the cropping process, and marketing diversification. Measures have been put in place to facilitate greater access to the Brazilian market, and new deals have been struck in Haiti.

The mining and quarrying sector recorded mixed performances in 2013. Record gold production of 481,087 ounces (an increase of 9.7 percent) was able to stimulate growth in the mining sector despite price declines from an average of $1575 per ounce in 2012 to $1344 in 2013. The prospects for the gold industry remain high as production by small and medium mines has surpassed that of large mines. Authorities remain optimistic about the future of gold mining as several large scale operations advance. The major downside risks to the gold sector stem from price volatility and the needs for improved oversight and technological adaptions to minimize the heightened levels of environmental degradation. Bauxite production declined by 11 percent due to rising costs of production and logistical issues.

Fiscal Expansion Reflects Ambitious Capital Projects

The fiscal deficit increased from 4.6 percent of GDP in 2012 to 4.7 percent in 2013. Authorities attributed the deterioration to higher wages and salaries (10.6 percent); more goods and services expenditures (9.8 percent); increased transfers (1.3 percent), especially hikes in pension payments and an expanded electricity subsidy program for pensioners; and higher expenditures on infrastructural maintenance. Given these developments, authorities project further widening of the fiscal balance to 4.9 percent of GDP in 2014.

Figure 2. Total Revenue and Expenditure



Source: Guyana Ministry of Finance

Central Government revenue (net of Guyana REDD Investment Fund (GRIF) inflows) grew by 4.8 percent to G$135.7 billion in 2013. Tax revenues amounted to G$126.5 billion (6.9 percent higher than 2012) and accounted for 93.3 percent of total current revenue collections, net of GRIF inflows, mostly because of higher corporation tax receipts of G$21.6 billion representing a 16.5 percent increase. In contrast, personal income tax declined by 5.9 percent because, effective January 2013, that tax rate was reduced from 33 to 30 percent. Capital revenue and grants declined G$4.6 between 2012 and 2013, reflecting decreases in grant aid. Assistance from the HIPC Initiative[1] remained relatively unchanged, while other types of development project assistance dropped between 2012 and 2013.

Current expenditures increased even more in 2013, but this was somewhat offset by a slower-than-expected capital expenditure. Noninterest current expenditure increased by 7 percent to G$115.9 billion, mostly attributed to a 10 percent increase in public sector employment costs and public goods and services. Capital expenditure decreased by 11 percent compared with the previous year because of timing and execution issues surrounding several key development projects that include (a) the ICT (e-governance) project; (b) upgrading and expanding of the electrification system; (c) Low Carbon Development Strategy projects, in particular the Amaila Falls Hydropower Plant; (d) slowed construction of the 197-room Marriott Hotel; (e) budget wrangling with specialty hospital project; and (f) the Cheddi Jagan International Airport expansion project. The trend, however, over the past few years, has been for a widening gap between expenditures and revenues (Figure 2).

The 2014 National Budget of G$215.8 billion, the largest in Guyana's history, was presented by Finance Minister Dr. Ashni Singh on March 24, 2014, under the theme *A Better Guyana for All Guyanese.* The 2014 estimates represented a 5.2 percent increase over the original 2013 submission and a 25 percent increase over the actual 2013 budget spent. The new budget focuses on (a) medium-term capital investment needs in energy, transport, and communication infrastructure; and (b) structural diversification.

A second hydroelectric power project, in addition to Amaila Falls, is advancing. Primarily designed to export electricity to Brazil, this project in the upper Mazaruni is under study. Two Brazilian construction firms are expending a reported US$45 million to determine whether the project is technically and economically viable. The project is expected to be fully financed by those two Brazilian firms and by the Brazilian National Development Bank.

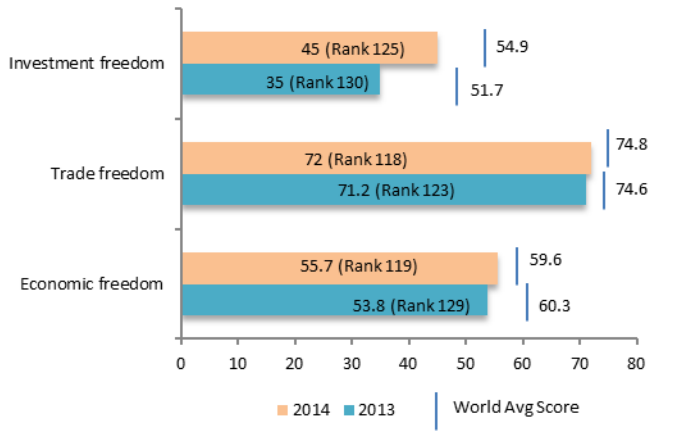
Table 1: Macroeconomic Indicators

	Last data	Period	Prior data	Period
Annual GDP growth (percent)	5.2	2013	4.8	2012
Exports (12-month growth)	-2.8	2013	23.6	2012
Imports (12-month growth)	-7.5	2013	11.6	2012
Private sector credit growth (percent)	14.5	2013	24.7	2012
Inflation	0.9	2013	3.5	2012
Exchange rate (end of period)	206.3	2013	204.8	2012

[1] HIPC stands for *Heavily Indebeted Poor Countries*, a group of developing countries that are eligible for debt relief from the International Monetary Fund and other multilateral development finance institutions

The degree of economic openness and trade freedom of Guyana has improved despite continued volatility in the global markets. Greater access to foreign merchandise and investment inflows to the domestic economy have resulted in Guyana's moving up on the list of economically free countries to a rank of 119th in 2014 from 129th in 2013, out of total 178 countries surveyed. The index appeared in the Heritage Foundation's annual report on global economic freedom. However, Guyana remains below the world average (Figure 3).

Figure 3. Degree of Economic Openness



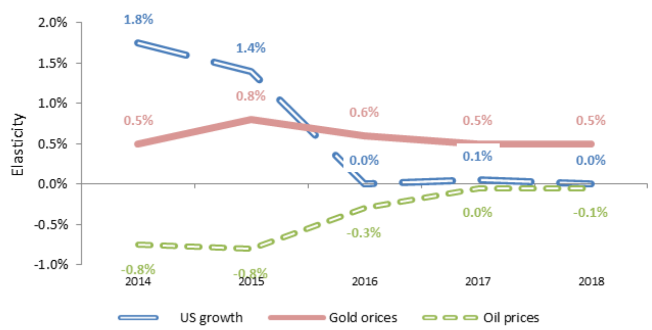
Source: The Heritage Foundation, Global Economic Freedom Index, 2014.

However, greater openness increases the avenues for the transmission of external shocks to the Guyanese economy. Given the economy's limited export diversification and its exclusive dependence on fuel imports, vulnerability to commodity price shocks presents a downside risk. Stress tests were conducted to ascertain the level of susceptibility to an increase (reduction) of 10 percent in various external variables. The results show that a gain of 1 percent in the price of gold increases Guyana's GDP by 0.5 percent in the first year, 0.8 percent in the second year, and 0.6 percent in the third year; then, the effect stabilizes around 0.5 percent in the following years. However, the effects of an oil price increase of 1 percent reduces GDP by 0.8 percent in the first 2 years, then quickly dissipates thereafter, as shown on the impulse response function in Figure 4.

More related to trade dynamics, the economic performance of the United States, Guyana's largest trade partner, also impacts the domestic economy. Stress test results show that a 1 percent increase in the growth of the U.S. economy would increase GDP by 1.8 percent the next year and 1.4 percent the following year as a result of increased export demand from U.S. citizens.

The developments in the current account reflect Guyana's high degree of openness and vulnerability to commodity price volatility. In 2013, the current account deficit deteriorated to 16.3 percent of GDP, from 12.8 percent of GDP in 2012, largely on account of high commodity prices and growing import demand (which increased by 9 percent in 2013) fueled by foreign direct investment growth, and an aggressive public capital investment program that further worsened the trade deficit. Over the medium term, the current account deterioration is expected to escalate to more than 14 percent of GDP as a result of greater oil import demand and imports related to large-scale foreign direct investment ventures in the mining and construction sectors.

Figure 4. Impulse Response Function



Source: IDB Caribbean Economic Team.

The current account deficit is expected to remain fully financed by foreign capital flows and earnings. Foreign direct investment inflows have grown by 11.8 percent over 2009–2014 to almost 15 percent of GDP and have thus become a significant driver behind the current account dynamics (Figure 5). International reserves in 2013, summed to US$776.3 million, representing 3.9 months of import cover.

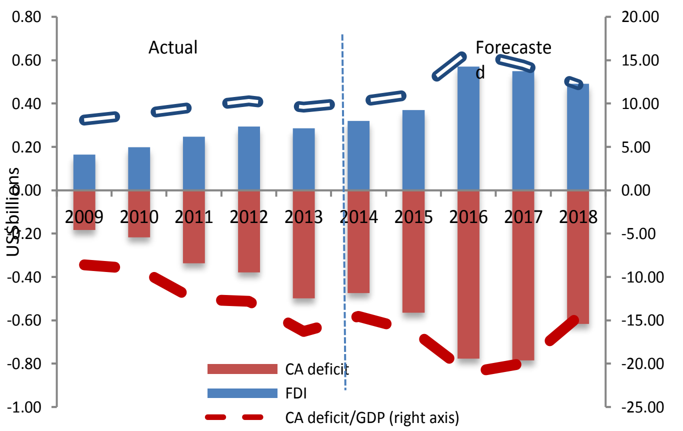
Comparatively, other sources of foreign exchange have witnessed growth over the 2009–2014 periods. In particular, exports and remittances have grown on average by 7.3 percent and 3.3, respectively, despite the consequences of the recent global recession and fall of on export demand (see Figure 6).[2]

Export growth, which declined by 2.8 percent in 2013, also suffered from falling prices, notably gold, which saw earnings fall by 9.5 percent after a sharp decline in average prices from US$1,575 per ounce in 2012 to US$1,344 per ounce in 2013. However, rice exports were able to mitigate the depression in

[2] See the January 2014 Quarterly Bulletin for a discussion about the impact of remittances on the Guyanese economy.

gold earnings by expanding by 22 percent, primarily on account of large shipments of rice and paddy at premium prices under the rice compensation agreement with Venezuela. However, strong downside risks have emerged regarding the prospects for the rice[3] sector, which stem from the potential collapse of the PetroCaribe agreement and the rice compensation agreement amid recent political and economic turmoil in Venezuela.[4]

Figure 5. Evolution of Current Account and Foreign Direct Investments Flows 2009–2018

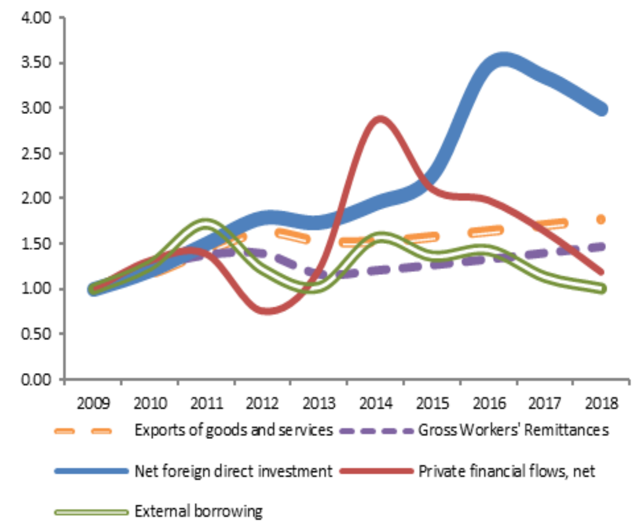


Source: International Monetary Fund World Economic Outlook 2013, Bank of Guyana.

Going Forward

Guyana, with its high degree of trade openness, limited economic diversification, relatively small domestic market size (est. 2013 population: 746,900), and lower middle-income classification, continues to be vulnerable to external factors beyond its control. These factors, which can threaten the hard-won macroeconomic stability and debt sustainability, include growth rates and asset price movements in major trading partners; commodity price volatility; high dependence on imported fossil fuels; occurrence of natural disasters, especially flooding; flows of investment funds and remittances; and possible ending of trade preferences and concessional financing. To develop resilience and better manage these risks, Guyana's tasks are to increase fiscal space, broaden the economic base, improve private sector competitiveness, narrow social gaps, and address energy costs.

Figure 6. Cumulative Growth Rate of Major Foreign Inflows 2009–2018



Source: IDB Guyana Country Office, Ministry of Finance.

Governance and Policy

To date, Guyana has not passed the Anti-Money Laundering/Counter Terrorism Financing (AML/CFT) bill. A Parliamentary impasse resulted in two missed deadlines set by the Caribbean Financial Action Task Force; Guyana has thus lobbied for an extension to February 28, 2014. However, because that deadline was not met and the bill was not passed before the Caribbean Financial Action Task Force May plenary meeting, a recommendation for sanctioning action is likely to be made to the worldwide Financial Action Task Force. The consequences of blacklisting will probably be reputational damage; loss of correspondent banking relationships; increased transaction costs associated with cross-border money transfers; dampening of foreign investor interest; and stifling of financial innovation, especially related to further expansion of electronic transfers and mobile payment platforms

[3] In 2013, rice exports accounted for approximately 22 percent of export earnings.
[4] In 2013, Venezuela, under the compensation, accounted for more than 70 percent of rice exports, representing a significant market for the sector.

Guyana: Selected Indicators

	2009	2010	2011	2012	2013
(Annual percentage changes, unless otherwise indicated)					
Real Sector					
Real GDP	3.3	4.4	5.4	4.8	5.2
Nominal GDP (GYD millions)	359549	400922	460108	511337	n.a.
Inflation (end of period)	3.7	4.5	3.3	3.5	0.9
External Sector					
Exports of goods and services	-0.8	14.6	25.8	18.4	n.a
Imports of goods and services	-6.8	17.9	25.1	13.6	n.a.
Current account (percentage of GDP)	-8.5	-10.7	-16.4	-15.7	-14.2
FDI (percentage of GDP)	8.1	9.9	9.9	10.8	7.3
(In percentage of GDP, unless otherwise indicated, on a fiscal year basis)					
Central Government					
Revenue and grants	27.2	26.0	26.5	27.9	22.1
Current expenditure	19.5	18.8	19.8	21.1	19.8
Capital expenditure and net lending	7.7	7.2	6.7	11.1	8.2
Overall balance	-3.7	-2.9	-3.2	-4.7	-4.4
Debt Indicators					
Central government debt	67.0	68.0	69.3	72.1	57.4
Central government debt over revenues	246.7	261.7	261.6	n.a.	n.a.
External public debt (end of period)	45.9	46.1	48.6	54.2	41.5
External debt service as percentage of exports of goods and services	1.8	2.6	3.0	n.a.	n.a.

Source: Central Bank of Guyana, International Monetary Fund World Economic Outlook, April 2013.

Highlights

Jamaica's outlook continues to improve despite continuing challenges ahead.

The International Monetary Fund completed its third review of the Extended Fund Facility on March 19, 2014 without the need for waivers.

Implementation of the comprehensive tax reform has started with the tabling of two central legislations. The new tax system has been fully implemented as of April 1, 2014.

Fitch rating agency updated Jamaica's long-term foreign and local debt to B- from CCC. Moody's affirmed Jamaica's credit rating and changed the country's outlook from stable to positive.

Jamaica remains fragile, making the outlook dependent on avoidance of shocks and strict reform implementation.

IDB approved two PBLs amounting to US$140 million in February 2014.

Recent Developments

Jamaica's outlook continued to improve in the fourth quarter of 2013. The government's strong commitment to fiscal consolidation and the deep reforms required in the Extended Fund Facility with the International Monetary Fund have improved the outlook compared to end-2012 and early 2013. Jamaica experienced positive growth of 1.4 percent in the fourth quarter of 2013 (year-on-year). Nevertheless, Jamaica's economy continues to face important vulnerabilities in the short to medium term. Investors remain cautious given the challenging structural reforms and quantitative targets mandated by the International Monetary Fund program.

The Executive Board of the International Monetary Fund completed the third review of the Extended Fund Facility with Jamaica on March 19, 2014. Overall, policy implementation under the program remained strong and Jamaica met all structural and quantitative targets without needing waivers for the end-of-December-2013 test date. The International Monetary Fund also noted that the execution of the 2013/14 budget has been broadly on track. The approval resulted in a drawing of SDR 45.9 million (US$71.4 million).

In line with Standard & Poor's, Fitch rating agency upgraded the long-term credit rating for Jamaica. Fitch upgraded Jamaica's rating from CCC to B- with a stable outlook. The rating agency stated that the key drivers for the upgrade were the reduced financing risks resulting from fiscal consolidation, the national debt exchange, the International Monetary Fund program remaining on track, and the access to multilateral funding. Although Moody's did not upgrade Jamaica's credit rating, it affirmed the country's long-term debt rating at Caa3 and changed the outlook from *stable* to *positive*.

The Jamaican dollar continued its depreciation. The Jamaican dollar depreciated by 14.4 percent in 2013 alone, leading to a real depreciation of 4 percent over the same period. The real depreciation should improve competitiveness, which is central for the long-term sustainability of the external accounts. Nonetheless, it adversely affects the import-dependent industries and consumers in the short term.

Business and consumer confidence improved, but the depreciation of the dollar is still a major concern. After falling to one of the lowest levels since the inception of the survey in the third quarter of 2013, the business and consumer confidence index improved for two consecutive quarters. All components of the confidence index improved, with firms increasing their investments and households expecting a rise in their living standards. Despite the improvement, job prospects remain low, and the depreciation of the dollar overtook crime as a major concern. As such, the improvement reflects a recovery from a very low level rather than a resurgence of optimism.

Growth accelerated in the fourth quarter of 2013. Economic growth for the fourth quarter is estimated at 1.4 percent compared with 0.5 percent in the third quarter. Performance of most industries improved, with the key driver being mining, agriculture, and tourism. The projections for the first quarter of 2014 remain positive at 1 to 2 percent, resulting in 0.9 percent for the fiscal year 2013/14. Notwithstanding the positive development, the growth outlook continues to be weak. The projected acceleration to more than 2 percent in FY16/17 will depend on the implementation of growth facilitating reforms.

International reserves are approaching desirable levels. Net reserves declined from more than US$2 billion as of April 2011 to less than US$900 million as of January 2014. Reserves have recovered to US$1.3 billion as of the end of March 2014, meeting the Extended Fund Facility March target but remain just above the minimum Bank of Jamaica threshold of US$1.2 billion. Official inflows will continue to be needed in the short to medium term as a recovery in foreign direct investment and private capital flows to cover the balance of payments deficit is expected to take time.

Interest rates continue to trend upwards since the National Debt Exchange in 2013. The February 2013 debt exchange reduced the reset margin (the spread above the benchmark T-Bill) on variable rate debt, as well as interest rates on fixed-rate debt. The benchmark 90-day T-Bill rate has been increasing since its low of 5.5 percent in February 2013, reaching 8.3 percent as at March 2014. The resulting interest rates on variable rate Government of Jamaica securities are now higher than immediately before the National Debt Exchange. The increase was expected and should stop or even reverse with improvements in investor confidence. Almost 40 percent of Jamaica's domestic bonds, which are equivalent to around 20 percent of direct public debt, have a variable interest rate, making interest rates a major factor for fiscal sustainability.

The government has not accessed the domestic debt market since the NDX. One year after the debt exchange, the financial sector remains reluctant to maintain or increase its already high exposure to GOJ securities. Nevertheless, the government managed to repay amounts equivalent to 2.5 percent of GDP in the first quarter of 2014. The maturing securities comprised one-year NDX bonds for retail investors, some securities that did not participate in the exchange, and US$ denominated securities that the government had intended to retire. The repayment will not only benefit retail investors but also banks that were major holders of the US$ denominated securities.

Liquidity remains low in the financial sector. The National Debt Exchange, combined with the introduction of a Central Treasury Management System (centralization of its accounts at the Bank of Jamaica) and open-market operations by the central banks, has reduced liquidity in the financial sector curtailing the lending ability of financial institutions in Jamaican dollars. The Bank of Jamaica increased liquidity operations but has been cautious in an effort to preserve foreign reserves. As a result, liquidity remained relatively tight and concentrated.

Projections indicate that Jamaica's public debt is on a downward trajectory. The debt-to-GDP ratio is projected at 138.9 percent for the FY 2013/14. This downward trend is expected to continue on the basis of primary surpluses of 7 percent and higher. The macroeconomic framework supported by the Extended Fund Facility projects that the debt-to-GDP ratio will fall below 100 percent by March 2020.

Although economic performance has improved, the general population is still adversely affected. Unemployment decreased from its high of 16.3 percent in April 2013 to 13.4 percent in January 2014, the first year over year decline since January 2012. However, this still represents an increase compared with 9.4 percent in 2007. Unemployment remains high among the female population, and youth unemployment remains a concern at over 30 percent.

Security continues to be a major concern in Jamaica. The number of homicides has decreased since 2010, partly because the state security forces have restricted gang operations. The government is making efforts to dismantle informal governance arrangements and is empowering citizens in affected communities to reintegrate into the main society; however, some areas remain volatile. Despite the decrease and ongoing efforts to curtail major crimes, recent statistics indicate that there is an increase of approximately 10 percent in the number of people murdered between 2012 and 2013. In addition, there was a steep increase in the number of killings committed by police: in 2013, 258 civilians lost their lives in incidents involving the security forces compared to 219 civilians in 2012 and 210 in 2011.

Issues to Watch Out For

- The economic recovery remains fragile, and sustaining the reform momentum and continued implementation of sound macroeconomic policies will be necessary to assist with the persisting challenges and risks.
- Low investor confidence could delay growth prospects. Continued adherence to the Extended Fund Facility and support of growth-friendly reforms are needed to revive investor confidence and new investments.
- Important reforms coincide with the budget for the current fiscal year, which began April 1, 2014, including the implementation of the comprehensive tax reform, the incorporation of the legally binding fiscal rule, and financial sector reforms.

The reforms embedded in the Extended Fund Facility, the protection of poor and vulnerable groups, and the implementation of the government's growth agenda continue to offer various opportunities for Jamaica's development partners to provide technical and financial support.

High-Frequency Macroeconomic Indicators				
	Last data	Period	Prior data	Period
Annual GDP growth (%)	1.4	Q4 2013	-0.4	Q2 2013
Inflation (Quarterly)	1.9	Q4 2013	3.7	Q3 2013
Net International Reserves (USD Mill)	1069.4	Feb-14	1052.8	Dec-13
Exchange rate (end of period)	108.34	Feb-14	106.38	Dec-13
Unemployment rate (%)	14.9	Oct-13	15.4	Jul-13

Source: Bank of Jamaica, International Monetary Fund, and Statistical Institute of Jamaica.

Introduction

As with other small economies, Jamaica combines a narrow export base with a strong import dependence. Jamaica consumes more than it produces, building up international liabilities and requiring ongoing financing of the deficit, either from foreign direct investments, private investments, or loan financing. Chronic current account deficits are attributable primarily to the strongly negative balance of traded goods, including energy imports. Given that Jamaica is a major tourist destination and has a substantial diaspora, the deficit in goods is partly compensated by the surplus in the service balance and current transfers from remittances. However, the deficit remains substantial and the external imbalance constitutes a short-term risk and a major long-term challenge for the country. The underlying reason for Jamaica's weak export performance is the same reason behind its disappointing growth performance: a lack of export diversification and a bias towards imports over domestic production

Short-Term Risks

International reserves are an important buffer against external shocks. Given that international reserves can be used to mitigate capital flight and sharp movements in the exchange rate, they contribute to investor confidence. However, net reserves fell from over US$2 billion in April 2011 to US$1.3 billion as of end-March 2014, just above the level required to cover 1 year of short-term external obligations. Furthermore, reserves would be even less adequate to cover short-term liabilities in addition to the current account deficit, which would be relevant if the country experienced a sudden stop in capital inflows. The indicator would further worsen if foreign-denominated deposits—which can play a role in bank runs, because they force the Central Bank to use reserves to provide liquidity to the banking sector—are included.

The low level of international reserves is a major short-term vulnerability for Jamaica's economy, but improvements are programmed. Reserves have been recovering from a low of US$881 million in August 2013 to US$1.3 billion in March 2014, which will help strengthen Jamaica's resilience against external shocks. The external position is expected to improve further under the Extended Fund Facility, which provides for a steady build-up of international reserves. In addition, funds from the International Monetary Fund are part of the gross reserves, currently around US$2 billion, equivalent to 14.3 weeks of imports of goods and services.

The Bank of Jamaica intervenes in the foreign exchange market to smooth fluctuations in the currency and to meet reserve targets under the International Monetary Fund program. Interventions have been concentrated on buying U.S. dollars even though demand for foreign exchange outstripped supply and, combined with uncertainty, has led to a supply shortage for foreign exchange. Larger capital inflows will be needed to normalize the working of the foreign exchange market that would require increased official financing and foreign direct investment and a decrease in capital flight.

A key factor of external financing is the dependence on the Petrocaribe fund. Like many other countries in the Caribbean, Jamaica relies on the Petrocaribe agreement for balance of payments and budget support. Part of the petroleum payment is made directly to the domestic Petrocaribe Development Fund (not Venezuela). Therefore, the external financing requirement is substantially lower than if petroleum were paid in full.[1] In addition, both the government and state-owned enterprises, as direct beneficiaries, have access to a credit facility on concessionary terms from the Petrocaribe Development Fund.

The Exchange Rate and Competitiveness

A long period of real appreciation has recently been reversed. The Jamaican dollar has been appreciating in real terms over extended periods of time, which cheapens import prices for consumers and import-dependent industries, but hurts international competitiveness because it makes domestic products more expensive. However, in 2013 alone, the Jamaican dollar has depreciated by 14.4 percent, leading to a real depreciation of 4 percent over the same period. The real depreciation should improve competitiveness as it supports consumption switching to domestic goods and supports local producers. Nonetheless, it adversely affects the import-dependent industries and consumers in the short term.

Depreciation poses a major difficulty for businesses. Jamaican businesses depend heavily on imports, including for fuel, machinery and intermediate goods. The depreciation causes anxiety as reflected in the decline in the business confidence index, which fell in the third quarter 2013 to one of the lowest levels since the inception of the survey in 2001. The index

[1] According to government estimates, Petrocaribe financing of the balance of payments is equivalent to about US$500–US$600 million per year, or between 25 percent and 30 percent of last year's current account balance.

slightly recovered, but uncertainty related to the depreciation overtook crime as a major concern.

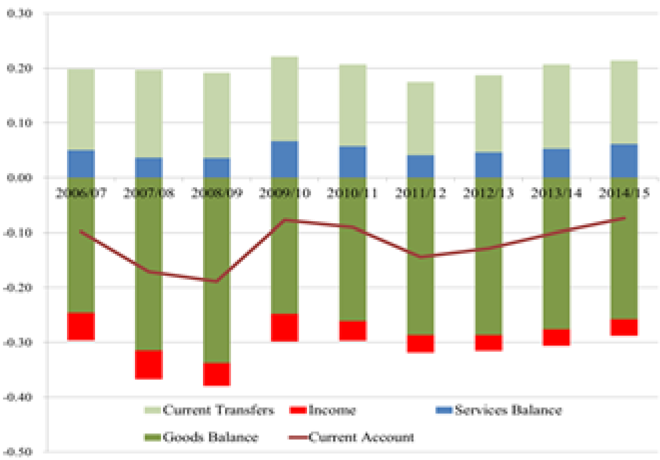
Competitiveness comprises many aspects. While a real depreciation helps domestic and export-oriented industries to compete internationally, structural reforms boost long-term competitiveness. Moreover, adjustments through the real exchange rate alone would be slow, given the rigidity of import demand, small export base, and distortions in the economy, highlighting the importance for complementary reforms that spur competitiveness. These include business climate reforms and measures to facilitate export diversification.

External Balance

Jamaica traditionally has had a current account deficit. The trade balance deficit is partly offset by the surplus in the service balance from tourism and the surplus in transfers from remittances. However, the deficit in the goods balance can move considerably with changes in international prices, especially for energy (Figure 1).

Fuel imports constitute about one third of all goods imports, making the price of oil one of the major risks for the current account. According to Bank of Jamaica estimates, an increase in the average oil price by 10 percent leads to a current account deterioration of 0.8 percent of GDP. After falling during the world economic downturn, the current account deficit has been increasing again. However, the depreciation is expected to improve the trade balance, leading to a current account deficit under 10 percent of GDP in FY 2013/14 and going forward.

Figure 1. Jamaica: Current Account Balance FY 2006/07 to FY 2014/15 (% of GDP)



Source: Bank of Jamaica and own calculations.

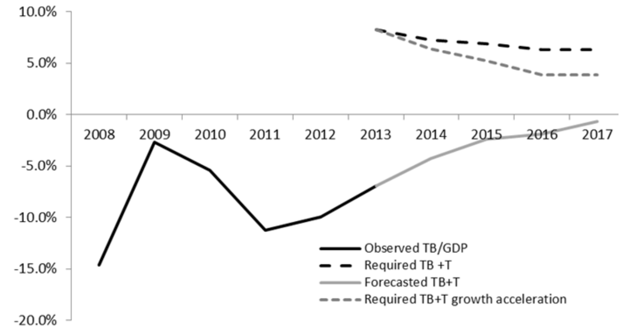
The consistent current account deficit has led to a steady worsening of Jamaica's international investment position. The international investment position (IIP) shows an economy's stock of external financial assets and liabilities of the public and private sectors. The difference between the stock of external assets and external liabilities is the net IIP. The majority of foreign liabilities in Jamaica consist of direct investment (net assets from foreign direct investment amounting to US$12.1 billion) and loans. As of September 2013, the net foreign asset position was estimated at around –135.5 percent of GDP (from 127 percent of GDP in 2012). A negative net investment position signifies that Jamaica has been consuming (importing) more than it has exported, financing the difference either through debt or investment flows, including foreign direct investment. As Jamaica has a net liability, the country will have to export more than it imports at some stage in the future to repay the liability.

The long-term sustainability of the external position is currently not fulfilled. The External Sustainability Assessment of the exchange rate compares the projected non-income current account balance (equal to the trade in goods and services balance plus transfers) to the one that would stabilize net foreign asset positions at a constant level.[2] Assuming a long-term projection of 2 percent for annual GDP growth and a 5 percent real external interest rate, the simulation shows that average current account balances should be around 4 percent of GDP to maintain external sustainability. However, projected balances are on average –4 percent of GDP, substantially below the stabilizing one, implying that Jamaica's already very high net foreign liabilities will continue to grow.

On the bright side, the gap between the required and the estimated non-income current account balance is expected to narrow. A projected increase in net remittances combined with a decrease in the trade balance deficit and continued recovery of economic growth should slow the accumulation of foreign liabilities (Figure 2). However, Jamaica will continue to build up external liabilities even under a scenario in which GDP growth accelerated significantly over time (see the dotted gray line in Figure 2). This is not sustainable over the long run because the repayment of international liabilities requires a period of sustained current account surpluses.

[2] For the External Sustainability Assessment of the exchange rate developed by the International Monetary Fund, see "Exchange Rate Assessments: CGER Methodologies," IMF Occasional Paper No. 261, 2008."

Figure 2. Net Foreign Assets Stabilizing Trade and Transfers Balances Versus Actual Balances, 2008-2017 (% of GDP)



Sources: Bank of Jamaica and authors' own calculations.
Notes: Growth acceleration assumes GDP growth of 4 percent instead of 2 percent.

How to Consolidate Recent Efforts

The external position of Jamaica is undergoing important corrections. The Jamaica dollar has depreciated 14.4 percent in FY 2013/14, equivalent to a real depreciation of about 5 percent. At the same time, the current account deficit is expected to have declined to less than 10 percent of GDP compared with 13 percent in FY 2012/13 and close to 20 percent in FY 2008/09.

However, the decline in reserves and the worsening of liquidity indicators highlight the country's continued vulnerable external position. Continued adherence to the International Monetary Fund program and the projected increase in international reserves will improve Jamaica's resilience against external shocks and help improve investor confidence. Official financing will be required until private capital inflows and foreign direct investment increase.

Structural reforms will be an important complement to the real depreciation. A thin export base, combined with high dependence on imports poses a special problem for Jamaica's external position and is not sustainable in the long run. It is also the main reason why Jamaica's growth is below desired levels. Therefore, reforms in the export base are the key to making the Jamaican economy more competitive and alleviate external imbalances. The depreciation has helped competitiveness; however, a correction of the current account imbalance through a real depreciation alone would be costly to obtain given the high level of foreign-denominated debt, the small export base and the low responsiveness of imports and exports to real exchange rate changes.

Jamaica: Selected Indicators

	2009/10	2010/11	2011/12	2012/13	2013/14 (F)
(Annual percentage changes, unless otherwise indicated)					
Real Sector					
Real GDP	-2.6	-0.6	1.3	-0.3	0.9
Nominal GDP	8.1	7.8	5.9	7.8	10.6
Inflation (end of period)	13.3	7.8	7.3	9.0	9.5
Exchange rate (end of period)	89.5	85.7	87.3	98.9	109.0
External Sector					
Exports of goods and services(yoy, %)	-19.1	-0.1	6.2	2.9	5.5
Tourism receipts	43.2	44.7	47.1	45.6	0.8
Imports of goods and services(yoy, %)	-30.3	8.2	17.4	-3.5	4.2
Current account (percentage of GDP)	-7.6	-8.9	-14.8	-11.6	-10.0
Treasury bill rate (percent, end of period)	10.5	6.5	6.2	5.8	8.0
(In percentage of GDP, unless otherwise indicated, on a calendar year basis)					
Central Government					
Revenue and grants	27.1	26.4	25.5	25.5	26.9
Budgetary expenditure	38.1	32.8	31.9	29.5	26.9
Primary balance	6.1	4.5	3.1	5.4	7.5
Budget balance	-11.0	-6.5	-6.4	-4.0	0.1
Public sector balance	-12.4	-7.0	-6.4	-4.4	-0.4
Debt Indicators					
Public sector debt	139.5	141.3	143.7	146.4	138.9
Public sector debt over revenues	514.1	536.1	563.7	n.a.	516.4
Foreign currency public debt (end of period)	80.5	83.3	81.4	76.0	76.4
External interest payments as percentage of exports of goods and services	12.1	11.5	10.4	n.a.	n.a.
International Reserves					
Net international reserves (USD Mill)	1752	2553	1777	884	1248
Gross international reserves (weeks of good and services imports)	18.4	23.4	17.8	<12	14

Note: (F) Forecasts numbers for 2013/14.

Source: Ministry of Finance and Planning, Bank of Jamaica, Statistical Institute of Jamaica, International Monetary Fund and own calculations.

Recent Developments

During this first quarter of 2014, the authorities are becoming more cognisant of the needed adjustments to their reform agenda based on outcomes from 2013 (previous quarterly bulletin) and the forecasts for the medium term. On the basis of recent medium-term projections for global trends in economic performance and commodity prices, this bulletin highlights the main areas for ensuring sustainability in Suriname.

Credit rating agency Moody's revised Suriname's outlook from positive to stable while maintaining the country's Ba3 sovereign rating. The credit agency noted that although economic growth remains strong and positive over the medium term, fiscal performance and rising debt levels have markedly deteriorated. Sustained narrowing of the fiscal deficit and strengthening of the budgetary and fiscal framework could stimulate improvements to the outlook. The authorities are expected to introduce a more robust and modern budget act in 2014.

The economy grew around 4 percent in 2013. Total investment, and expansion of the services sector (fuelled by commodity-related activities) drove growth in 2013 and will continue to do so over the medium term. The International Monetary Fund projects the average medium-term real GDP growth to be around 4.4 percent. This outlook assumes no further substantial decline in gold prices, and decisive actions for improving the business climate to stimulate non-mineral sectors.

The Bureau of Statistics presented the third and final volume of the 2012 Census results in early 2014. The third volume focuses on households, housing, families, environment, and crime. The results highlighted that 33 percent of women are heads of the household, while 84.5 percent of persons own their own home. The first volume with demographic, social, and migration data was presented in September 2013. In December 2013, the second volume followed with a focus on education, employment, traffic, fertility and mortality rates, health, and sports .

Inflation continues to decline into the low single digits dropping to 2.9 percent in February 2014. The country is currently experiencing the lowest level of inflation in 25 years, following the high of 22 percent in 2011 and the hyperinflation levels of the 1990s of 300 and 400 percent (figure 1). While inflation remains low, it is still vulnerable to international export prices and is very sensitive to the movements of international food prices. Annualised monthly inflation rates averaged 1.9 percent in 2013, reaching a high of 3.6 percent in June and falling to a low of 0.6 percent in December 2013. Core inflation also continues to be low; it fell to –0.4 at the end of December, as the government continues to tighten monetary policy (figure 2).

Highlights

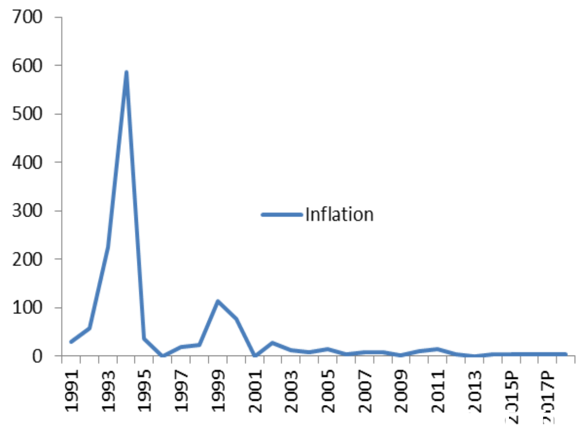
The real economy grew by around 4 percent in 2013.

Credit rating agency Moody's downgraded Suriname's outlook from positive to stable, while maintaining the country's Ba3 sovereign rating.

The Council of Ministers approved a minimum wage.

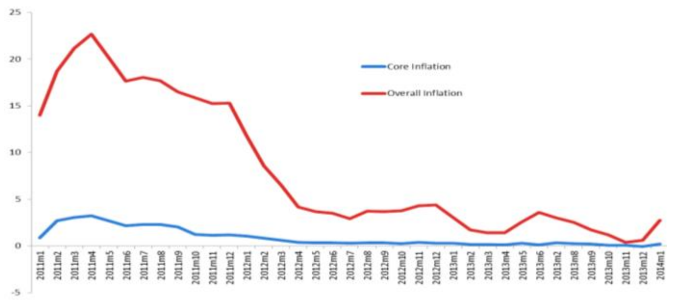
The IDB and other multilaterals will continue to be active in Suriname over the next few years.

Figure 1. Historical Inflation Levels



Source: Bureau of Statistics and Central Bank.

Figure 2. Monthly Headline and Core Inflation, 2011–2013



Source: Bureau of Statistics and Central Bank

The Council of Ministers recently approved a bill setting a minimum wage. The next step will be to submit the draft bill to the National Assembly for consideration before it can be implemented. Suriname currently does not have a minimum wage law. Discussions on the best way to approach the implementation of a minimum wage has been ongoing since the 1970s among the government, trade unions, and businesses. The minimum wage bill forms part of the progressive social program of the current administration.

The Islamic Development Bank approved a US $10 million loan for a technical and vocational education project in Suriname. The government is expected to contribute US$3 million toward this project. The core components of the project includes the establishment of a National Training Agency, improvement of the technical vocational curriculum, and the implementation of a labour market information system. In February, the IDB approved a US$60 million loan for the health sector, while the OPEC Fund for International Development (OFID) also approved a US$26.5 million loan to construct and renovate four health care sector facilities. The operation envisions the expansion of the Academic Hospital of Paramaribo and will construct other primary health care facilities.

The World Bank and the Caribbean Development Bank fielded missions to prepare full country strategies with Suriname for 2014. Both strategies are expected to be ready by the second semester of this year. The missions signal Suriname's desire to diversify its international debt profile and strengthen its multilateral partnerships. No notional lending envelope has been defined for either the World Bank or the Caribbean Development Bank.

The Government of Suriname announced it is in the process of having a draft consumer protection law ready to present to the National Assembly by the end of this year. Consultations with key stakeholders from the financial sector and the general public are underway. The consumer protection law is expected to form part of a comprehensive legislative package for improving the private sector framework that will be presented to the National Assembly this year.

While the Caribbean region worries about the potential changes to Petro Caribe, Suriname shows minimal vulnerability to this possibility. Suriname, through Staatsolie, pays full price for the oil bought from Venezuela in cash. A fund that could finance production and community development projects was in the process of being formalised; however, no project was yet approved.

Already political parties are positioning themselves for the national general elections, to be held in 2015. Suriname is currently headed by a coalition government because no one party was able to garner the majority of seats in the National Assembly to form the government in 2010. The current coalition government comprises Mega Combination, A-Combination, and People's Alliance. It is still unclear whether these parties will enter the elections individually or as a coalition in 2015.

IDB and Suriname

The 2014 lending pipeline supports reforms and investments in agriculture, energy, and private sector development. It also provides additional support to the reform agenda in capital expenditure and revenue management, energy, and agriculture. The program includes three investment loans for US$60M and five programmatic policy-based loans for US$70M. The lending program is complemented with relevant technical cooperation and one grant in energy from the European Union–funded Caribbean Investment Facility. Because of its primary focus on structural reforms, the main risk for the 2014 lending program rests in the authorities' ability to continue piloting the reform process in the run up to national elections scheduled for May 2015, amid less favourable macroeconomic conditions. They have also requested IDB support in the preservation of the status of cultural heritage, as recognised by UNESCO, of the capital city of Paramaribo in the wider context of improved urban planning. The IDB has responded positively to the request and will begin discussions with the authorities in May 2014.

High-Frequency Macroeconomic Indicators	Last data	Period	Prior data	Period
Annual GDP growth (%)	4.7	2013	4.8	2012
Exports (12-month growth)	16.1	Q4 2012	9.5	Q1 2012
Imports (12-month growth)	12.2	Q4 2012	14.4	Q1 2012
Inflation	2.9	Feb-14	0.6	Dec-13
Exchange Rate (End of Period)	3.35	Mar-14	3.35	Dec-13
Unemployment rate (%)	10.3	2012	9.5	2004

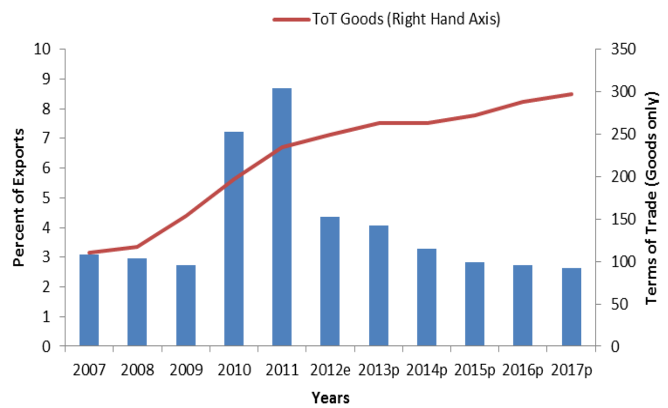
Introduction

Over the past few years, Suriname has embarked on critical actions that will have an implication for its future trade regime and international relations. Trade missions to territories such as Turkey, stronger bilateral ties with the East, and deeper relations with South American counterpart suggests a future away from the traditional trade partners (figure 4). The country is also becoming more open as new investments in several sectors move forward. This section takes a look at the external macroeconomic factors related to these developments. Sustainability can be preserved once the weighted commodity price index remains stable, planned investments lead to timely expansion of production, structural reforms facilitate the development of a more export-oriented private sector, and the monetary framework remains flexible and conducive to the overall macroeconomic ideals.

Trade

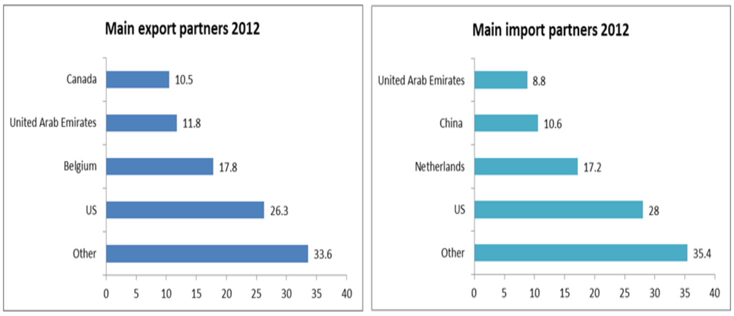
Suriname remains a very open economy. Total trade equalled around 97 percent of GDP in 2013. Alumina, oil, and gold account for more than 90 percent of the country's export value. The contribution of the non-mining exports to total exports as a share of GDP is expected to decline considerably over the medium term as the goods terms of trade continues to increase (Figure 3). This trend provides a basis for concern that Suriname is susceptible to the Dutch Disease phenomenon as its terms of trade and productive structure are highly sensitive to changes in commodity prices. Accordingly, the government is pushing for structural reforms to facilitate the private sector in leading growth. The revised sovereign wealth fund (when tabled again in the National Assembly) can play a key role in protecting against this phenomenon as well.

Figure 3. Non-mineral Exports' Share of Total Export Value



Source: International Monetary Fund 2013 and IDB Staff Calculations.

Figure 4. Suriname Top Export and Import Partners as Shares, 2012

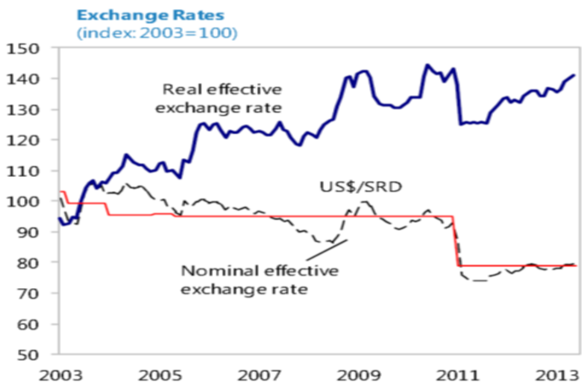


Source: Economist Intelligence Unit, Centrale Bank van Suriname, and International Monetary Fund 2013.

Monetary Policy and the Exchange Rate

Tight monetary policy continues to support the external framework. For most of its history, Suriname has engaged in multiple exchange rate practices. However, in January 2011 when the authorities devalued the Surinamese dollar by approximately 20 percent, its trading value was unified with that of the parallel (unofficial) market. The Central Bank actively tracks the spread between the official and unofficial rates. Figure 5 shows the evolution of the real effective exchange rate, which, after the significant devaluation in early 2011, has now appreciated a level similar to the middle of 2009. The Central Bank continues to monitor the exchange rate system given that Suriname is vulnerable to global movements in commodity prices.

Figure 5. REER Versus Nominal Exchange Rate and US$/SR$

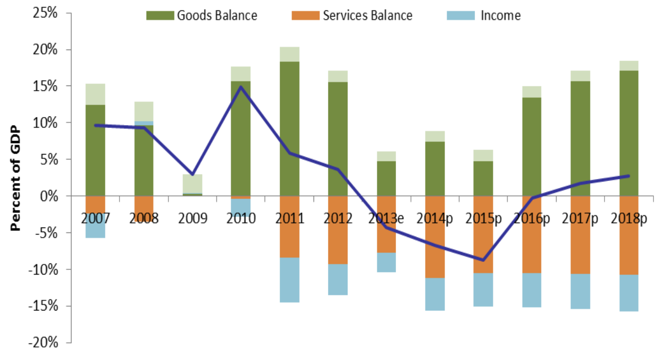


Source: International Monetary Fund Article IV 2013.

Current Account and Its Sustainability

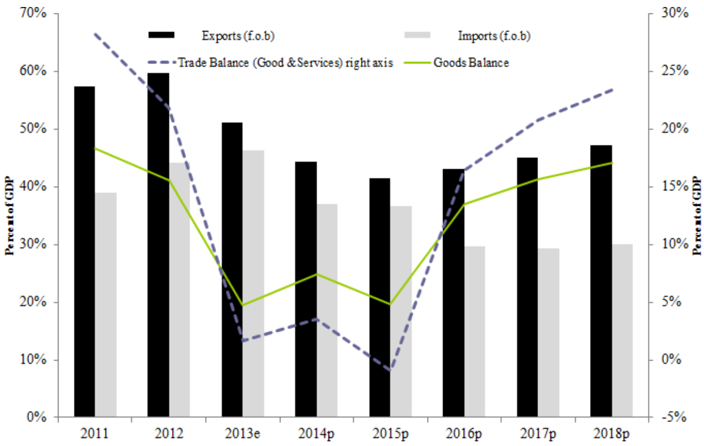
As projected, the current account moved into negative territory in 2013, registering a deficit of about 4 percent of GDP. Export value declined by an estimated US$300 million (over 2012), while the country maintained a large import of capital goods and services to support the major public and private investments underway. This trend will continue until 2015, reaching 9 percent of GDP before reversing as these large-scale projects end. Figure 6 illustrates the relationship among the various components of the current account and the projections according to the International Monetary Fund's recent Article IV staff report and Centrale Bank van Suriname. According to these figures, the goods balance is expected to erode by 10 percent of GDP as import demand expands. This trend is explained also by the moderation of export value particularly given the decline in gold prices. Nevertheless, exports are expected to recover to around 47 percent of GDP by 2018, after falling to a low of 41 percent in 2015. Figure 7 presents a more detailed analysis of the trade balance and provides a disaggregated performance of the trade balance, which is expected to expand between 2015 and 2018.

Figure 6. Current Account Performance in Suriname, 2007 2018p



Source: International Monetary Fund 2013 and Centrale Bank van Suriname 2014.

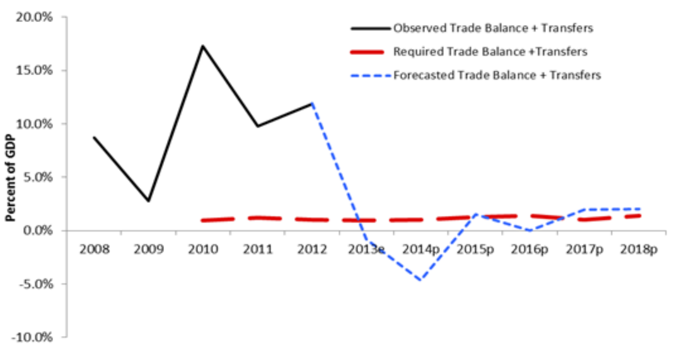
Figure 7. Suriname Trade Balance Performance Between 2011 and 2018p



Source: International Monetary Fund 2013 Article IV Staff Report and Centrale Bank van Suriname 2014.

Present and projected external current account levels suggest they will be sustainable over the medium term. As a measure of long-term external sustainability, a "sustainable current account" exercise was conducted for Suriname through an external sustainability assessment of the exchange rate developed by the International Monetary Fund. The methodology computes the required current account balance but excluding interest payments—namely the trade balance plus the balances on services and transfers. Using the medium-term averages for growth estimated by the International Monetary Fund and the real interest rate, the minimum noninterest current account balance as a share of GDP that stabilises net foreign assets at current levels is 1.21 percent. The subsequent table shows the noninterest current account balance required (and correlated adjustments) for various interest and growth rates. Figure 8 shows the result of estimating the required noninterest current account balance on an annual basis juxtaposed with historical and projected data. The latter illustrates that the forecasted current account performance will tend towards exceeding sustainable levels starting from 2015.

Figure 8. Net Foreign Assets Stabilizing Trade and Transfers Balances Versus Actual, 2007–2018p

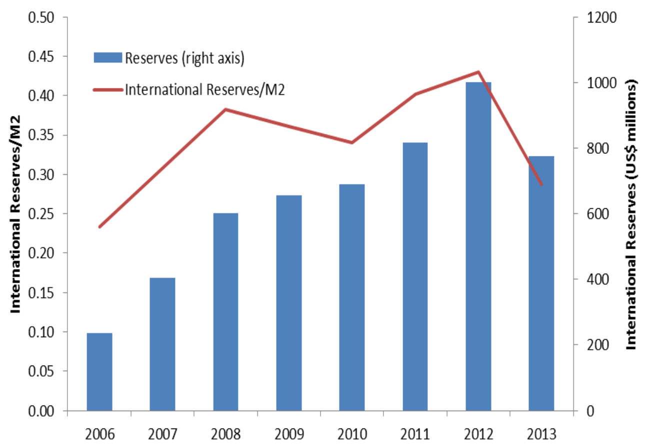


Source: Own calculations using International Monetary Fund, Centrale Bank van Suriname Data 2014.

International Reserves and Liquidity

International reserves, although lower, remain at broadly adequate levels. Gross international reserves are now around US$770 million and represent 4.2 months of imports. They are recovering from a low of US$725 million (November 2013) and are expected to grow to US$1.2 billion (5.6 months of imports) by 2018. International reserves equal about 20 percent of GDP. They are also more than nine times the short- and long-term debts that are due within a year. Although data are not easily accessible to calculate the Guidotti-Greenspan international liquidity ratio, international reserves as a share of M2 (see evolution in Figure 9) were estimated to be 0.29 (below average for the Caribbean but equal to the average if Jamaica and Trinidad and Tobago are excluded). Reserves appear high enough to act as an adequate buffer over the next 12 to 24 months.

Figure 9. International Reserves in Suriname



Source: Centrale Bank van Suriname 2013.

Conclusion and Outlook

New private and public investment projects will drive demand for capital imports and services, which will affect the trade and subsequently current account balances going forward. The current account balance will become more negative on a temporary basis until 2017. From 2016 on, the current account balance will improve as the trade balance expands. The performance of the current account balance will, on average, support the accumulation of international reserves to higher levels by 2018. Suriname's current account sustainability is vulnerable to the performance of a few commodities. Such vulnerability is exacerbated by the fact that the country's trading activities are concentrated among a few partners, some of which are facing less than optimal outlooks. The future sustainability of Suriname's current account is closely linked to a dramatic diversification of the real sector and export basket. Therefore, Suriname's strategy of building new trade and economic linkages with different partners should support its objective of enhancing its external sustainability.

SURINAME

SELECTED ECONOMIC INDICATORS

Suriname: Selected Indicators

	2009	2010	2011	2012E	2013P
(Annual percentage changes, unless otherwise indicated)					
Real Sector					
Real GDP	3.5	4.5	4.2	4.8	4.7
Nominal GDP	-3.1	13.2	25.8	11.94	5.3
Inflation (end of period)	1.3	10.3	15.3	3.4	0.6
Exchange Rates (end of period)	2.75	2.75	3.35	3.35	3.35
(In percent of GDP, unless otherwise indicated, on a calendar year basis)					
External Sector					
Exports of goods and services	68.2	54.3	64.5	63.1	n.a
Imports of goods and services	60.7	62.7	73	68.8	n.a
Current Account	-1.1	1	0.4	-0.2	-2.1
Gross International Reserves (USD Mill)	763	785	987	1,209	775
Savings and Investment					
Private Sector Balance	1.9	9.6	4.7	-0.6	-2.0
Public Sector Balance	-2.4	-3.1	0.9	0.5	0.0
Savings	3.3	1.8	6.9	6.3	5.6
Investment	5.7	4.9	6	5.8	5.7
Central Government					
Revenue and Grants	36.4	25.8	26	25	24.1
Total Expenditure	35.3	28.2	25.2	24.5	24.1
Primary Balance	-1.2	-2.3	1.8	1.4	0.9
Overall Balance	-3	-3.6	0.9	-4.0	-3.9
Consolidate NFPS balance	-3	-3.6	0.9	0.5	n.a
Debt Indicators					
Total Public Sector Debt	18.5	21.6	19.1	21.5	28.0
Public Sector Debt over Revenues	61.5	81	73.3	74.4	75.2
External Debt (end of period)	8.3	8.7	7.6	11.5	14.0
Domestic Debt (end of period)	10.2	12.9	10.8	10	14.0
External debt as percent of exports of goods and services	15.8	14.5	17.3	18.9	22.2

Source: Based on IMF Article IV Country Report and Central Bank of Suriname

Recent Developments

Economic growth is expected to be robust after a long period of maintenance-related shutdowns in the energy sector and a slowly recovering nonenergy sector. The Central Bank estimates economic growth at about 1.5 percent in 2013, because the improved economic performance in the first half of the year—particularly for the nonenergy sector—is expected to support overall economic recovery. For 2014, the Central Bank anticipates fairly broad-based growth of about 2.5 percent. With the completion of major maintenance work on offshore gas platforms, energy production is set to recover to full capacity during 2014, although much of the renewed activity will go into investment. Public spending is expected to increase going forward during 2014 before national elections, which will also help fuel demand.

The unemployment rate in the first quarter of 2013 (latest available data) is reported to have fallen to 3.7 percent, although economic recovery in the nonenergy sector is gradually recovering. The report emphasizes an increase in jobs—particularly in construction—and professionals in the energy services sector, consistent with a ramping up of activity in energy investment. The continuation and expansion of various make-work programs, such as the Community-Based Environmental Protection and Enhancement Programme (CEPEP) and the Unemployment Relief Program (URP), mainly provide low-skilled labor such as landscaping services. These low-skilled workers' hourly wages are higher than those of minimum wage earners who do comparable work because the latter typically work less than a full work week. This underemployment also creates incentives for comparable private sector low-skilled workers to put in less effort if this attractive alternative is available. Given these circumstances, many private businesses complain that overgenerous programs, although helpful as a safety net, may also lead to a culture of low productivity. Also, authorities and businesses are concerned that certain types of skilled labor, such as nurses, are scarce.

Inferences about the relation between unemployment and output in Trinidad and Tobago are difficult to make. Figure 1 suggests that the relation is counter to what theory suggests. High growth should be the result of more people working and should thus correlate with a low unemployment rate; however, the relation in Figure 1 looks positive for three possible reasons. First, the energy sector—which comprises 40 percent of GDP—has a long gestation cycle and is very capital-intensive, so the fall in oil and gas output does not correspond one-for-one with higher unemployment rates in that sector. A second reason is that the aforementioned government make-work programs account for a substantial part of employment: Unemployment Relief Program workers make up almost 20 percent of all construction workers, and any underemployment in terms of hours worked is not reflected in the statistics. Third, persistent logistical problems in the Central Statistical Office have delayed the full adoption of the new labor survey, making it difficult to check the consistency of survey responses. Moreover, quarterly output data in the nonenergy sector is an estimate constructed by the Central Bank, given that national accounts are not produced quarterly, nor have they been updated beyond 2011.

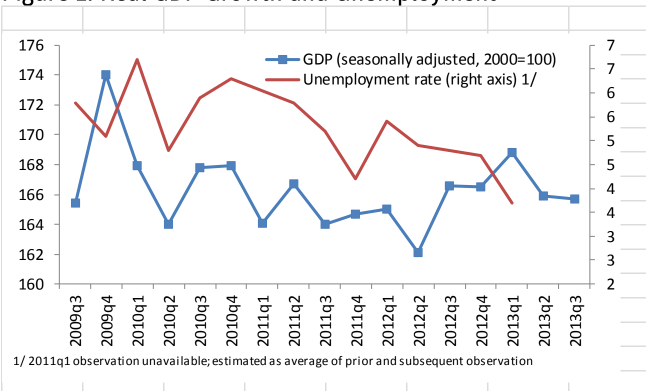
Highlights

Growth is set to pick up in 2014, and the employment numbers suggest that the economy is using greater capacity. However, the numbers may also reflect generous make-work programs.

Activity in the oil and gas sector, particularly seismic exploration activity, suggests promising prospects.

Unlike Petrotrin, the National Gas Company is commanding an increasingly important presence in the gas infrastructure of the country.

Figure 1. Real GDP Growth and Unemployment



Source: Central Bank of Trinidad and Tobago.

Lackluster business credit reflects few investment opportunities amid high liquidity, despite healthy consumer credit. Private sector credit is growing at 5 percent annually, but the business component is still flat. Annual inflation continues to slow, to an annual rate of 3.9 percent to February 2014. However, as the economy approaches capacity and interest rates everywhere begin to rise, inflation may pick up slightly in the coming year. Moreover, with excess liquidity in the banking system, monetary policy will have to continue contending with a structural liquidity overhang for the foreseeable future.

The Energy Sector Is Looking Ahead

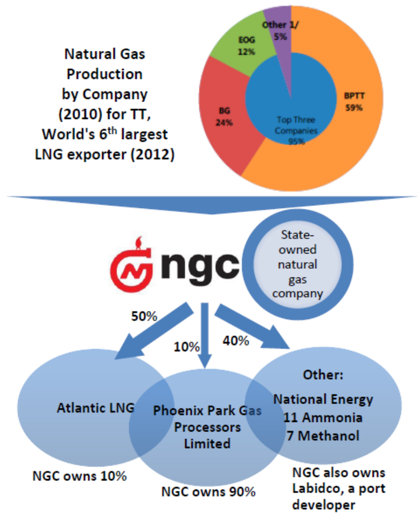
Domestic oil and gas production is expected to increase over the medium term, as the private sector ramps up investment. Recent fiscal incentives for deep-water drilling and enhanced oil recovery of mature fields—an area where the country had previously been relatively slow to attract new investment—have led to many successful production contracts signed over the past 2 years which are now at the exploration investment phase. Preliminary seismic findings by BPTT and BG suggest promising signs in areas geologically akin to structures off the west coast of Africa where offshore oil is abundant. Technology has permitted companies to utilize previously inaccessible acreage, as only a third of Trinidad and Tobago's offshore areas have been exploited.

In contrast, the state oil company Petrotrin has slowed output considerably because of a lack of sufficient investment. Chronic cash-flow problems, a loss of skilled staff over the years to the more lucrative private sector, and strong unionization have taken a toll. A recent global benchmarking study by Shell suggested that Petrotrin is overstaffed by 75 percent. Its refinery has also suffered recently from competition by North American refiners which are refining domestic production.[1]

Unlike oil, the natural gas sector is dominated by the powerful and profitable state company, National Gas Company (NGC). It is a monopsony, the sole buyer of natural gas from all producers, with an increasingly large influence on all aspects of the gas economy (Figure 2). NGC provides the entire feedstock used by the downstream petrochemical sector, which is one of the largest world exporters of urea and methane. NGC partly owns Atlantic LNG, the liquid natural gas (LNG) exporting terminal that has some of the lowest operating costs in the world. Moreover, NGC has equity investments in some of the most important new projects: (a) after a recent acquisition it now owns 100 percent of the Phoenix Park Gas Processing Limited, one of the largest gas-to-liquids processing plants in the Western Hemisphere; (b) it has an equity stake in the Eastern Caribbean Pipeline project and the Gasfin project to set in motion medium-scale natural gas regasification floating barges for exporting gas to other Caribbean islands; (c) the country's electricity sector is fueled entirely by natural gas from NGC; and (d) it is fully funding the compressed natural gas (CNG) initiative, building CNG service stations and importing CNG-run buses for public transport all over the country, as well as subsidizing CNG conversion kits for passenger vehicles.

Because the natural gas markets tend to have very specific characteristics in every country, it is not always clear what is the right price at which NGC should buy from gas-producing companies, and at what price it should sell to exporters and the downstream sector. Is the middleman needed? There is very little transparency in this matter, so the Minister of Energy has commissioned a Natural Gas Master Plan to review and, if necessary, reconsider the structure of the country's natural gas market and pricing in the medium term.

Figure 2. National Gas Company (NGC) and the Structure of the Gas Market in Trinidad and Tobago.



Although global energy markets are changing considerably, oil production is still generally considered much more profitable than natural gas is for producers, given the simpler export logistics of liquids. Fortunately for Trinidad, they have the infrastructure available to process whatever comes out of the ground, whether oil or gas.

High-Frequency Macroeconomic Indicators	Last data	Period	Prior data	Period
Annual GDP growth (%)	-0.5	Q3 2013	2.3	Q2 2013
Exports (12-month growth)	-11.8	Q2 2013	17.0	Q1 2013
Imports (12-month growth)	-27.9	Q2 2013	-3.0	Q1 2013
Private sector credit growth (%)	4.8	Sep-13	4.7	May-13
Inflation	4.4	Nov-13	2.7	Oct-13
Exchange rate (end of period)	6.42	Dec-13	6.42	Nov-13
Natural gas production (%, annual change)	-0.2	Q3 2013	3.6	Q1 2013
Unemployment rate (%)	4.8	Sep-12	4.9	Jun-12

[1] The United States still prohibits the export of crude petroleum—originally a policy established for national security reasons—so with the sharp rises in shale oil production, North American refineries are able to get cheap local feedstock and reduce their import supplies.

TRINIDAD AND TOBAGO MAINTAINING EXTERNAL SUSTAINABILITY

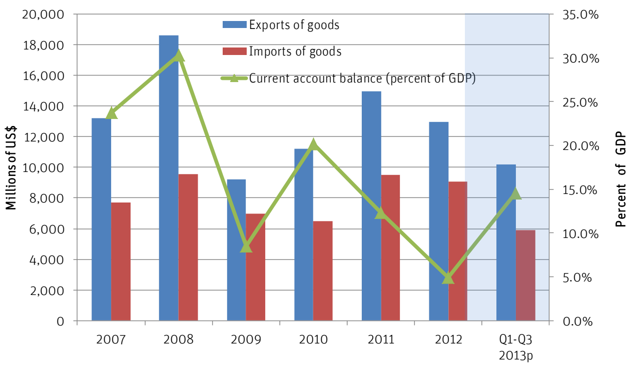
Introduction

The question of external sustainability in Trinidad and Tobago is drastically different from what normally pertains in many middle-income countries. Unlike its Caribbean peers, the standard short-term macroeconomic sustainability indicators depict a strong economy with ample buffers, even compared with advanced economies. This note presents these macroeconomic indicators of external sustainability and considers some aspects for improving long-term external competitiveness.

Standard Indicators Suggest Sound Sustainability

The country is a small, energy-based exporter. Trinidad and Tobago has a population of 1.3 million, with total trade equivalent to 91 percent of GDP. Although energy constitutes the main export of the country. Trinidad and Tobago is diverse in terms of trading partners, given that it exports to many continents as well as within CARICOM. Oil, petroleum products, and gas exports represent 64 percent of the country's total exports as of 2012 (latest data available), while fertilizers and products derived from petroleum constitute more than 17 percent of total exports, the remainder consisting mostly of manufactured goods. Exports to the United States represent 50 percent of energy exports, and other Caribbean countries are the main destination of manufactured products exported from Trinidad and Tobago. The country also imports crude petroleum (about 30 percent of the total) for refining, most of it for domestic consumption, but some for re-export to CARICOM.

Figure 3. Trinidad and Tobago Merchandise Trade and Current Account Balance

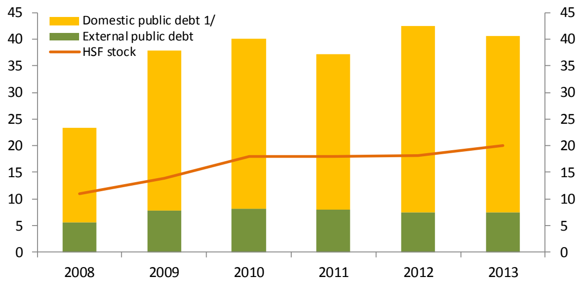


Source: Central Bank of Trinidad and Tobago.

The country typically runs a current account surplus (Figure 3). This surplus reached almost 30 percent of GDP in the middle of the past decade, with favorable volumes and prices of hydrocarbons, which led to GDP growth rates close to 10 percent. However, the fall in energy prices led to a narrowing of the surplus starting in 2009, to an estimated 5.5 percent in 2012 (also partly because of outflows of foreign investment profits). These surpluses will rise with the projected growth in energy output in 2014, however, imports are growing, particularly for automobiles.

A key component of its external sustainability is the presence of a strong savings bias of the Heritage and Stabilization Fund. The Heritage and Stabilization Fund, created in 2007, operates mostly as a savings fund, with US$3.5 billion (68 percent of the current stock) considered the heritage component, that is, a floor below which funds cannot be accessed for stabilization purposes. Over the past few years, the government has postulated a deliberately conservative oil and gas price assumption for budget purposes, which means that actual revenues have systematically exceeded budgeted revenues, triggering the rule for deposits into the Fund. Taking the Fund into account, the country's net external debt is half of gross debt.[2] The stock was at US$5.154 billion at the end of 2013, equivalent to 20 percent of 2013 estimated GDP, covering 47 percent of total gross public debt and 253 percent of external public debt (Figure 4).

Figure 4. Public Debt and the Heritage Stabilization Fund



Source: Ministry of Finance.
1/ Excludes OMOs and includes contingent liabilities and CLICO).

Reserve levels are also high. The level of gross official reserves stood at almost US$10 billion or 12 months of prospective imports of goods and nonfactor services by end-2013, a growth of US$0.5 billion during the year. The ratio of international reserves is also more than 17 times larger than the entire debt service amortization in 2014, substantially above the threshold of 1 established by Greenspan and Guidotti. Another measure

[2] This concept of net debt is sometimes favored for assessing debt sustainability. In the overwhelming majority of countries with public debt, the difference between the definitions is minor.

considered is whether reserves can back the liquid money supply in the hypothetical scenario of a sudden capital outflow. In this case, reserves are only 83 percent of M2 because M2 has expanded as commercial banks' cash and deposit liabilities continue to grow. A standard ratio would be 100 percent or greater. Nonetheless, in this instance the problem is in the very large denominator and not the adequacy of reserves. Table 1 shows these and other standard indicators of external sustainability. In all cases, Trinidad and Tobago seems to meet or comfortably exceed standard benchmarks.

Table 1. External Sustainability Indicators

External indicators	2010	2012	2013
Current Account Balance (in percent of GDP)	20.2%	5.5%	n.a.
Capital Account Balance (in percent of GDP)	-18.2%	-6.5%	n.a.
Net Foreign Direct Investment (in percent of GDP)	2.7%	3.2%	n.a.
Gross International Reserves (mill of USD)	9,070	9,201	9,987
Gross International Reserves (in months of g&s imports)	13	10	12
Gross International Reserves (in percent of M2)	103%	83%	83%
Real Effective Exchange Rate appreciation, end of	7.5%	4.5%	0.4%
S&P Rating (Foreign Currency Long Term Debt) 1/	A	A	A

Source: Central Bank of Trinidad and Tobago.
1/ Outlook was downgraded in 2011, but not rating

A final measure of external sustainability is an approach developed my Lane and Milesi-Ferreti.[3] The approach considers what the net wealth position of the country is in relation to the rest of the world, assuming medium-term growth of 2.5 percent and a real interest rates of 3.5 percent. If net foreign assets were at or above acceptable levels, perhaps because of persistent current account surpluses, sustainability issues would not be a concern. The exercise for Trinidad and Tobago yields a negative number for the adjustment on the current account that would be required to keep the net foreign assets at their current level, in other words, the country is not only sustainable, but also has an extra cushion equivalent to 15.7 percentage points of GDP—about the size of the energy fiscal revenues—illustrating the strong dependence that the country still has on energy exports for its wealth.

But foreign assets for an oil-based economy should be saved. Using the same theoretical underpinnings, the International Monetary Fund's 2013 Article IV consultation looked at the evolution of the net foreign assets by adjusting the current account under the income allocation rule to see the exchange rate level which would yield intergenerational equity. Their analysis suggests a need for additional savings of energy income to maintain a stable level of domestic absorption in the long term (across generations). In other words, it would suggest that Trinidad and Tobago should make the Heritage and Stabilization Fund savings rule stricter to accumulate funds faster, and that current public expenditure may be too high and not contribute sufficiently to intergenerational equity.

Three Impending Challenges

Like many small middle-income countries, Trinidad and Tobago has a fear-of-floating syndrome. This means that although the exchange rate regime is legally and in theory a floating rate, de facto exchange rate movements are rare and kept at a complete minimum by active interventions in the foreign exchange market by the central bank. The market for foreign exchange has various tiers: an auction market established by the Central Bank, a supply from the three main energy companies, and a so-called noncompetitive tier where the supply is allocated to authorized dealers according to a predetermined share. Recently, the latter tier of the market has been significantly reduced in order to allow more competition. The complicated tier system has created gaps and inefficiencies in the past, including delays in the accessibility to foreign exchange by smaller buyers; however, they always get the rate and amount demanded. Unusually long delays in supply in early 2014 were likely due to languished energy export receipts. Nonetheless, there is clearly not a structural foreign exchange scarcity.

Second, like many small countries in the region, anecdotal evidence suggests that the country is also a transit area for drug smuggling to North America and Europe. Increasing incidences of crime and purchases of high-end real estate are consistent with these worrying trends. Nonetheless, there is no proof of the extent and impact of this, only anecdotal evidence.

Third, a more long-term challenge is how to reduce the dependence on energy exports. Can the country create activities using the energy services sector as a launching pad to increase competitiveness in nontraditional sectors? The Ministry of Trade has been working diligently to improve the environment for foreign investment, studying various components of the World Bank *Doing Business* indicators on order to address the factors behind the country's ranking on each indicator. For example, the time it takes to open a business was recently reduced from 3 days to 1 day. The IDB-financed program to support the country's positioning as a world renowned location for global provision of IT-enabled services will help. In the long term, however, labor productivity in the nonenergy sector will have to improve so that the country can realize its potential.

[3] Lane, Phillip, and Gian-Maria Milessi-Ferreti. 2001. "The External Wealth of Nations: Measures of Foreign Assets and Liabilities." *Journal of International Economics* 55 (201): 263--294.

Trinidad and Tobago: Selected Indicators

	2009	2010	2011	2012	2013 (F)
(Annual percentage changes, unless otherwise indicated)					
Real GDP	-4.4	0.2	-2.6	0.2	1.6
Nominal GDP	-30.8	8.3	14.5	9.2	5.4
Inflation (end of period)	1.3	13.4	5.3	7.2	4.0
External Sector					
Exports of goods and services*	-50.5	21.9	33.0	-8.1	3.1
of which: oil and natural gas*	-51.8	18.8	34.7	-16.8	n.a.
Imports of goods and services*	-27.1	-6.8	46.2	-11.8	5.4
Current account (percentage of GDP)	8.5	20.2	12.3	4.1	4.7
FDI (percentage of GDP)	3.7	2.7	3.3	3.2	8
(In percentage of GDP, unless otherwise indicated, on a fiscal year basis)					
Central Government**					
Revenue and grants	29.0	34.1	32.6	32.3	32.6
of which: energy revenues	14.5	18.4	19.0	17.3	16.8
Current expenditure	27.7	28.9	28.6	29.4	31.6
Capital expenditure and net lending	6.2	5.0	4.8	4.3	4.8
Primary balance	-2.3	2.7	1.2	0.8	-0.7
Overall balance	-4.9	0.2	-0.8	-1.4	-3.8
Consolidate NFPS balance (incl. CLICO)	-9.0	-6.5	-0.6	-6.8	-1.2
Debt Indicators					
Public sector debt^	30.6	35.5	33.4	38.7	33.4
Public sector debt over revenues	105.5	104.1	102.5	122.8	111.5
External public debt (end of period)	7.7	6.7	6.4	6.7	7.2
External debt service as percentage of exports of goods and services	0.8	0.6	0.4	0.5	n.a

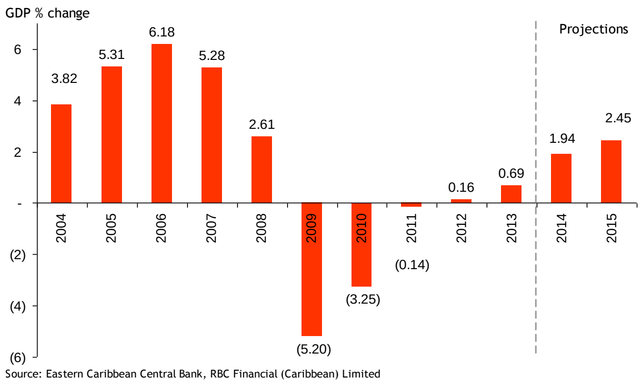
Notes: * refers to annual change in value (USD Million); ** 2013 refers to October 2012-September 2013; ^ Non Financial Public Sector Debt. Excludes debt issued for sterilization and since 2012 it includes debt increase due to issue to CLICO debt holders. FDI= foreign direct investment; NFPS= Non-Financial Public Sector. (F) Forecasts numbers for 2013.

Source: Central Bank of Trinidad and Tobago, International Monetary Fund 2013 Article IV Press Release, IMF World Economic Outlook, October 2013.

OECS Overview

Although earlier a moderate economic expansion had been reported for the first half of 2013, the economy of the Eastern Caribbean Currency Union contracted in the first 9 months of 2013 (the period under review) compared with the same period the previous year.[1] For the period under review, economic activity is estimated to have expanded only in Grenada, St. Kitts and Nevis, and St. Vincent and the Grenadines, while the remaining member states contracted or showed no growth. The decline in overall economic output reflects the broad-based contraction in sectors including hotels and restaurants, construction, transportation, storage and communications, financial intermediation, manufacturing, and agriculture. Only real estate, renting, and business activities saw improvement; however, it was insufficient to mitigate declines in the other sectors.

Figure 1. ECCU Real GDP Growth Rates



Prices fell by an estimated 0.3 percent year-on-year in 2013, based mainly on softer food and energy prices, which also contributed to a 2.6 percent narrowing of the merchandise trade deficit. Outstanding domestic credit to the private sector expanded by 3.1 percent (up from a 1.6 percent growth for the corresponding period in 2012), based largely on a 6.5 percent uptick in credit to businesses.

The total public sector debt stock declined by 1.9 percent to XCD12.9 billion, while both central government debt and state enterprises' debt fell marginally to XCD1.989 billion during the period under review. Public sector debt declined only in St.

[1] As reported in the September 2013 *Economic and Financial Review* published by the Eastern Caribbean Central Bank.

[2] According to the Economic Survey of Latin America and the Caribbean 2013.

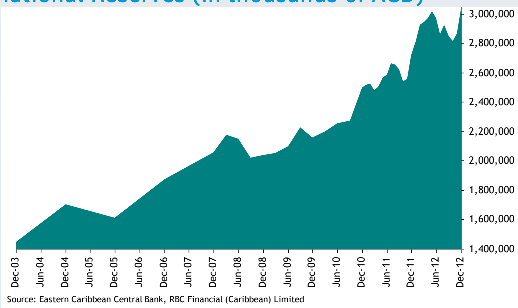
External Strength and Stability

The Eastern Caribbean Central Bank (ECCB) has a so-called quasi-currency board arrangement. *Unlike an orthodox currency board, the ECCB is a central bank, responsible for monetary policy management, liquidity management, payment system maintenance, and banking sector regulation and supervision. Given the openness of the economies and the quasi–currency board arrangement, the ECCB's priority is to preserve the currency's external value, which limits the effectiveness of monetary policy tools and its lender-of-last-resort capacity. According to the International Monetary Fund (2013):*

> The ECCB manages a common pool of reserves and extends credit to governments and banks when needed, up to a limit determined both by the reserve coverage and by individual country limits. Under the arrangement, the ECCB must hold foreign exchange equivalent to at least 60 percent of its demand liabilities (mainly currency in circulation and commercial banks' non-interest-earning reserves). Operationally, it targets 80 percent reserve coverage, but in practice it has been close to 100 percent. This mechanism limits the risk of a balance of payments crisis, but the reserve cover rule is achieved at the expense of flexibility in providing liquidity. Orthodox currency boards typically hold in excess of 100 percent of demand liabilities in foreign currency.

The Eastern Caribbean Currency Union has healthy and growing foreign reserves. *Figure 2 shows that at end-2012, reserves were more than US$1.2 billion, at 16 weeks of import coverage.[2] Moreover, a balance-of-payments surplus persists—an enviable position by regional comparison. The level of net foreign assets attributable to each member country, held at the ECCB, is largely stable; this stability excludes St. Kitts and Nevis, which experienced a noticeable uptick partly resulting from inflows related to Citizenship-by-Investment programs.*

Figure 2. Eastern Caribbean Currency Union Net International Reserves (in thousands of XCD)

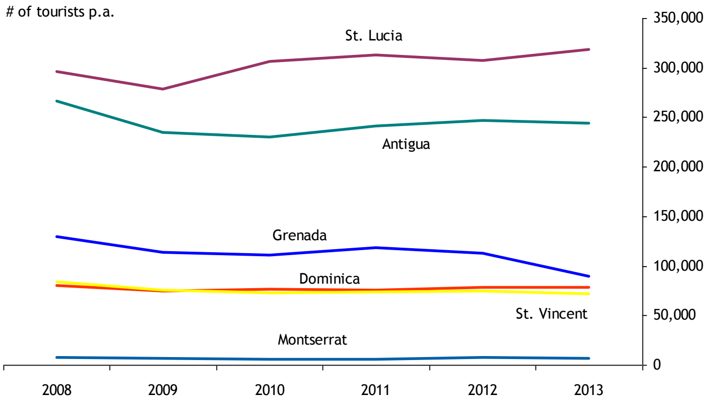


Source: Eastern Caribbean Currency Union and the RBC.

Kitts and Nevis and Montserrat, but the substantial decline in the former country offset increases elsewhere.

Unlike several of its regional neighbors, the ECCU has not seen much change to its stopover arrivals over the past few years. According to the Caribbean Tourism Organization, Antigua and Barbuda have the highest amount of stopover visitors (Figure 3). Data for Grenada are available only up to September 2013, showing a 0.8 percent year-on-year decline. Antigua and Barbuda saw 1.2 percent fewer stopover arrivals in 2013 compared with 2012, and St. Vincent and the Grenadines declined by 3.5 percent in 2013, according to the Caribbean Tourism Organization.

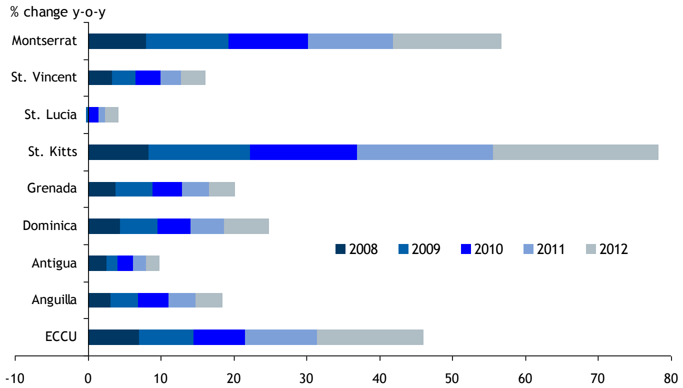
Figure 3. ECCU Stopover Arrivals



Source: Caribbean Tourism Organisation, RBC Financial (Caribbean) Limited

The balance-of-payments surplus for the currency union overall narrowed to an estimated XCD157 million in 2013. However, net international reserves of the ECCB grew by 8.3 percent for the period under review, to XCD3.28 billion (about US$1.21 billion). All countries have shown positive growth in import cover since 2008 (Figure 4).

Figure 4. ECCU Growth in Import Cover, 2008 to 2012



Source: Eastern Caribbean Central Bank, RBC Financial (Caribbean) Limited

The ECCB estimates that the economy returned to positive growth in Q4 2013. The construction, hotels and restaurants, and wholesale and retail sectors are showing signs of recovery, and increased airlift is carded for some territories. As such, positive growth is expected for 2013 overall, as seen in Figure 1. The ECCB's latest GDP data estimate real growth of 0.79 percent for 2013 and 1.94 percent for 2014.

ANTIGUA AND BARBUDA

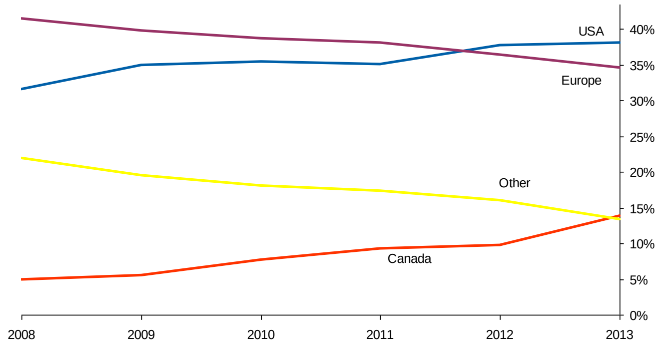
The ECCB's *Economic and Financial Review* estimates a contraction in economic activity in Antigua and Barbuda from January to September 2013. The construction and tourism sectors declined; total visitor arrivals dropped by 4.9 percent year-on-year, and private construction activity slowed. As a result, wholesale and retail trade also suffered.

The contraction has caused inflation to decelerate, with prices rising by a mere 0.2 percent during the first three quarters of 2013, down from 1.1 percent for the corresponding period in 2012. The merchandise trade deficit narrowed by 2.5 percent year-on-year to XCD938 million for the period under review, based mainly on a 34 percent jump in the value of re-exports. Moreover, credit to the private sector slipped by 3.2 percent on continued deleveraging, and central government loans declined by 4.7 percent because borrowing has shifted toward market instruments.

The fiscal deficit widened by 143.3 percent to XCD116.3 million, as current expenditure expanded by 4.5 percent, while current revenue slipped by 7.3 percent year-on-year. The primary balance consequently deteriorated to a deficit of XCD69.6 million after a small surplus in the same period of 2012. These trends prompted a 4.1 percent rise to XCD3 billion in public sector debt. However, Antigua and Barbuda's imputed share of the Central Bank's foreign reserves increased by 26 percent, according to the ECCB. Despite the completion of an International Monetary Fund program in early 2013, fiscal pressures continue, in particular due to the high resolution costs of failed banks.

The Caribbean Tourism Organization indicated that in 2013, "other" markets (mainly regional) became the least important to Antigua and Barbuda, giving way to Canada, which expanded from 9.8 percent of stopover arrivals in 2012 to 13.9 percent in 2013, shown in Figure 5. According to the ECCB, the number of visitors from Canada grew 27.9 percent for the period under review.

Figure 5. Antigua and Barbuda Stopovers Source Market Share



Source: Caribbean Tourism Organization, RBC Financial (Caribbean) Limited

DOMINICA

Economic performance for the period under review has been described as "mixed" in the ECCB's *Economic and Financial Review*. Disease has adversely affected banana output, causing production levels to fall by almost 40 percent year-on-year. Construction activity softened to a greater degree in the private sector, where the value of construction dropped by more than 37 percent; however, the manufacturing sector grew during that period. Although stopover arrivals grew by 0.2 percent year-on-year in 2013, the Caribbean Tourism Organization indicated that according to the ECCB, total visitor arrivals dropped by more than 21 percent year-on-year.

During the first 9 months of 2013, the price level fell by 0.8 percent on slower economic activity and lower fuel costs. However, exports grew during that period.

Public borrowing offset a smaller fiscal deficit. The overall fiscal deficit also shrank by more than 24 percent year-on-year as a result of higher revenues and lower capital spending. Consequently, the primary deficit fell by more than 32 percent year-on-year, to XCD75.4 million. However, total public sector debt increased, by 0.2 percent for the first 9 months of 2013, mainly on higher central government borrowing from commercial banks. This prompted a 6.7 percent annual increase in domestic credit, while credit to the private sector expanded by less than 1 percent year-on-year.

According to the ECCB, Dominica's imputed share of foreign reserves declined by 12.4 percent.

GRENADA

On March 14, 2014, the International Monetary Fund announced that it had reached a staff-level agreement with Grenada on an economic program under a 3-year Extended Credit Facility in the amount of USD21.9 million. The program, designed by Grenada's authorities, has been described by the International Monetary Fund as "ambitious," involving fiscal and debt consolidation, structural reforms to promote sustainable long-term growth, and measures to safeguard financial sector stability. Other multilateral lending agencies have also committed to lend financial and other forms of support to this effort, and negotiations continue on debt restructuring. In early April 2014, the government announced two options for restructuring the US$194 million in bonds—one involving a 50 percent haircut, and the other a 60 percent haircut on the face value.

Stopover arrivals fell slightly, but the ECCB reports a 15 percent drop in total visitor arrivals. In 2013, the United States overtook Europe to become the top most important source market for stopover arrivals (more than 25 percent, compared with Europe, which now has 23 percent). Nonetheless, other (mainly regional) markets constitute about 45 percent of the total.

Output is estimated to have grown during the first 9 months of 2013, compared with a contraction during the corresponding period of 2012, according to the ECCB. The construction sector continues to grow, based on the 25 percent increase in imports of construction materials. Manufacturing output is likely to have expanded as well, prompted mainly by higher beverage production. Owing mainly to St. George's University, the education sector is estimated to account for about 18 percent of Grenada's total GDP, and indicators suggest that this sector also expanded during the period under review. Agriculture has also likely expanded, given the 21 and 3.6 percent increase in nutmeg and banana production, respectively, in the first 9 months of the year.

Price deflation of 1.5 percent was recorded for the first 9 months of 2013, based on a softening in economic activity and an 18.5 percent drop in the communications subindex. Commensurately, domestic credit contracted by 7.4 percent based largely on a 4.8 percent decline in credit to the private sector. The ECCB reported that the overall fiscal deficit narrowed by 28 percent to XCD69 million on higher revenues and lower expenditure.

On the external front, the merchandise trade deficit widened by 1.3 percent year-on-year. Higher imports, mostly in construction, overshadowed a 13.5 percent growth in exports. In addition, external and domestic public debt grew by about 5 percent in the first 9 months of 2013, while Grenada's imputed share of ECCB's reserves increased by 8.8 percent.

ST. KITTS AND NEVIS

Fiscal consolidation experienced positive progress. The International Monetary Fund recently concluded its 2014 Article IV consultation and the seventh and eighth review under a 36-month Stand-By Arrangement with St. Kitts and Nevis. The Fund estimates growth at 1.7 percent in 2013, given the improved performance in the tourism sector and a recovery in construction prompted by the Citizenship-by-Investment program and other tourism-related projects. Inflation has eased, and the banking sector remains resilient and well capitalized. Recovery is expected to gain momentum; the Fund projects growth at 2.7 percent in 2014. The overall fiscal balance increased from a deficit of 7.8 percent of GDP in 2010 to an estimated surplus of 10.6 percent in 2013, according to the Fund. Debt has been reduced from 164 percent of GDP in 2010 to 105 percent in 2013 based on debt restructuring and International Monetary Fund–supported fiscal consolidation.

The estimate that economic activity grew during the first three quarters of 2013 was likely supported by an expansion of the construction sector. According to the ECCB, public spending on construction grew by 51 percent year-on-year, imports of construction material increased by 23 percent, and construction-related borrowing rose by 2.5 percent, supporting the notion that the construction sector expanded. In the tourism sector, stopover arrivals increased in 2013 by 3.2 percent to almost 101,000, according to the Caribbean Tourism Organization. As a result, the ECCB noted that hotels and restaurants have reported heightened levels of activity. Total crop production grew by 13.3 percent, but manufacturing output (particularly beverage production) is estimated to have declined after the country lost its license to produce many internationally renowned brands. The merchandise trade deficit widened by 14 percent to XCD363.6 for the first 9 months of 2013 year-on-year, based on (a) higher imports of fuel and construction material and (b) lower exports.

However, prices and credit fell. Disinflation reduced the inflation rate to 0.4 percent during the first 9 months of the year, compared with a rate of 1.9 percent for the corresponding period in 2012. Domestic credit declined further by 22 percent during the period under review, after an 8.1 percent year-on-year decline during the corresponding period in 2012, based mainly on much lower government borrowing.

The federal government's overall fiscal surplus widened to XCD176.6 million during the first 9 months of 2013 compared with the same period in 2012, given that the extent of revenue growth outpaced that of expenditure. The primary fiscal surplus almost doubled to XCD188.8 million. However, the level of public sector debt continued its downward trend, falling by 21 percent year-on-year to XCD2.125 billion at end-September 2013. St. Kitts and Nevis' imputed share of ECCB reserves increased by 39.1 percent.

ST. LUCIA

The level of economic activity is estimated to have remained largely unchanged for the first 9 months of 2013. according to the ECCB, partly given the increase in total visitor arrivals. Indeed, the Caribbean Tourism Organization reported a 3.9 percent increase in stopover arrivals in 2013 to 318,626. A notable uptick in tourists from the United States accounted for 40 percent of total stopover arrivals.

An estimated rise in construction activity was noted for the period under review; there was higher spending despite a decline in the level of imports of construction materials. Agriculture is estimated to have grown, while manufacturing may have declined year-on-year.

Prices fell by 2.1 percent year-on-year in the first 9 months of 2013 compared with inflation of 1.5 percent in the corresponding 2012 period. Domestic credit expanded by 1.8 percent year-on-year because public and private sector lending grew. The overall fiscal deficit narrowed by 5.4 percent year-on-year to XCD146 million, as the current account moved into surplus based on higher value-added tax revenues and slightly lower expenditure. As central government increased its level of borrowing, the stock of public sector debt grew by 2.1 percent year-on-year.

The merchandise trade deficit narrowed by nearly 19 percent mainly because of a significant drop in commodity imports. St. Lucia's imputed share of ECCB's foreign reserves slipped by 5.2 percent year-on-year, to XCD533.2 million.

ST. VINCENT AND THE GRENADINES

The economy of St. Vincent and the Grenadines is estimated to have expanded for the first 9 months of 2013, with broad-based improvement across many sectors, according to the ECCB. The nearly-tripled public capital expenditure and higher imports of construction materials signals healthy growth in the construction sector. However, manufacturing output is estimated to have contracted during that period, based on lower levels of domestic demand and consumption. Domestic credit expanded by 1.9 percent, prompted mainly by higher levels of household borrowing.

The merchandise trade deficit expanded by 4.1 percent year-on-year to XCD652.7 million as a result of a 5.2 percent increase in imports, which outstripped a 13.2 percent rise in exports.

Stopover tourist arrivals declined by 3.5 percent in 2013 year-on-year, to 71,725, according to the Caribbean Tourism Organization. However, the ECCB reported a 2.5 percent year-on-year increase in total visitors to 145,709 for the first 9 months of 2013, which compares favorably to a 5.9 percent year-on-year contraction during the same period in 2012. Historically, other markets (mainly regional) remain the most important source at about 35 percent of the total (Figure 6). However, Europe has now just overtaken the United States as the second most important market for stopover tourists.

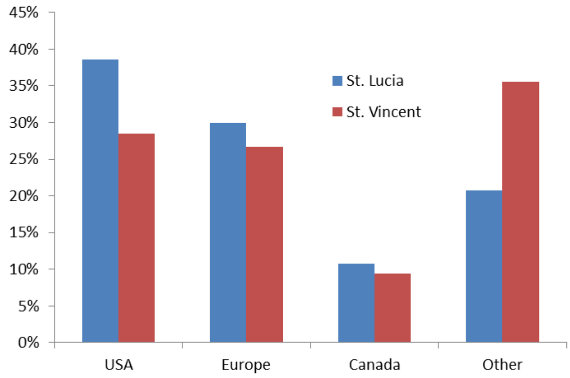
The overall fiscal deficit widened by 28.6 percent to XCD37.3 million during the first 9 months of 2013 year-on-year; capital expenditure nearly tripled to XCD62.6 million. The primary balance thus shifted from a surplus in 2012 to a deficit in the first 9 months of 2013. From January to September 2013, total public debt outstanding grew by 2.1 percent; external debt rose by 6.1 percent and domestic debt contracted by 7.1 percent. St. Vincent and the Grenadines' imputed share of the ECCB's foreign reserves grew by 8.9 percent during the period to XCD321 million.

Outlook and Financial Sector Issues

Looking ahead, growth in the six OECS countries is expected to rise somewhat this year but remain constrained by debt overhang, weak competitiveness, and necessary fiscal consolidation. The April 2014 World Economic Outlook projects growth at 1.6 percent in 2014 and almost 2 percent in 2015 (compared to an estimated 0.85 percent in 2013). Inflation is generally low across the six countries as domestic demand remains weak and food and fuel prices remain soft, but is projected to rise mildly to average about 1.8 percent annually in 2014.

Nonetheless, according to the International Monetary Fund (2014), the fallout from further delays in the resolution of troubled financial institutions constitutes an important risk to the outlook. The report recommends an updated asset quality review of banks and legislative reforms to strengthen the bank resolution framework, in addition to strengthening supervision and crisis management.

Figure 6. St. Lucia and St. Vincent average stopover source market share (2008–2013)



Source: Caribbean Tourism Organization, RBC Financial (Caribbean) Limited

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	Population 2012 (000)	Nominal GDP 2013 (USD millions) (proj.)	2013 Real GDP change (%) (est.)	Public debt/GDP 2013 (%) (est.)	Primary Fiscal Balance 9 months to Sept 2013 (XCD MM)	Overall Fiscal Balance, 9 months to Sept 2013 (XCD MM)	2013 BoP Current a/c (% of GDP) (proj.)	Inflation y-o-y Sept 2013 (%)
Antigua and Barbuda	88	1,230	0.14%	90.3%	(69.60)	(116.30)	(19.9)	0.2%
Dominica	71	505	0.20%	73.4%	(75.40)	(93.30)	(14.3)	-0.8%
Grenada	105	834	2.74%	111.0%	(27.00)	(69.00)	(25.5)	-1.5%
St. Kitts and Nevis	57	743	1.95%	105.0%	188.80	176.60	(8.4)	0.3%
St. Lucia	168	1,332	-1.59%	75.1%	(45.00)	(146.00)	(7.5)	-2.1%
St. Vincent and the Grenadines	110	726	3.14%	70.9%	7.60	(37.30)	(35.6)	0.3%
Eastern Caribbean Currency Union		5,714	0.69%	86.0%	17.30	(294.60)	(17.8)	-0.9%

XCD = Eastern Caribbean dollar. 1 USD = 2.7 XCD approximately.

Source : IMF, ECCB

The Caribbean Quarterly Bulletin

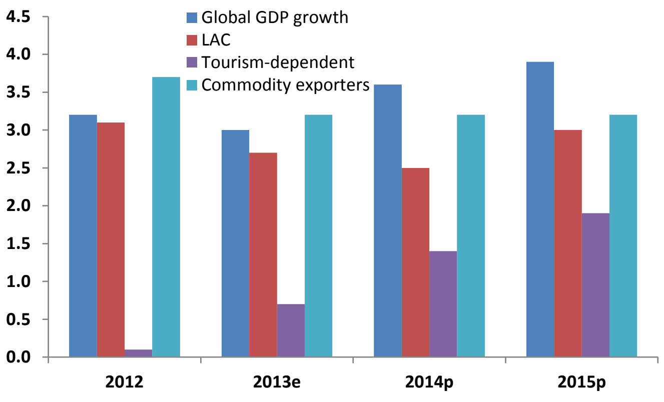
REGIONAL SUPPLEMENT: KUNDALINI FALLING : INTERTWINED FISCAL AND EXTERNAL SUSTAINBILITY

Introduction: The Current State of Play

Despite the possibility of worldwide economic recovery, some looming risks still threaten the Caribbean. On the one hand, growth has accelerated and favorable scenarios have been projected; on the other, possible shocks that could destabilize the global economy cannot be ruled out. This supplement looks at the global economic outlook as it relates to the Caribbean, and the impact and policy options for the region should a low-probability but extreme negative shock materialize.

According to the International Monetary Fund's April 2014 World Economic Outlook, global growth is projected at 3.8 percent in the next 2 years, considerably above the 3 percent average outturn over the past 2 years. Although growth in emerging economies slowed to 4.7 percent in 2013, it is expected to rise to 5.1 and 5.4 percent in 2014 and 2015, respectively. Latin America and the Caribbean (LAC) region is expected to grow close to its potential at 3 and 3.3 percent over the same time periods. Caribbean economies have been growing at about 2 percent over the past 2 years and are expected to grow at 2.3 and 2.6 percent in 2014 and 2015, respectively. Within this group, the Caribbean commodity exporters are the primary drivers with expected growth rates of 3.2 percent in 2014 and 3.2 percent in 2015, while the tourism economies are expected to grow at 1.4 and 1.9 percent, respectively (Figure 1).

Figure 1. Global and Regional GDP Growth (2012–2015)



Source: International Monetary Fund Regional Economic Outlook, April 2014.

Risks to the Global Economy: What Can Go Wrong?

Two main risks currently drive global economic uncertainty. The first risk is that, given the Federal Reserve's taper talk from 2013, subsequent actions, and overall strategy for exiting the unconventional monetary policy of quantitative easing, interest rates might increase in the United States at a faster rate than expected. The second risk is China's growth rate could decline, thereby causing ripple effects on other parts of the world. IDB's 2014 Latin America and Caribbean Macroeconomic Report, *Global Recovery and Monetary Normalization: Escaping a Chronicle Foretold?* simulates these risks among others to determine the potential impact on LAC (Table 1).

Table 1. Global Shocks That Could Impact the Caribbean

	Actual					Projected			
	2010	2011	2012	2013	***Average***	2014	2015	2016	***Average***
Decline in real equity returns in the US									
Baseline	18.2	9.8	5.9	9.9	***11.0***	9.0	6.7	4.9	***6.9***
Shock						3.7	4.0	3.2	***3.6***
Decline in Chinese growth									
Baseline	10.4	9.3	7.7	7.7	***8.8***	7.5	7.3	7.0	***7.3***
Shock						6.0	5.3	5.5	***5.6***

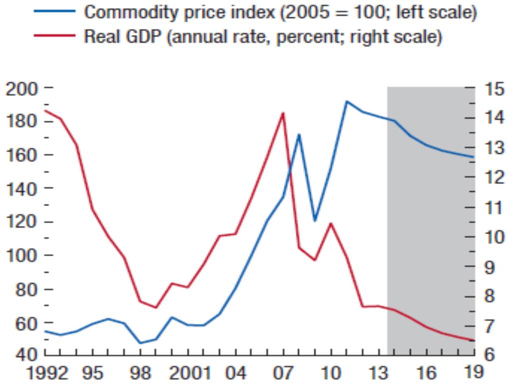
Source: Latin America and Caribbean Macroeconomic Report, Global Recovery and Monetary Normalization: Escaping a Chronicle Foretold?, IDB, 2014.

As described in the IDB's aforementioned 2014 LAC Macroeconomic Report, Ben Bernanke's famous speech from May 22, 2013, had a three-pronged effect on capital markets in most emerging markets and developing countries almost immediately. First, the secondary market yields on emerging market bonds increased dramatically. Second, the LAC nominal exchange rates depreciated. And third, an exodus of capital from various emerging markets and developing countries also affected LAC.

China has experienced an extended period of overinvestment and free-flowing credit, and the situation going forward will have an impact on the Caribbean as well as on other emerging markets. However, the likelihood of a sudden drop in economic activity continues to be small given that the Chinese authorities are well-positioned to intervene should asset quality problems appear to threaten the economic stability. That said, credit growth is still continuing. Although this credit growth fuels the gross capital formation (which, in turn, is one key source of growth), balance sheet risks to the economy are growing. If the risks materialized in the form of a financial crisis, spillovers—specifically through commodity prices—may impact LAC (Figure 2). However, recent analysis performed by the IDB suggests that within LAC the risks appear to be more tilted toward South America than Central America and the Caribbean.

While any of these shocks individually would impact the region, a combined shock is also a possibility. A negative shock to the US equity returns along with laggard growth in China may have relatively serious repercussions for the regional economy, especially if the second-order effects turn out to be large and reinforce a negative feedback loop.

Figure 2. China: Real GDP and Commodity Prices

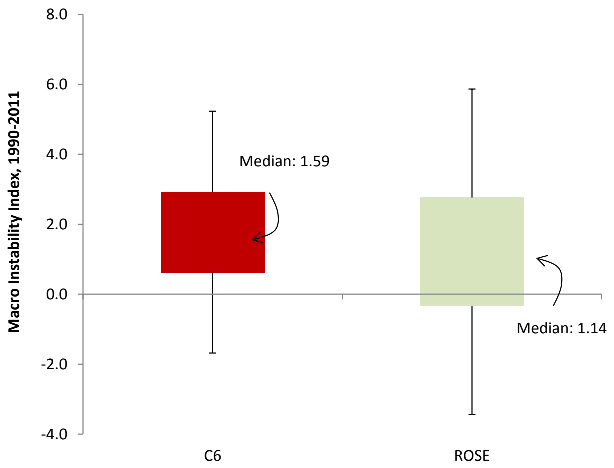


Source: World Economic Outlook, April 2014.

Is the Caribbean Prepared?

The relative macroeconomic stability of the Caribbean countries is weak, even compared to the rest of small economies (ROSE). On the basis of an index that includes the consumer price index, exchange rate, reserves, imports, fiscal balance, and nominal GDP, it can be seen that the Caribbean countries are outliers among small economies (Figure 3).

Figure 3. Relative Macroeconomic Stability

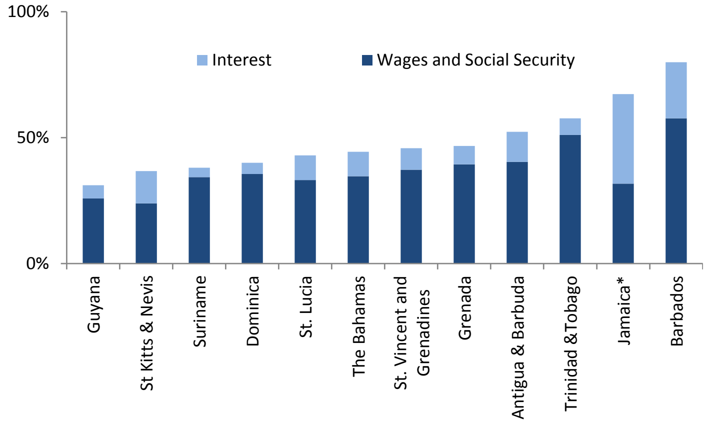


Source: Is there a Caribbean Sclerosis? IDB, 2014.

Caribbean economies have a longstanding history of monetary rigidity that makes fiscal policy the principal tool. All Caribbean countries follow monetary policy frameworks that are anchored to the U.S. dollar. Furthermore, they have exchange rate arrangements that generally allow for little movement. According to the International Monetary Fund's Exchange Arrangements and Exchange Restrictions Report (2013), The Bahamas and Barbados run conventional fixed exchange rate regimes, whereas Guyana, Suriname, and Trinidad and Tobago in practice keep the nominal rate relatively stable. Jamaica, with the most flexible arrangement, has a crawl-like arrangement. As a result of this inflexibility, the Caribbean region has relied on fiscal policies to manage the macroeconomy.

The fiscal stance of the region's economies over the past several years has deteriorated, and this trend is projected to continue. Overall the region has experienced a declining primary balance on average since 2007 with the overall regional average standing at 0.2 percent of GDP. By 2015, the average primary balance for the region is expected to decline to –2.0 percent of GDP. More broadly, the worsening of the primary balance is primarily driven by a slowdown in revenues and an expansion in largely inflexible public expenditures. Decomposing primary spending into categories reveals that a large part of the increase (about two thirds) comes from inflexible items such as wages, salaries, and current transfers (Figure 4).

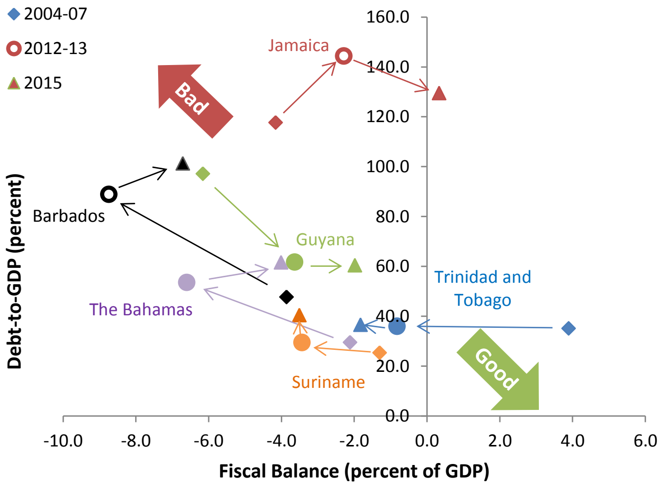
Figure 4. Inflexible Expenditures, 2007–11



Source: IDB, 2014.

Moreover, the fiscal buffers have weakened for most countries in the Caribbean. In Figure 5, the countries represented by the arrows pointing northwest indicate a worsening situation: increasing debt-to-GDP ratio and deteriorating fiscal balance. On the contrary, the arrows going southeast reflect the opposite: an improvement. Of the six countries, only one—Guyana—shows an improving historical and projected trajectory. The other five show a worsening situation in both dimensions or improvement in one and deterioration in the other.

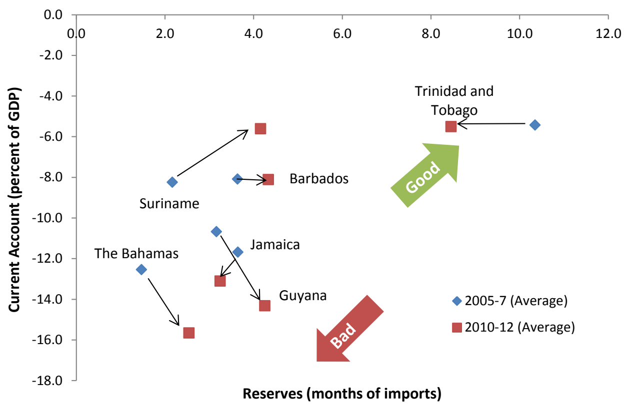
Figure 5. Evolution and Projection of Fiscal Buffers, 2004–15



Source: Is there a Caribbean Sclerosis? IDB, 2014.

External buffers that would serve as the first line of defense against a potential sudden stop or capital flight downside scenario also reveal a similar situation. Figure 6 is oriented such that the arrows going northeast indicate an improvement in the current account balance in percentage of GDP while alongside an increased reserve cover; arrows going southwest indicate the opposite. Except for Suriname, all other countries face an environment of potentially elevated risks with an increasingly vulnerable external position.

Figure 6. Historical Evolution of External Buffers, 2005–12

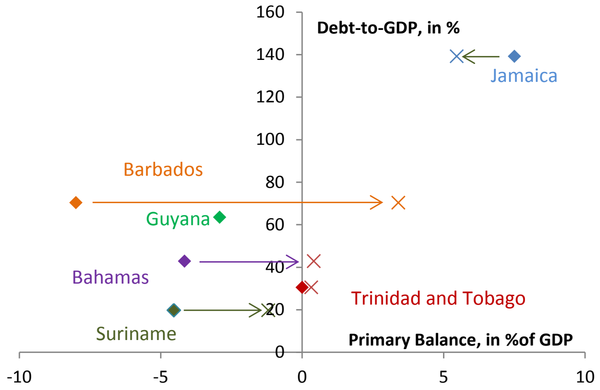


Source: Is there a Caribbean Sclerosis? IDB, 2014.

Fiscal and external sustainability are thus linked, in that fiscal policy would have to be the first line of response against a shock. The ability to respond depends not only on the primary balance, but also on the initial level of public debt. Figure 7 shows the required fiscal adjustment of the primary balance needed to maintain the public debt-to-GDP level at current rates. It also corroborates the fact that tourism-dependent economies have less fiscal room to maneuver. In this representation, Barbados needs the largest adjustment. Jamaica needs a smaller adjustment; however, its debt levels are already very high.

Macroeconomic instability significantly constrains Caribbean growth. With high debt-to-GDP ratios for tourism-dependent Caribbean countries and negative primary balances, adequate fiscal space is not available to effectively make use of countercyclical policies in the event of an external threat.

Figure 7. Required Fiscal and External Adjustment



Source: Central Banks and IDB, 2014.

Can the Caribbean Be Ready?

The short answer is yes. But it will be difficult for the Caribbean economies to effect the relevant changes without a deliberate and explicit push. As pointed out in a recent report published by the IDB, *Is There a Caribbean Sclerosis? Stagnating Economic Growth in the Caribbean* efforts need to be made in establishing macroeconomic policies, building new trade relationships, and boosting the private sector.

External devaluation can be a good approach for countries where current account deficits have been persistent but may not be appropriate for Caribbean economies because of natural difficulties increasing demand for nontradables. The transmission mechanism for successful expansionary external devaluations works by lowering the real exchange rate, which boosts domestic demand for nontradables and production of tradables. If capacity is available, output will increase, exports would grow, and the overall economy would grow. However, in some economies such as those in the Caribbean, expenditure switching can prove to be difficult (Worrell, 1986), and so an external devaluation can backfire by simply depressing real incomes (Krugman and Taylor, 1978). It can also have a negative effect on balance sheets of households and businesses by limiting their ability to borrow, making existing foreign-exchange debt more expensive to service and leading to pressures on the banking sector as a second-order effect.

Internal devaluation can be effective but requires a certain institutional setup that may be missing from several Caribbean economies. Because governments do not have direct control over prices, the mechanism to conduct internal devaluation normally includes cutting the government wage bill with the expectation that private sector wages will be affected accordingly and eventually reduce producer prices. Experience with internal devaluations indicates that an open economy with high factor mobility and flexible labor markets are needed for them to work. Without the right policy and institutional setup, pass-through to producer prices can be limited.

A fiscal devaluation can also be performed by implementing a tax reform aimed at reducing labor costs. The transmission mechanism works in the same manner as an internal devaluation aimed at the wage bill, except that the source of lower costs is different. Caribbean tourism countries have made use of tax waivers to make the tourism sector more competitive. A modern approach is to reduce payroll taxes and increase value-added taxes because, with nominal wages fixed in the short run, this would reduce the unit labor costs. According to the International Monetary Fund, "fiscal devaluations can have significant effects" and should be considered as a policy tool in the Caribbean.

Deepening trade with new partners around the world—particularly developing middle-income countries—could help the Caribbean economies become less dependent on their historically significant developed trade partners such as the United States and Europe. It would also help diversify spillover risks from the low-probability extreme events identified. In particular, such middle-income countries have substantial room to grow, which, in turn, could allow Caribbean economies to participate in the growth surge of their new trade partners. As such, a search for new and growing markets is needed as part of a new pan-Caribbean development strategy. IDB's *Is there a Caribbean Sclerosis?* simulates an exercise whereby Brazil is assumed to be the main trading partner for five of the Caribbean economies over 2008–18. This exercise revealed that Caribbean per capita income under such a scenario would increase by more than US$300 in 2012 and would be US$600 higher by 2018 relative to the baseline. Boosting the private sector is a good way to achieve a balanced growth path that can be sustained over time while reducing the need to have large fiscal buffers and naturally create external buffers through increased exports.

Conclusions

While the global economy has begun to pick up, high-impact, low-probability events could materialize. Two specific risks—unexpected increase of interest rates in the United States and a negative growth shock in China—can have repercussions for the Caribbean. The region's economies are particularly vulnerable to external shocks given their history of exchange rate rigidity. At present, the economies do not have adequate fiscal or external buffers to sustain such an impact. Macroeconomic and structural policies are needed that allow the Caribbean to (a) develop resilience against such risks and (b) become stronger in the long run. Solutions include improving the macroeconomic policy frameworks given the uniqueness of Caribbean countries' location, endowments, comparative advantages and smallness; engendering laissez faire economic growth; and expanding trading horizons to find "new neighbors."

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