Caribbean Region Quarterly Bulletin

Year in Review

Volume 4, Issue 4 | January 2016

IDB
Country
Department
Caribbean

Volume 4, Issue 4
January 2016

SUMMARY

CARIBBEAN REGION

HAPPY SWEET 16?

This issue looks back at major developments in the Caribbean in 2015 and gives an economic outlook for the region.

Selected Indicators	Real Growth Rate	Annual Inflation (% end of period)	General Government Primary Balance (% of GDP)	General Government Overall Balance	Current Account balance (% of GDP)	General Government Gross Debt (% of GDP)
Jamaica	1.4	6.1	7.3	-0.4	-3.7	124.8
Barbados	0.5	1.2	1.9	-5.9	-4.8	103.9
The Bahamas	1.2	1.5	-0.9	-3.8	-22.2	65.8
Guyana	2.4	1.2	-3.7	-4.6	-16.4	52.4
Trinidad and Tobago	-1.5	6.0	-2.2	-4.2	0.71	44.0
Suriname	1.5	5.2	-7.8	-9.1	-9.4	36.9
CCB Average	0.9	3.5	-0.9	-4.7	-9.3	71.3

Source: International Monetary Fund and country authorities.
Note: Year is 2015 or closest available date. Barbados debt figure excludes NIS.

Summary by Country

2015 was disappointing for The Bahamas *as the uncertainty related to delayed completion of the BahaMar resort slowed down economic growth and job creation. At the same time, the fiscal situation has been improving as the introduction of the new Value Added Tax has been successful.* Strong tourism demand in the United States in addition to the expected resolution of the BahaMar issues should support an economic recovery over the next few years.

Barbados *has benefited in 2015 from stronger tourism arrivals. The external situation has also improved as a result of lower energy prices. The government has introduced a series of new tax measures, and continued fiscal consolidation is expected over the next few years.*

In ***Guyana,*** *2015 growth estimates for 2015 have been reduced to 2.4 percent as Guyana's main economic sectors face challenges. However, foreign direct investment flows and continued public investment in infrastructure are expected to maintain a positive economic outlook.*

Jamaica's *outlook continues to be favorable as the International Monetary Fund's Executive Board approved the tenth review of Jamaica's Extended Fund Facility in December 2015. However, challenges remain, especially in accelerating economic growth to support economic adjustment and improving the livelihood of the population.*

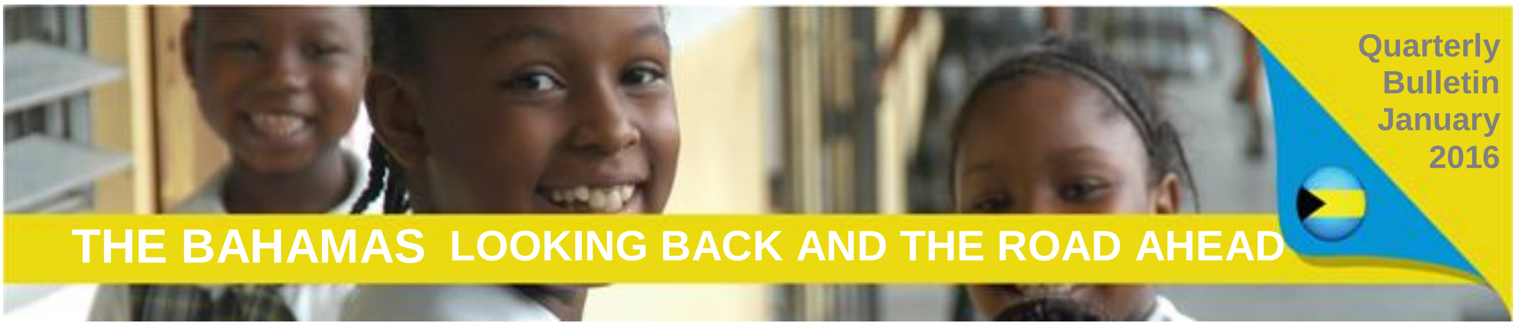
Suriname's *macroeconomic performance continues to be constrained by falling commodity prices. However, reforms to reduce vulnerabilities have started, and new investments should support economic growth.*

Trinidad and Tobago *was marked by challenges arising from lower oil and gas prices. The Trinidadian economy contracted in 2015 and economic growth is projected to remain negative in the near future. The fall in energy prices also has negative consequences for the budget. The government is introducing several measures to constrain expenditures and increase non-energy revenues, targeting a balanced budget by 2018.*

The countries of the Eastern Caribbean Currency Union/Organization of Eastern Caribbean States have been experiencing a tourism-led recovery. The economic recovery also benefits fiscal consolidation that is being implemented in several countries. Their growth outlook remains positive in 2015, even though Dominica is expected to have contracted in 2015 as a result of the significant damages and losses from Tropical Storm Erika.

Special Regional Report: Lift-Off

Following several years of near-zero interest rates in the United States, the US Federal Reserve has raised its target interest rate by 0.25 percent, marking the beginning of a gradual increase in US borrowing costs. The regional supplement explains the importance of this development and explores how it could affect The Bahamas, Barbados, Guyana, Jamaica, Suriname, and Trinidad and Tobago (Caribbean Country Department).



Highlights

A value-added tax (VAT) was introduced after years of debate and discussion of the need for a new form of taxation.

BahaMar filed for Chapter 11 protection in the US courts on June 29, 2015.

During October 2015, the southeastern Bahamas was devastated by Hurricane Joaquin.

The Year 2015 in Review

The year was complete with notable political, fiscal and social developments. From the implementation of the VAT to the controversy surrounding BahaMar and the looming launch of universal health care, 2015 was eventful.

Implementing the Value-Added Tax (VAT)

On January 1, 2015, the VAT was introduced after years of debate and discussion on the need for a new form of taxation. Despite the outcry before the VAT launch and the speculation from commercial and residential stakeholders regarding their lack of preparation time, VAT implementation has been hailed locally as a resounding success. By summer 2015, registration for VAT certificates exceeded government projections by 1,700, with a compliance rate above 90 percent.

The newly formed Central Revenue Authority has begun to coordinate collection of the VAT, business licensing fees, customs duties, and many other government fees. The agency has a new stand-alone government complex, with newly trained staff and new equipment. To curb fears of excessive inflation following VAT implementation, a new chair has been appointed to the Price Control Commission to prevent price gouging.

BahaMar's Ongoing Litigation

After missing two opening deadlines, BahaMar filed for Chapter 11 protection in the US courts on June 29, 2015. As a part of the Chapter 11 process, the developer, Sarkis Izmirilian, also arranged funding for the debtor-in-possession financing facility to operate and meet its financial obligations while in Chapter 11. The US bankruptcy proceedings were not recognized in the Bahamian courts, and the government of The Bahamas subsequently filed for a court-ordered liquidation and restructuring of the company.

To mitigate fallout, government representatives travelled to China on several occasions to mediate discussions. It has been reported that the hotel resort and casino is roughly 97 percent complete, and an additional $400 million to $600 million would ensure completion. At the time of the Chapter 11 filing, approximately 2,500 full-time staff had been hired; the headcount is estimated at 5,000–8,000 at completion.

In September 2015, the Chapter 11 case was dismissed in US courts in favor of allowing the Bahamian courts jurisdiction over the matter. This dismissal came on the heels of the appointment of KRyS Global and AlixPartner Services UK as joint provisional liquidators for the property, with a mandate to preserve the assets until the dispute can be resolved. In late September, the provisional liquidators announced that the contractor CCA had been reengaged and had begun site inspections with a view to completing the resort and opening as soon as possible.

On October 22, 2015, the joint provisional liquidators received approval in the Bahamian courts to terminate approximately 2,200 staff. Subsequently, on October 30, 2015, the court appointed the accounting firm Deloitte and Touche (the local office received assistance from the China-based office) as receivers on behalf of the ExIm Bank. With this appointment, the BahaMar board of directors has resigned in favor of allowing the legal process to run its course.

According to the local press, Sir Sol Kerzner, the Atlantis resort developer, has been in talks with the ExIm Bank to acquire BahaMar. Authorities indicated the deal is to be financed by the Island Capital Group and its principal, Andrew Farkas.

National Health Insurance (NHI)

In October 2014, the government received recommendations from Sanigest International on the recommended NHI benefits and costs. The report estimated an annual cost of $362.6 million to fund the basic vital benefits plan.

Subsequent analysis of the NHI plan by industry experts indicated NHI costs would be much higher. Analysis by the Bahamas Insurance Association indicates a cost of $895 to $965 million for universal health care. A subsequent review of the NHI plan by the firm PwC indicated a funding shortfall of $125.6 million.

Despite setbacks, NHI launched on January 1, 2016. Amidst controversy regarding the cost of funding the NHI plan, the government remained committed to launching the initiative in phases throughout 2016.

Recovery from Joaquin

During October 2015, southeastern Bahamas was devastated by hurricane Joaquin. While the final assessment of the damage has yet to be completed, more than 800 homes were reported to local insurance companies as damaged or destroyed. While no loss of life was directly attributed to the storm, the damage was so extensive that one island had been evacuated by the GoBH for several weeks.

Preliminary estimates place recovery costs in the range of $60 to $100 million. While the formal assessment has not been completed, this estimate is based largely on losses to residents and commercial enterprises, such as docks, marinas, hotels, and the like.

Electricity-Sector Transformation

In early 2015, the Government announced the selection of PowerSecure as its partner to manage the operations of Bahamas Electricity Corporation for a period of five years. The process to select a private partner was announced in 2013 as part of the effort to rescue the electricity provider from its $20 million per year losses. It has been reported that as part of the deal, PowerSecure would lower consumers' electricity cost to $0.20 per kilowatt hour, an almost 50 percent reduction to the current billing rate.

In July 2015, a transition services agreement with PowerSecure was signed with the promise of a business plan within 60 days. The plan was intended to provide specific measures and recommendations to improve operations. Up to $600 million is needed to rehabilitate the struggling corporation, in addition to the $400 million of legacy debt from past capital projects and operating costs.

To date, the promised plan has not been released. However, several key pieces of legislation have been drafted to advance the privatization effort. These include the new Electricity Act, updates to the URCA Act that allow the transferring of regulatory power to an independent regulator, and an act to allow for the creation of a special-purpose vehicle to address the legacy debt issue.

The Cellular Monopoly Was Broken

In mid-October 2015, Cable Bahamas Limited (CBL) was awarded the right to purchase a 49 percent stake in the new mobile licensee. Until recently, the incumbent Bahamas Telecommunications Company had retained a monopoly for the country's mobile services. Under conditions of the new deal, the new licensee will be 51 percent government owned and 49 percent CBL owned, with a 15-year license term.

The value of the 49 percent stake in the new license was $62.5 million. This value includes the right for CBL to manage operations of the new mobile operator. The license was issued by the end of 2015, giving CBL the opportunity to begin operations in early 2016. Since winning the final bid, the company has made no announcements regarding new mobile products, services, or even devices to be offered, leaving the public in eager anticipation of the possible offerings.

Building up to the 2017 General Elections

With less than 18 months before the next general election, political tension is mounting. While elections can bring uncertainty, as with other countries, it does present many commercial merits. As election day draws near, the country is typically immersed in political rallies, motorcades, parties, media campaigns, flyers, and numerous other employment-creating activities.

Last year saw mild campaign action with no political conventions. Neither of the major political parties had elections during 2015 to alter or confirm party leadership in advance of elections, and only a few rallies were held to garner political support on various issues. The current year should provide ample opportunity for campaign activities, which will likely provide some relief from high unemployment levels.

Economic Outlook

The groundwork laid presents a positive picture for 2016. With the arduous demands and pains of 2015 now behind, the foundation has been laid for a 2016 that is rich with new mobile options, lower electricity rates, universal health care, and maybe a new mega-resort, among other things.

Table 1. Economic Projections of The Bahamas (2015–2017)

Bahamas	2015	2016	2017
Real GDP Growth	1.2%	2.3%	2.7%
Inflation	1.6%	1.3%	1.2%
Debt-to-GDP	60.8%	61.1%	60.6%
Primary Surplus	1.1%	1.3%	2.0%
Fiscal Deficit	-2.0%	-1.7%	-1.0%

Source: *World Economic Outlook,* IMF (October 2015).

The IMF's October 2015 *World Economic Outlook* foresees strong economic recovery for The Bahamas in 2016 and 2017. However, given the delays in the BahaMar opening, economic recovery is probably going to be slower, with acceleration of the economy being delayed for one or two years. Fiscal outcomes, including debt to GDP, are also expected to be adversely affected by the weaker-than-expected growth performance.

A resolution of the plan to complete BahaMar will boost economic performance. Even though it will be later than projected, the eventual opening of the BahaMar property is expected to give a strong boost to the Bahamian economy. Stronger growth will also support the government's fiscal consolidation as well as facilitate a reduction in the debt-to-GDP ratio and a more robust buildup of buffers against shocks.

The VAT

In January 2016, the first year of implementation of the impact of VAT on the Bahamian economy (income distribution, inflation, poverty, GDP) will be assessed.

Further progress on VAT implementation will include formal tax audits of VAT registrants during 2016. These audits will be conducted by the Central Revenue Administration and the VAT Department and are part of the process to ensure the government is receiving all monies due to it. Companies have been advised by the government "to certify that due sums have been paid to the Treasury."

Banking Sector Developments

New global standards under Basel II and III will be implemented in 2016 at banks in the Bahamian banking system. A central bank report indicated that the overall required regulatory capital levels of licensees has increased—it now includes 'operational risk' in determining capital needs. Furthermore, changes for meeting Basel standards on risk-weighted asset factors will affect banks' total capital needs.

The report anticipates that the additional requirements of Basel II and Basel III may constitute a stressor for licensees who were already near the minimum capital levels. This will likely require such institutions to raise more qualifying capital from new or existing shareholders. Generally, banks' capital levels are assessed as robust under the Basel II/III framework, however, additional studies are expected to examine any additional impacts of such standards on the banking sector.

Hawksbill Creek Agreement

An unreleased McKinsey report that is especially important to the government's short- and long-term actions toward Freeport (particularly on tax incentives) remains at the center of controversy about the agreement. The findings of the report, which have been presented to the government, have not yet been released to the stakeholders it consulted. Ongoing legal battles surrounding the report's release have resulted in legislation that extends Freeport's Business License and real property tax exemptions until February 4, 2016.

Energy Sector

The Utilities Regulation and Competition Authority is now the energy sector's independent regulator. Rate increases to fund modernization and create greater transparency in the sector will have to be approved by the regulator. To support the organization's new role, the government introduced legislation to parliament that would facilitate long-awaited reforms. The legislation package included the Electricity Bill 2015, the Utilities and Competition Amendment Bill 2015, and the Electricity Rate Reduction Bond Bill 2015.

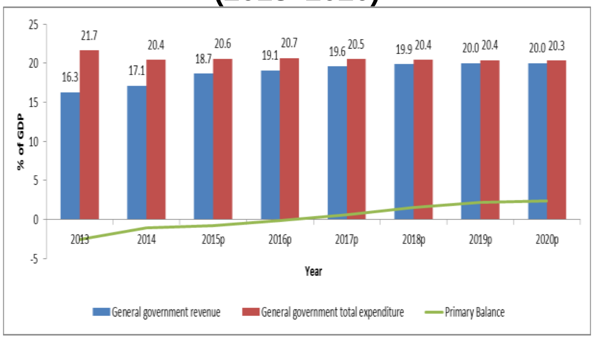
The government's Renewable Energy Self-Generation program has been suspended until 2016. This decision was made to allow wider industry reforms to take effect as part of PowerSecure's new business plan. The company's business plan for the new Bahamas Electricity Corporation is tied to the government's National Energy Policy goal of 30 percent renewable penetration by 2030.

In recent months, the GoBH committed to global standards on automatic tax information exchanges and enhanced the framework for the offshore financial sector. For the offshore sector, The Bahamas executed a Model I Intergovernmental Agreement (IGA) with the US government to implement the Foreign Account Tax Compliance Act (FACTA) in November 2014.

Several training sessions for Central Bankers were held in 2015. They focused on the Internal Capital Adequacy Assessment Process (ICAAP) which forms part of the Supervisory Review Process (i.e. Pillar II of the Basel II capital framework). It was also reported by the Central Bank that through a partnership with CARTAC, the Central Bank successfully held an Industry Session on the ICAAP, with the intention of sensitizing licensees on key components of the ICAAP, the roles and responsibilities of senior management and the board, in addition to supervisory expectations regarding submission of the ICAAP.

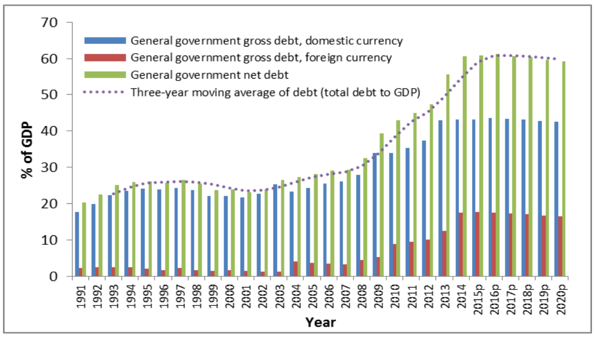
Primary balance is improving…

Figure A: Primary Balance and Components (2013–2020)



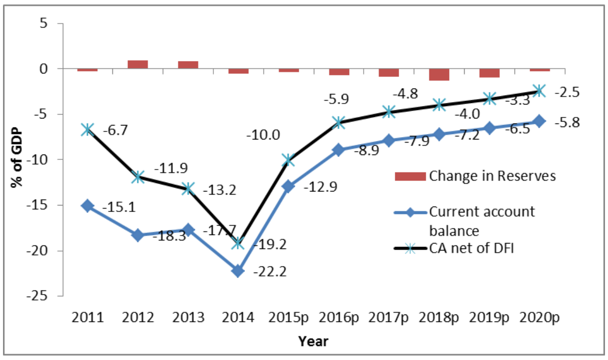
Debt is growing, but expected to decline…

Figure B: Components of Debt (1991–2020)



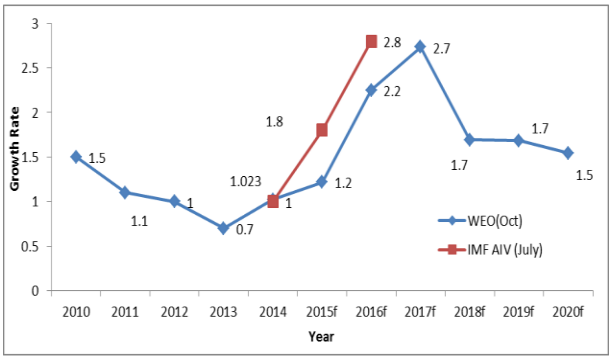
Current account deficit is large…

Figure C: Current Account Deficit (2011–2020)



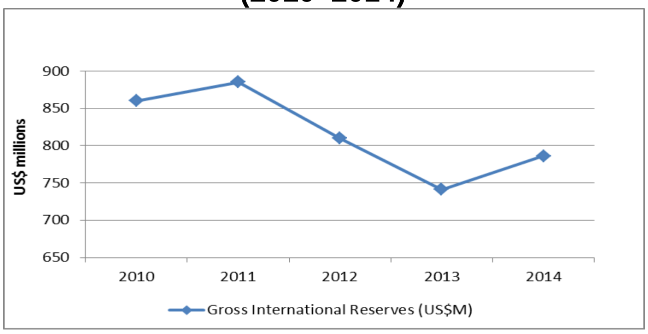
Growth is low…

Figure D: Real GDP Growth (2010–2020)



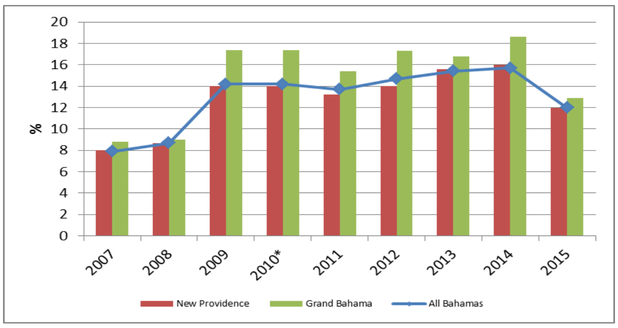
Gross International Reserves are low…

Figure E: Gross International Reserves (2010–2014)



Unemployment is still high…

Figure F: Unemployment Rate (2007–2015)



Source: Central Bank of the Bahamas; Ministry of Finance; Department of Statistics; WEO. *Notes:* p – projections; * indicates the same rate as previous year, due to it being a census year.

Table 1: Selected Indicators (2009-2014)

	2009	2010	2011	2012	2013	2014
(Annual percentage changes, unless otherwise indicated)						
Real Sector - Department of Statistics/IMF						
Real GDP	-4.2	1.5	1.1	1.0	0.7	1.2
Nominal GDP	-5.2	1.1	0.3	3.6	2.5	5.4
Inflation (end of period) - Central Bank	1.3	1.4	3.2	1.9	0.4	2.0
External Sector - IMF						
Exports of goods and services	-9.3	-6.2	1.6	16.0	2.1	3.1
Imports of goods and services	-20.2	2.9	-1.0	9.4	2.4	3.7
Current account (percentage of GDP)	-10.3	-10.1	-15.3	-18.4	-19.6	-22.2
FDI (percentage of GDP)	9.6	12.2	12.3	7.1	n.a.	n.a.
(In percentage of GDP, unless otherwise indicated, on a fiscal year basis)						
Central Government - Ministry of Finance	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Revenue and grants	16.5	16.6	18.3	18.1	16.4	17.1
of which: tax revenue	14.4	16.4	16.2	14.9	15.9	16.9
Recurrent Revenue	n.a.	n.a.	17.9	16.6	17.4	19.4
Total Expenditure	21.0	20.9	22.9	23.7	23.0	22.3
Recurrent Expenditure	n.a.	n.a.	20.4	20.0	20.1	19.9
Current Expenditure	18.1	19.3	19.7	19.0	19.7	19
Capital Expenditure			4.9	4.2	3.4	3
Primary balance	-2.7	0.5	-3.1	-3.8	-2.8	-0.3
Overall balance	-4.4	-3.2	-5.5	-6.3	-5.4	-3.2
Debt Indicators - IMF & Ministry of Finance						
Central Government Debt - Min of Finance	42.5	47.2	48.4	56.3	60.9	65.8
Central government debt over revenues - IMF (aligned with MTFP)	20.4	4.5	8.1	4.0	n.a	n.a.
External public debt (end of period) - IMF	9.8	11.6	13.2	17.8	17.8	19.7
External debt service as percentage of exports of goods and services - IMF	24.7	11.1	8.0	7.4	11.3	4.9

Source: Central Bank of the Bahamas.
[a] Department of Statistics, IMF.
[b] IMF.
[c] Ministry of Finance.
[d] IMF, aligned with government's Medium Term Fiscal Plan.

Developments in 2015

External and domestic factors had a favorable impact on the economy in 2015. Higher tourism arrivals—due to recovery of the main trading partners' economies—and lower international fuel prices had a positive impact on growth during the year. The growth led to an improved external position and stabilized reserves. Local gas prices followed the trend of global oil prices and fell during the year, which resulted in a decline in electricity tariffs. Weak domestic demand and low oil prices kept inflation low, below 2 percent; however, unemployment remained in the double digits. The government introduced a series of new tax measures, which led to a reduction in the fiscal deficit. However, fiscal consolidation has not yet stabilized the increasing trend in public debt. Growth is projected to rise 1 percent in the medium term as tourism-related private-sector projects begin.

Recovery in the tourism sector was conducive to growth. Externally, tourism demand recovered throughout the year, and arrivals surged with double-digit growth from the three main source markets, namely the USA, Canada, and the UK. Tourism arrivals grew by 14.5 percent and value added in the tourism sector rose by 6.3 percent during the first nine months of 2015. The tourists' economic contribution was lower as their length of stay declined. The increase in airlift with new Delta flights and greater JetBlue frequency contributed to the dynamism. However, the non-tradable sectors were less dynamic, which subdued spillover effects to the business services and retail sectors; construction fell by 1.7 percent. This resulted in growth of 0.3 percent at the end of September 2015.

Barbados's fiscal deficit reduced. As part of its fiscal consolidation program, the government announced new revenue measures that contributed to reducing the financing gap.[1] The fiscal deficit declined by almost US$10 million, to reach US$145 million at the end of September 2015, when compared with the same period in 2014. The fiscal deficit is projected to rise to 4.7 percent of GDP at the end of fiscal year 2015/16, ending in March. This represents an improvement from the 6.9 percent of GDP recorded a year earlier. However, fiscal consolidation has not yet stabilized the increasing trend in public debt, which reached an estimated 139 percent of GDP at the end of September 2015 (inclusive of holdings from the National Insurance Scheme).

Highlights

Higher tourism arrivals and external factors, like the recovery of Barbados's trading partners and lower fuel prices, had a positive economic impact in 2015.

Private investments in tourism projects would be conducive for growth in 2015/16.

Barbados's fiscal deficit reduced during 2015 and consolidation will continue through 2016.

Lower oil prices eased pressures on the exchange rate peg and contributed to greater stability of reserves.

The financial sector remains stable, liquid, and well capitalized.

Budget financing continued to rely on domestic sources. Government financing during the first six months of the fiscal year (April–September 2015) came mostly from the Central Bank of Barbados and accounted for 82 percent of total financing. The National Insurance Scheme has been reducing exposure to public debt instruments (treasury bills) from previous years and covered 3.5 percent of the financing gap.

The central bank aimed to change its financing profile toward more medium-term instruments. The bank has been seeking to reduce its reliance on shorter term instruments, namely treasury bills, that come with interest-rate and rollover risk. The bank issued a series of savings bonds at an interest of 5.5 percent with a 5-year maturity during 2015. These bonds were well received by the domestic investors, which is reflective of the high liquidity in the market and greater sense of stability when compared with the previous year.

Declining oil prices eased pressures on the exchange rate peg and contributed to the stability of reserves. Households and businesses also benefitted from lower international fuel prices. The pass-through effect to domestic gas prices led to a 49 percent reduction in electricity tariffs between October 2014 and September 2015. The combination of increased travel receipts and lower fuel imports, which represents more than 20 percent of total imports, led to an improvement in the external position. The current account balance fell to 5.9 percent of GDP at the end of September 2015. This is a significant improvement to the 10.6 percent of GDP recorded the previous year. However, on the downside, the lower oil prices led to a reduction in revenues with lower receipts from VAT and excises applied to imported fuels.

[1] In the 2015/16 Financial Statement and Budgetary Proposals, the government announced a series of new tax measures, which included the expansion of the VAT base, an increase in land-tax rates, an excise tax on sweetened beverages, and a tax on all milk and milk substitutes.

Reserves stabilized over the year at around 14.4 weeks of imports of goods and services (as of September 2015). Reserves declined slightly to US$488.4 million at the end of September compared with US$532.7 (14.6 weeks of imports) reported in the similar period a year earlier. The decrease is indicative of weaker internal demand, which dampened imports, and lower international commodity prices.

Lower commodity prices and weak domestic demand kept inflation low. Inflation fell to 0.4 percent at the end of August 2015, compared with 1.7 percent a year earlier. However, unemployment remained elevated, at above 12 percent, which affected household consumption and kept inflation in check during the year.

The financial sector remains stable. Non-performing loans in the commercial banking sector were stable, at 11 percent, by the end of June 2015 in comparison with 11.4 percent a year earlier. The capital adequacy ratio remained high, at 21 percent, on average and well above the Central bank's 8 percent minimum requirement. At the same time, liquid assets rose to 23 percent of total assets by the second quarter. Credit demand remained subdued and grew marginally to 0.1 percent by the end of August. It represents an improvement relative to the 4.6 percent drop reported for the same period in 2014. The government also eliminated the minimum savings rate on bank deposits, which previously stood at 2.5 percent.

A plan for the restructuring of CLICO International Life Insurance Limited was approved by the High Court in Barbados, which will see New Life Investment Company provide BBDS $52 million to satisfy the immediate cash needs of policy holders. Barbados signed the Multilateral Competent Authority Agreement (MCAA) on October 2015, which implements the new international standard on Automatic Exchange of Information (AEOI). The adoption of the AEOI and MCAA binds Barbados to the exchange of information standards of the Organization for Economic Cooperation and Development's (OECD) and shows its commitment towards greater transparency as a global financial services destination.

Barbados's credit rating remained unchanged. With fiscal consolidation efforts and an improved external environment, Standard & Poor's and Moody's affirmed Barbados's long-term sovereign credit ratings of "B" and "B3," respectively, and maintained their "negative" outlook. This followed four consecutive downgrades from Moody's, moving from investment grade to junk status during 2011–2014.

Economic Outlook

The IMF's October 2015 *World Economic Outlook* foresees a slight improvement of the economy. External developments and private investments in tourism-related projects should support growth of around 1 percent following three years of near stagnation. The medium-term growth outlook also benefits from lower oil prices and new tourism investment. The economic recovery in the United States and the increase in airlift (new JetBlue and Avianca flights) are set to benefit the tourism industry. Lower energy costs and inflation at below 2 percent would contribute to competitiveness as businesses benefit from lower input costs and the response from household consumption. However, the ongoing fiscal adjustment could limit the growth outlook in the short term.

Table 1. Economic Projections (2016–2017)

Barbados	2016	2017
Real GDP Growth	1.1%	1.2%
Inflation	1.1%	1.6%
Debt-to-GDP	105.3%	107.5%
Primary Balance	2.1%	2.5%
Fiscal Deficit	-5.8%	-5.2%

Source: Article IV, World Economic Outlook, IMF (October 2015).
Note: Debt excludes National Insurance Scheme.

Fiscal adjustment will continue. The IMF projects deficits of around 6 percent of GDP in 2015 and 2016, slightly above government projections of a decrease from 6.9 to 4.7 percent of GDP from fiscal year 2014/15 to fiscal year 2015/16. The projected reductions are driven by lower current expenditures and new revenue measures. This year the government relied less on financing from the National Insurance Scheme with the fund nearing its operational limits in terms of exposure to government paper. Moreover, domestic financing from local banks could come at higher interest rates.

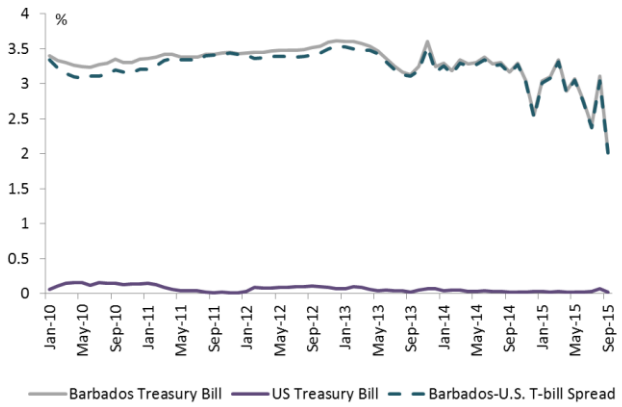
The external position will continue to improve. With declining global oil prices, weak domestic demand for imports, and the recovery in the tourism sector, the current account deficit would likely fall to 5 percent of GDP at the end of 2015 and remain under that mark thereafter. Reserves are expected to remain stable, at above 3 months of imports, which would ease exchange rate pressures.

Inflation is projected to remain low, below 2 percent in the medium term. The IMF projected inflation would reach around 1 percent at the end of 2015. Low

international oil and commodity prices, weak economic conditions, and fiscal consolidation would contain prices. At the same time, unemployment rates would likely remain at the two-digit level.

The interest rate increase by the US Federal Reserve would affect Barbados less than other Caribbean economies. The impact would be felt strongly in economies that rely heavily on short-term capital flows. In Barbados, the financing of the current account has been mainly through foreign direct investment (FDI) and focused on tourism and real estate.[2] These private flows tend to have a medium term horizon. Domestic interest rates would remain stable amidst concerns that increases would raise the government's financing costs, strengthen the bias of commercial banks towards short-term lending, and increase Barbados public debt service that stands at over 16 percent of GDP. (See Figure 1.) The increase in US interest rates would raise the cost of external financing and future debt service. Two-thirds of public debt is held in domestic currency.

Figure 1. US and Barbados T-Bill Rates



Source: Central Bank of Barbados.

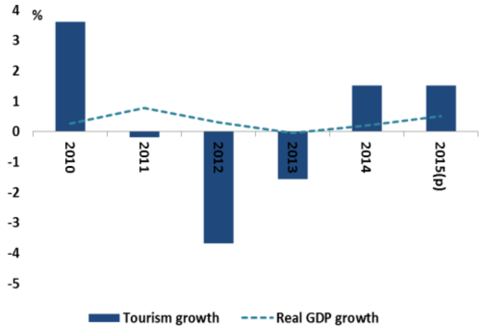
The financial sector would remain robust, highly liquid, and well capitalized. Barbados's banking system could likely withstand shocks, and it enjoys capital adequacy ratios above the central bank's minimum requirement of 8 percent. However, credit growth and profitability could remain subdued. Non-performing loans are likely to remain at the two-digit level over the medium term.

---

[2] FDI inflows have primarily focused on tourism and real estate, accounting for almost 9 percent of GDP from 2010–2015.

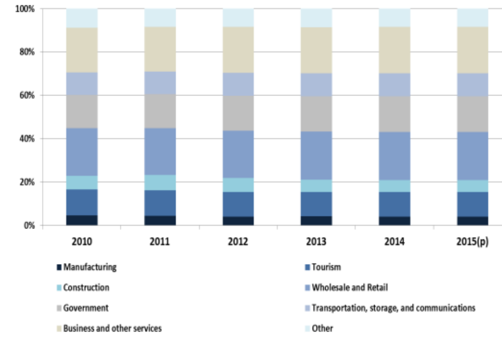
Gradual tourism recovery with weak domestic demand

Figure A. Real growth and Tourism growth



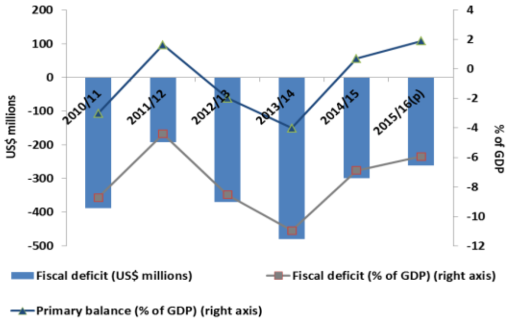
… which are the drivers of growth.

Figure B. Contribution to GDP (in % of GDP)



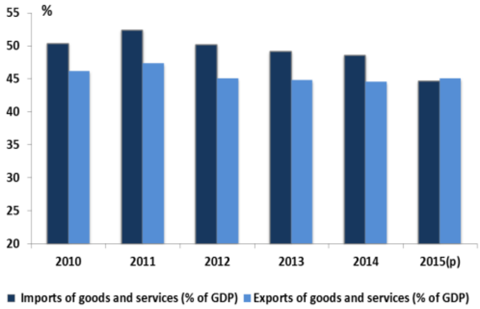
Fiscal consolidation to reduce fiscal deficits

Figure C. Revenues and Expenditures (% of GDP)



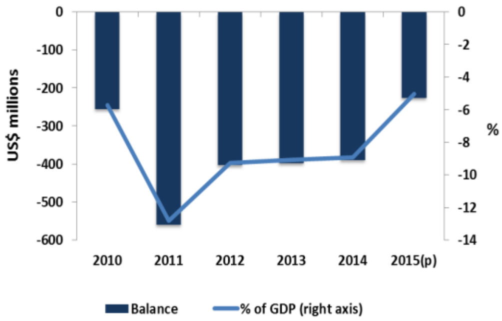
… and contained imports from lower oil and commodity prices..

Figure D. Exports and Imports (% of GDP)



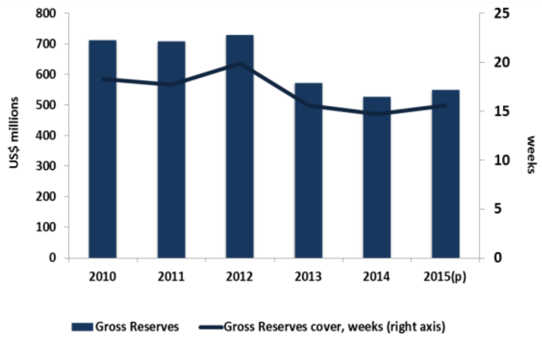
… have improved the current account balance

Figure E. Current account balance (% of GDP)



…and stabilized reserves.

Figure F. Gross reserves (US$ millions)



Sources: Central Bank of Barbados; World Economic Outlook, IMF (October 2015); Ministry of Finance.
Note: (p) projected figures for 2015.

Barbados: Selected Indicators

	2010	2011	2012	2013	2014	2015(p)
(Annual percentage changes, unless otherwise indicated)						
Real sector						
Real GDP	0.3	0.8	0.3	-0.1	0.2	0.5
Nominal GDP	-3.4	-2.0	-0.6	0.9	-0.4	2.4
Inflation (end of period)	5.8	9.4	4.5	1.8	1.9	1.2
Unemployment	10.3	11.2	11.5	11.6	12.3	12.3
External sector						
Exports of goods and services (% change)	7.9	0.4	-5.3	0.2	-1.0	3.6
Imports of goods and services (% change)	9.5	1.9	-4.8	-1.2	-1.5	-6.3
Current account (percent of GDP)	-5.7	-12.8	-9.3	-9.1	-8.9	-4.8
International reserves (US$millions)	711.9	707.4	728.9	572.1	526.1	549.9
International reserves cover (months)	3.8	3.7	4.0	3.2	3.0	3.3
(In percentage of GDP, unless otherwise indicated, on a fiscal year basis)						
Public sector						
Total revenue	25.6	29.3	28.4	26.7	28.8	28.7
Total expenditure	34.3	33.7	36.9	37.7	35.7	34.6
Central government primary balance	-3.0	1.6	-2.0	-4.0	0.7	1.9
Central government overall balance	-8.7	-4.4	-8.5	-11.0	-6.9	-5.9
Debt indicators						
General government debt	71.7	78.0	83.6	94.4	99.8	103.9
General government debt (inclusive of NIS holdings)	96.6	105.3	113.6	127.3	134.1	138.6
Central government debt over revenues	280.0	266.5	294.7	353.6	347.0	363.9
External debt service as percentage of exports of goods and services	10.2	6.9	7.3	6.9	7.4	8.1

Sources: Central Bank of Barbados; World Economic Outlook, IMF (October 2015); Ministry of Finance.

Note: (p) projected figures for 2015.

A Year of Slower Growth: 2015 in Review

Guyana's economic growth remained positive but slowed considerably, compared to previous years when the average rate was 4 percent. At mid-year 2015, Guyana recorded an anemic growth rate of 0.7 percent, and authorities projected an end-of-the-year real growth rate of 2.4 percent. While lower oil prices have provided much-needed relief to the oil dependent economy, sluggish commodity prices and high uncertainty created before and after the May 11 general elections stymied much of the economic activity in the early part of the year.

Table 1. Selected Economic Indicators (%)

	2015	2016	2017
Real GDP growth	3.2	4.9	4.1
Inflation	1.0	3.5	3.6
Debt to GDP	70.2	70.2	70.7
Primary balance	-3.7	-2.9	-2.5
Fiscal deficit	-4.6	-3.8	-3.5

Source: World Economic Outlook, IMF (October 2015).

Main Developments

Real sector performance was mixed: Sugar, rice, livestock, horticulture, and gold are expected to record positive increases in quantities produced over 2014's output levels. The primary sectors that are expected to show declines are timber, bauxite and fisheries. Services, with the exceptions of construction and manufacturing, are expected to expand. The gold sector in particular is facing a smuggling problem. An estimated 50-60% of total production is alleged to have been smuggled out of the country in the year, representing a significant loss of royalty payments to the central government that needs to be stanched.

Public expenditures, revenues, and public debt. A new administration came to power in May and presented the 2015 Budget in August (with just four months left in the year). Due to the suspension of Parliament and an early call for elections, a budget could not have been presented earlier. The August budget exercise was largely a legitimization of expenditures already made. The budget was slightly expansionary over the revised figures for 2014, featuring increased transfers for pensioners, transfers to some state-owned enterprises to cover their operational losses, and tax expenditures to assist the mining sector. Authorities projected a reduction in the fiscal deficit from 5.7 percent to 2.5 percent by year's end because of the 12 percent increase in tax

Highlights

Authorities expected stronger growth in second half of 2015 than in the first half.

Lower oil prices improved external account balances.

Many primary sectors faced either price or supply issues. The bauxite, rice, and sugar sectors faced lower prices, whereas bauxite, fisheries, and timber faced lower production levels.

Authorities planned to present the budget earlier in 2016 than in previous years to revive consumer and business confidence.

revenue and the very slow rate of disbursement on capital expenditure projects. At the half way point in the year, authorities reported a positive primary surplus (revenue minus non-interest expenditures). Total public debt to GDP ratio, however, has been well managed. In 2007, the year after debt relief, the ratio was 59 percent as share of GDP. As of December 2014, it was 65.8 percent. As of November 2015 it was 52 percent, due to a substantial cancellation of PetroCaribe debts. The Government used some of its above market paper valuation for the physical rice shipped to Venezuela to pay down the portion of debt incurred for the import of oil. The PetroCaribe agreement had three components. If the world oil price was greater than $40 per barrel at the time of oil import from Venezuela, a certain proportion had to be paid immeidately in cash; the rest of the bill was generously financed with a low interest rate over a long term; the agreement also contained a sales contract governing the shipment of physical rice at an above world-market price, whose total valuation could be then used to pay down on the financed portion of the oil import.

International balances. During the first half of 2015, the balance of payment deficit improved compared to the first half of 2014, dropping to US$34.9 million from US$93 million. The main reason for the improvement was the dramatic drop in oil prices. Oil imports historically account for 30–32 percent of total imports. Between February 25, 2011 and August 8, 2014, international prices hovered above the mark of US$100 per barrel. For the first nine months of 2015, West Texas Intermediate averaged $50.93 per barrel, and the average projection for 2016 is $46. Although positive for the import bill, this news may delay the extraction of oil from the Liza 1 field, which was recently discovered only 120 miles offshore, but at great depth. Further studies are needed to determine what would be the minimal feasible world price needed to justify extraction.

International reserves fell but adequate import cover retained. Gross international reserves fell from US$776 million in 2013 to US$621.4 million in 2014 and US$604.5 million at the end of October 2015. Import cover remains above the 3 month internationally accepted benchmark.

Interest rates remained stable. The central bank policy rate remained unchanged at 5 percent. Compared to previous years, the rate on the 91-day Treasury bill increased slightly, from 1.58 percent to 1.92 percent, and the weighted lending average rate dropped marginally, from 10.93 percent to 10.54 percent as of October 31, 2015.

Exchange rate remained stable, but pressures may be building for devaluation. Guyana has a de facto pegged currency, and the monetary authorities attempt to anchor the exchange rate in order to control expectations and prevent massive losses to commercial banks that have excess liquidity and hold significant amounts of local currency denominated assets. Guyana's exchange rate to the US dollar has fluctuated within a narrow band, trading between GY$203 and GY$207 from 2008 to the present. Moreover, the intraday trading range for the first 11 months of 2015 has been between GY$207.21 and GY$206.20. Despite the nominal stability, which helps moderate inflationary pressures, the real effective exchange rate has appreciated, reducing the competitiveness of Guyanese export products. With the normalization of US monetary policy, the US dollar is expected to strengthen, increasing devaluation pressures.

Unemployment has not been measured recently, but it is estimated in the teens. The last official unemployment statistic is 10.5 percent and dates from 2007. Given the slowdown in the medium- and small-mining and construction sectors, it is assumed that the unemployment rate has worsened in the last year, but no official figure is available. Third parties (the International Labour Organization and the World Bank) estimate the adult unemployment figure to be in the upper teens.

Inflationary pressures were low to nonexistent. Authorities are predicting a slight deflation of -1.6 percent for 2015. The main reason being a partial pass-through of lower international energy prices and a drop in consumer confidence and subsequently spending.

Economic Outlook

Growth expected in the two to three percent range. While the commodity price slump is expected to persist in 2016 for key sectors, authorities anticipate stronger GDP growth due to increased government spending, fewer production and marketing constraints in the sugar and rice sectors, ramped up gold production at two new large scale mines, and improved consumer and business confidence. Two large gold mines are expected to produce between 120,000–140,000 ounces next year, which is more than a third of total expected gold declaration.

Fiscal stimulus is expected. The administration will present its budget the third week of January as opposed to the normal presentation date of mid- to late-February. The 2016 budget is expected to detail the new government's public investment program and be strongly fiscally expansionary, with the purpose of stimulating economic activity. As a result, the fiscal balance is expected to worsen.

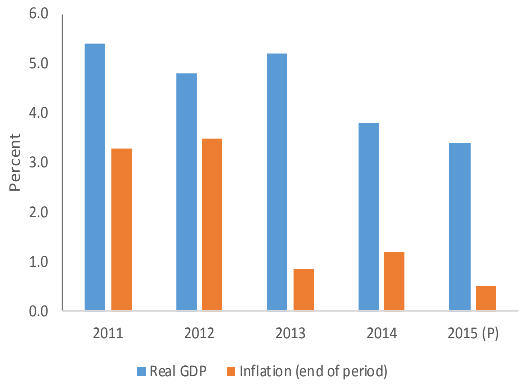
Conclusions

Guyana faces weaker growth prospects as international commodity prices moderate its principal exports. During the commodity bonanza, insufficient structural transformation, reform, and diversification occurred, so the country may face an era of renewed growth volatility. The intent to engage in countercyclical spending in the absence of fiscal space to bolster growth in the near term may not be sustainable in the long term, especially if structural issues are ignored, precipitating the need to consider fiscal adjustment.

Guyana's growth outlook is positive, but with downside risks. Growth is expected to be positive, in the two to three percent range. A strengthened US economy—the US is a major trade partner and source of remittances—will help with export demand and maintaining stable remittance flows, but the loss of the PetroCaribe rice-for-oil compensation scheme will place pressure on rice producers and millers to lower costs and find new markets. Continued low oil prices will help to lower oil import bills and narrow the current account deficit. Nonetheless, lower oil prices over the medium term may be a mixed blessing, in that they may delay the commercial exploitation of the recently discovered offshore oil reserves given the interaction between world price and the minimum feasible extraction price needed to cover costs. Lastly, the normalization of US monetary policy will lead to a stronger dollar that could put pressure on the exchange rate to devalue more than it has in the recent past.

Low commodity prices and high uncertainty depress growth…

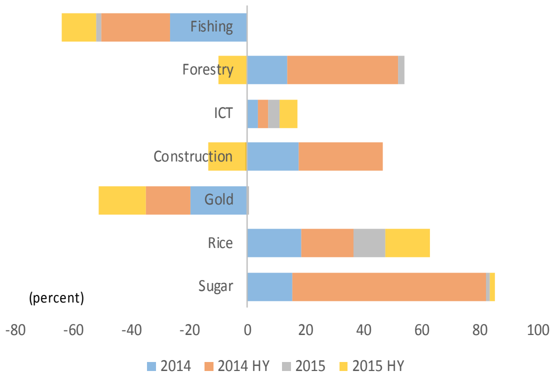
Figure A. Growth and inflation rates



Source: Ministry of Finance

…further compounding structural issues in key sectors

Figure B. Sectoral growth rates



Source: Ministry of Finance

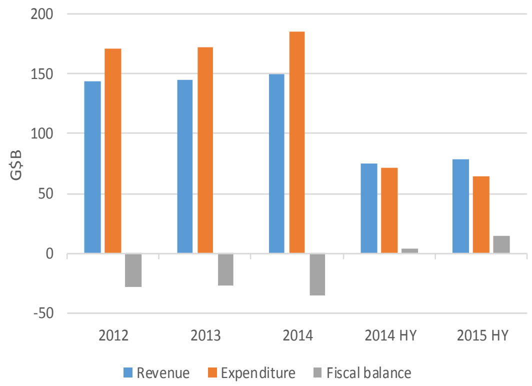
Meanwhile, low economic activity slows borrowing…

Figure C. Private sector borrowing

Source: Bank of Guyana

… however, lower capital investments, subsidies and higher revenue growth compensates for rise in transfers.

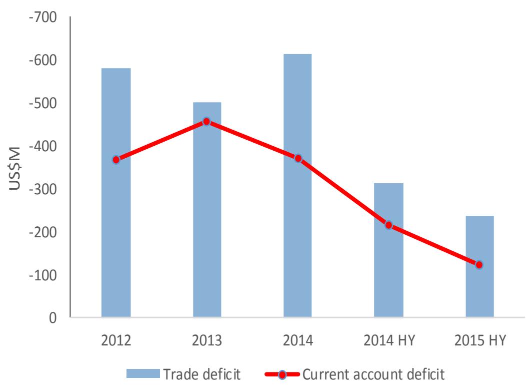
Figure D. Fiscal performance



Source: Bank of Guyana

Low oil prices offsets commodity slump as deficits decline…

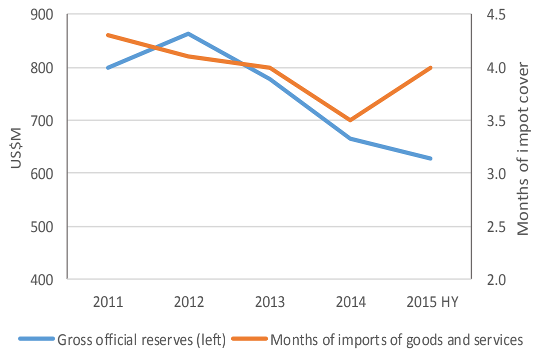
Figure E. Current account and trade deficits



Source: Bank of Guyana

…maintaining a favorable import cover despite lower reserves

Figure F: Gross International Reserves



Source: Bank of Guyana

Guyana: Selected Indicators

	2011	2012	2013	2014	2015(P)
(Annual percentage changes, unless otherwise indicated)					
Real sector					
Real GDP	5.4	4.8	5.2	3.8	3.4
Nominal GDP (GYD millions)	460108	511337	537428.0	555837.0	N/A
Inflation (end of period)	3.3	3.5	0.9	1.2	0.5
External sector					
Exports of goods and services	25.8	20.1	-10.7	-12.4	N/A
Imports of goods and services	25.1	14.4	-7.0	-6.7	N/A
Current account (percentage of GDP)	-16.4	-15.7	-14.2	-14.4	N/A
Remittances (percentage of GDP)	18.3	16.7	11.7	17.0	N/A
FDI (percentage of GDP)	9.9	10.8	7.3	9.8	N/A
(In percentage of GDP, unless otherwise indicated, on a fiscal year basis)					
Central government					
Revenue and grants	26.5	27.9	22.1	26.7	N/A
Current expenditure	19.8	21.1	19.8	21.8	N/A
Capital expenditure and net lending	6.7	11.1	8.2	13.13	N/A
Overall balance	-3.2	-4.7	-4.4	-4.9	N/A
Debt indicators					
Central government debt	69.3	72.1	57.4	N/A	N/A
Central government debt over revenues	261.6	N/A	N/A	N/A	N/A
External public debt (end of period)	48.6	54.2	41.5	45.3	N/A
External debt service as percentage of exports of goods and services	3.0	N/A	N/A	N/A	N/A

Source: Central Bank of Guyana, World Economic Outlook, IMF (April 2015).

Notes: (P) denotes projected figures. FDI= foreign direct investment.

QUITE A YEAR

Highlights

The International Monetary Fund (IMF) completed its 10th review of the Extended Fund Facility (EFF).

The debt-to-GDP ratio has improved markedly.

The economic outlook remains challenging but positive.

The Year 2015 in Review

Jamaica continued to advance its stabilization efforts in 2015. Most economic indicators improved in 2015 compared with 2014 and, even more so when compared with the end of fiscal year 2012/13, just before the beginning of the Extended Fund Facility (EFF) (Table 1).

Table 1. Selected Economic Indicators since the EFF Began

	FY2012/13	FY2015/16 (p)
Economic growth (year-over-year)	-0.8	1.4
Primary balance (% GDP)	5.4	7.3
Public sector balance (% GDP)	-4.2	-0.5
Nominal depreciation (end of period)	13.3	5.0
Net international reserves (US$ millions)	884.0	2,607.0
Current account balance (% GDP)	-10.0	-3.6
Inflation (average)	7.2	4.3

Source: International Monetary Fund (IMF).
Note: (P) denotes projected figures.

Main Developments

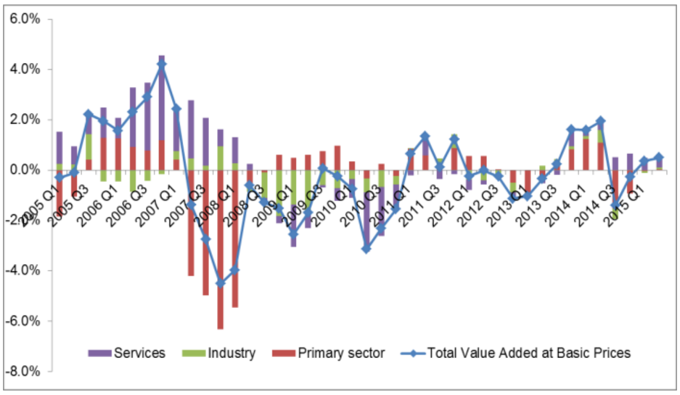
Jamaica continued its progress under the EFF with the IMF. The Executive Board of the IMF completed the tenth review of the EFF on December 16, 2015, with Jamaica meeting all targets. As a result, Jamaica passed 9 out of 10 reviews without a requirement for a waiver—a strong performance given the difficult adjustment the program required. The government and the IMF agreed on a relaxation of fiscal targets with the primary surplus target decreasing from 7.5 percent of GDP to 7.25 percent in FY2015/16 and 7 percent in FY2016/17. Nevertheless, in spite of the authorities' commitment, the risks to the program remain, including from low economic growth.

Growth remained weak in 2015. In part because of persistent drought conditions that have adversely affected the agricultural sector, growth projections have been lowered to 1.4 percent for fiscal year 2015/16, compared to an initial 2 percent projection. The projected expansion is well below precrisis levels but well above the 0.2 percent recorded in the previous fiscal year.

Jamaica benefited from low oil prices. At the end of October 2015, year-over-year inflation was 2.0 percent, compared to an average of 8.9 percent between 2010 and 2014. The lower oil prices also helped the current account and international reserves. The current account deficit as a share of GDP is projected at 3.7 percent for 2015, a substantial decline from the 7 percent recorded one year earlier. The effect on the current account will remain as long as oil prices are low, but the effect on inflation will dissipate as the change in oil prices levels out after one year; however, an increase in oil prices would be adverse for both.

International reserves remained at prudent levels. Total reserves at the end of November 2015 were US$2.343 million. These figures represent an increase of US$343 million since December 2014. A portion of these reserves are obtained through issuance of US$ denominated Bank of Jamaica instruments for the sole purpose of reserve accumulation.

Figure 1. Quarterly Year-over-Year Growth Rates



Source: Statistical Institute of Jamaica.

Exchange rate depreciation slowed. From January to December 15, 2015, the JM$ depreciated 4.9 percent to the US$, compared with 7.8 percent in 2014 and 14.4 percent in 2013. The real depreciation in 2013 and 2014 was an important part in re-establishing competitiveness. According to analysis by the IMF, the exchange rate is not overvalued anymore.

Interest rates continued to decline. In line with lower inflation expectations, the Bank of Jamaica reduced its 30-day certificate of deposit rate in 2015 from 5.75 percent to 5.25 percent. Similarly, the 30-, 90-, and 180-day Treasury bill rates declined between 0.4 percent and 1.1 percent between December 2014 and December 2015. In spite of the first policy rate reduction since end-2012, average commercial bank lending rates remain basically unchanged at 17.15 percent as of September 2015.

Unemployment continued to slowly decline. After peaking at 16.3 percent in April 2013, unemployment as of July 2015 has fallen to 13.1 percent. The decrease has been slow, as average unemployment in 2014 was 13.8 percent, partly because of an increase in the number of people joining the labor force. Poverty is likely to also have stabilized but the latest available data is 2012.

Economic Outlook

Projections pointed to further economic recovery (Table 2). Excluding unforeseen shocks, economic growth in the current fiscal year that ends in March 2016 should reach 1.4 percent. Further accelerations in growth are projected, given the strong performance of main export markets as well as the improved competitiveness from changes in the business climate and the 2012–2014 real exchange rate depreciation. In addition, pipeline investment projects in tourism, shipping, business-process outsourcing, and electricity generation should provide further traction. Finally, the reduction in the IMF target should give a modest fiscal stimulus in addition to more supportive monetary policy.

Table 2. Economic Projections in % (2015/16–2017/18)

	2015/16	2016/17	2017/18
Real GDP growth	1.4	2.5	2.6
Inflation	6.1	6.5	6.8
Debt to GDP	125.1	121.0	113.2
Primary balance	7.3	7.0	7.0
Fiscal deficit	-0.5	-0.4	0.1
Current account	-3.6	-2.6	-2.6

Source: Tenth EFF review, IMF (December 2015).

Projected low oil prices were set to continue to benefit the country. The effect of the fall in oil prices on inflation leveled out (as inflation measures a change in prices, not levels), but lower oil prices should still keep energy imports lower. In addition, projections for continued strong performance of the US economy bode well for further strong performance of Jamaica's tourism and remittances. The oil hedge that Jamaica bought with an average spot price of US$66 is likely to not be used.

Fiscal consolidation is poised to continue. In the absence of further debt liability operations, such as the Petrocaribe debt buyback or a fundamental change in economic performance, the primary surplus target is expected to remain around 7 percent of GDP to meet the 100 percent debt-to-GDP target by March 2020. A similar target is probably necessary to reach the 60 percent target in 2026, which was set in the recent fiscal rule that will take effect at the end of the EFF in March 2017.

The grace period of the National Debt Exchange expires in February 2016. Jamaica will see the first substantial repayment of domestic debt in three years. The liquidity from the redemption could support a re-opening of the domestic debt market that has been inactive since the National Debt Exchange. However, the government could also use cash balances from the July bond issuance to repay domestic bond holders.

The government will need to continue the reform agenda under the EFF. Public sector reform is has been slower than expected, which implies higher than anticipated wage expenditure for the government. Further reforms to the business climate would also benefit economic growth.

Elections are constitutionally due before March 2017. Uncertainty surrounding elections could increase in 2016 even though both parties highlight the importance to maintain fiscal consolidation and stability of the economy.

The Fed Liftoff

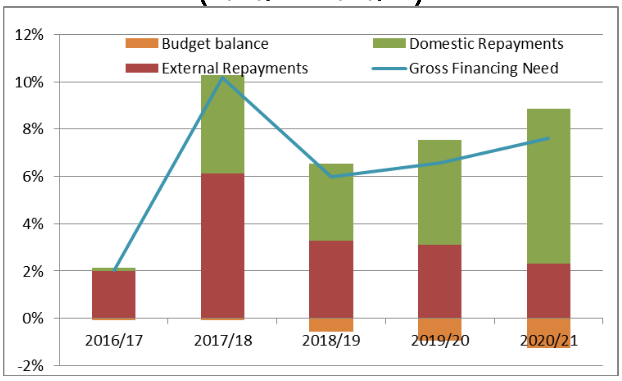
Given the restricted effects of monetary easing on Jamaica, direct effects from monetary normalization should be small. However, rising US interest rates will influence Jamaica's. In addition, the liftoff could affect the world economy, therein indirectly affecting Jamaica.

Given the stabilization of its economy, Jamaica benefited from global accommodative monetary policies. Since 2011, Jamaica has issued four international bonds amounting to more than US$3 billion (equivalent to more than 25 percent of current GDP). Each successive issuance was at a historically low interest rate, reflecting a lower country-specific risk premium in addition to low global interest rates. Similarly, private companies have issued international bonds with declining interest rates over the last few years. The situation is more complex for domestic interest rates. While policy and T-bill rates have declined the past two years, there has been no domestic bond issuance or secondary trading since the National Debt Exchange in February 2013. As such, there is no indication for domestic interest rates.

The fiscal framework foresaw only small deficits or even fiscal surpluses in the medium term. Given the ongoing fiscal consolidation, Jamaica is projected to produce fiscal surpluses starting in fiscal year 2017/18. However, financing needs will result from amortizing debt. Between fiscal years 2016/17 and 2019/20, financing amounting to around 30 percent of current GDP will be

required, including from maturing external debt. Tighter monetary policy would adversely affect the country when refinancing needs coincide with higher interest rates.

Figure 2. Drivers of Financing Requirements (2016/17–2020/21)



Source: IMF.

The most likely scenario is a slow but consistent increase in the US Federal Reserve's policy rate to around 3 percent by 2018 and beyond. Under this scenario, monetary tightening represents normalization from ultra-low interest rates, accompanying the recovery in the US and other advanced economies. The US recovery should bode well for Jamaica by supporting the three central pillars of Jamaica's economy—tourism, exports, and remittances. Higher external demand for Jamaican goods and services would also support continued, or increased, flow of direct foreign investments. Higher demand from the US could thus compensate for the higher interest rate costs and higher costs for investments.

Prudent policies could compensate for some of the increases in interest rates. Jamaica's current interest rates reflect international benchmark rates (US interest rates), a country risk premium, and, for Jamaican Dollar denominated debt, a premium for expected inflation/changes in the exchange rate. However, the interest rate differential between Jamaica and the United States depends on domestic factors. A continued decrease in debt to GDP, adherence to sustainable fiscal targets, and an acceleration of economic growth would all contribute to lowering the difference between United States' and Jamaica's interest rates. Similarly, prudent macro policies would contribute to keeping inflation and/or exchange rate movements low, thus reducing the premium required for Jamaican dollar issuances.

Conclusion

Jamaica's outlook improved. Economic growth is projected to increase in the short to medium term, which will facilitate and reinforce the still-required fiscal consolidation. Several important investment projects are in the pipeline—including for tourism, Business Process Outsourcing, energy, and logistics—that will support Jamaica's recovery. In addition, the country has become more competitive through real exchange rate depreciation and improvements in the business climate.

Jamaica's recovery is dependent on the US economy. As the major export market and source of tourists and remittances, the strong performance of the US economy is central for Jamaica's economic performance. Higher demand from the US should compensate, at least partly, for the adverse effects of higher international interest rates.

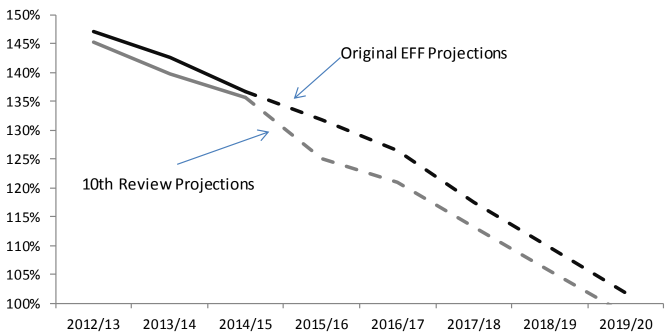
The normalization of interest rates should not hinder Jamaica's economic recovery. The increase in interest rates has been anticipated and is seen as a normal reaction of the US Federal Reserve to the economic recovery. Nevertheless, the taper episode also shows that even anticipated monetary policy changes can have substantive effects. Long-term US interest rates could increase quickly if the liftoff is interpreted as the beginning of an unfavorable monetary shock. Under this scenario, capital flows to emerging markets could dry up quickly, forcing rapid adjustments in emerging economies' exchange rates, interest rates, and asset valuations.

Jamaica is in a relatively good position to avoid a crisis from the liftoff. The country did not experience excessive capital inflows, and its macroeconomic indicators have improved markedly over the last two years. Importantly, policy credibility has improved considerably, with a strong commitment under the EFF, and with the accumulation of buffers. Nevertheless, Jamaica has benefited from higher global liquidity and lower risk premia, which might change.

The risks are balanced. Taken together, downside risks from higher interest rates and potential lower capital inflows and upside risks from higher external demand from a strong US economy seem balanced. Continued prudent macroeconomic policies have a high payoff given the still-high risk premium on Jamaican debt. The premium should continue to fall in line with the stabilization of the economy, which would partially compensate for the higher global interest rates. In addition, the increased buffers that Jamaica has been building up since 2013 should allow the country to go through periods of global uncertainty.

Petrocaribe deal supports reaching the debt target …

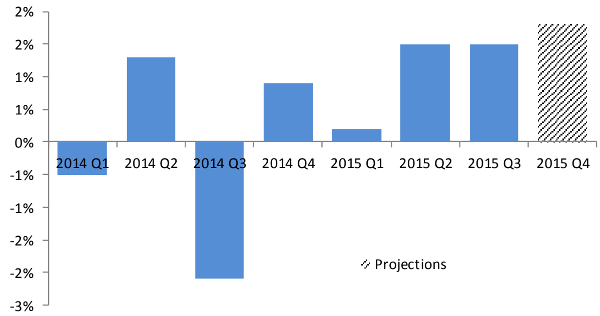
Figure A. Debt-to GDP 2011/12 - 2019/20



Source: International Monetary Fund

...in spite of slow economic recovery.

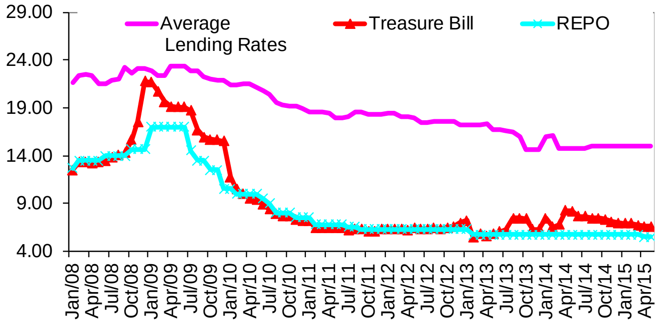
Figure B. Real Quarterly Growth Rate (Y/Y)



Source: Statistical Institute of Jamaica

Interest rates are declining only slowly…

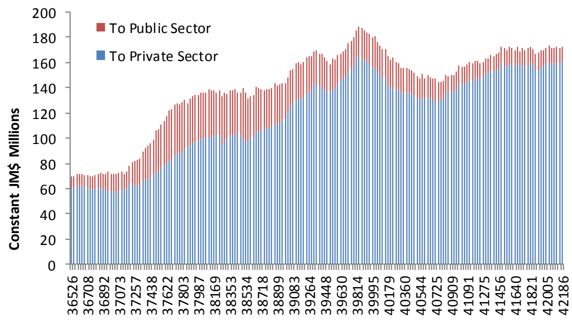
Figure C. Interest rates



Source: International Monetary Fund.

… negatively affecting credit growth.

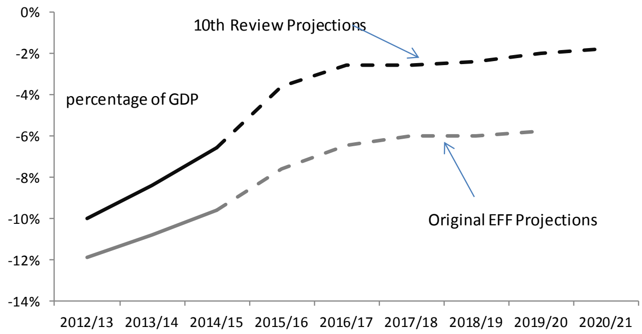
Figure D. Debt-to GDP 2011/12 - 2019/20



Source: Bank of Jamaica

The current account is expected to overperform…

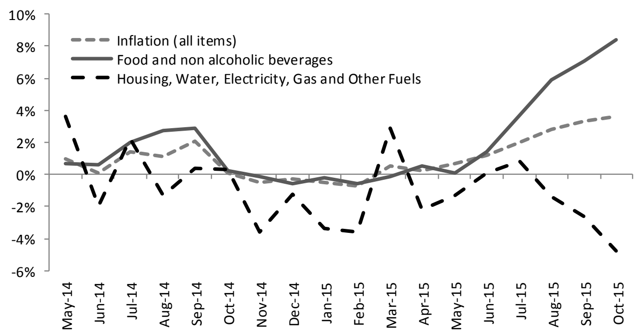
Figure E. Current Account Balance (% of GDP)



Source: International Monetary Fund

...and inflation has been under control

Figure F. Inflation and its Main Components



Source: Bank of Jamaica

Jamaica: Selected Indicators

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16 (P)
(Annual percentage changes, unless otherwise indicated)						
Real Sector						
Real GDP	-0.6	0.9	-0.7	0.9	0.2	1.4
Nominal GDP	7.8	7.5	6.1	8.9	6.9	5.8
Inflation (end of period)	7.8	7.3	9.1	8.3	4.0	6.1
Exchange rate (end of period)	85.7	87.3	98.9	109.6	115.0	...
External Sector						
Exports of goods and services (yoy, %)	0.8	13.0	3.5	3.5	-5.0	
Tourism receipts (yoy, %)	2.0	1.1	1.4	1.8	10.0	6.8
Imports of goods and services (yoy, %)	6.8	13.5	0.4	0.4	-7.3	-7.3
Current account (percentage of GDP)	-9.0	-14.9	-11.5	-8.4	-6.6	-3.6
Treasury bill rate (percent, end of period)	6.5	6.2	5.8	8.0	7.0	..
(In percentage of GDP, unless otherwise indicated, on a calendar year basis)						
Central Government						
Revenue and grants	26.8	25.6	25.8	27.2	26.3	27.6
Budgetary expenditure	33.2	32.0	29.9	27.1	26.8	28.1
Primary balance	4.5	3.2	5.4	7.7	7.5	7.3
Budget balance	-6.3	-6.4	-4.1	0.1	-0.5	-0.5
Public sector balance	-6.9	-6.4	-4.2	0.1	0.4	-0.5
Debt Indicators						
Public sector debt	141.3	143.7	146.4	141.6	124.8	125.1
Public sector debt over revenues	536.1	563.7	n.a.	516.4	491.6	453.3
Foreign currency public debt (end of period)	83.3	81.4	76.0	76.4	49.9	70.0
External interest payments as percentage of exports of goods and services	11.5	10.4	-	-	-	-
International Reserves						
Net international reserves (USD Mill)	2553	1777	884	1303	2294	2607
Gross international reserves (weeks of good and services imports)	23.4	17.8	<12	14.4	19.4	23.3

Note: (P) Preliminary estimates for FY 2015/16

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

SURINAME CHALLENGING TIMES, BUT MEASURES IN THE RIGHT DIRECTION

Highlights

There is political continuity from the government's re-election to another five-year term.

The macroeconomic framework weakened further because commodity prices have remained low.

Increased liquidity in the economy placed additional pressure on the fiscal and external situation.

The government has outlined and is implementing a structural reform agenda, combined with fiscal and monetary policies.

Overview

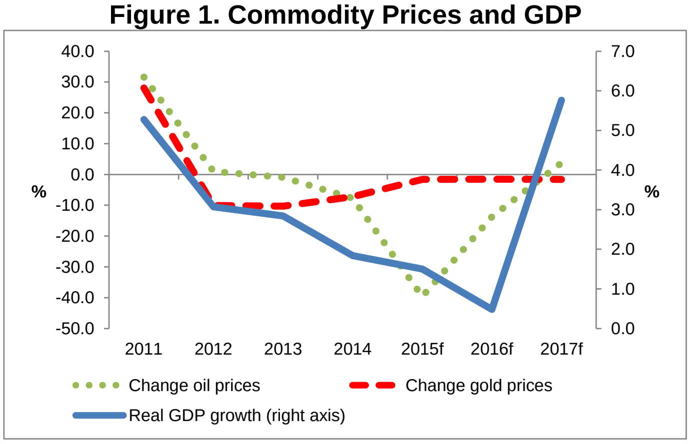
Low commodity prices weakened Suriname's macroeconomic framework in 2015. The re-elected administration has acknowledged the challenges and risks to the economy and laid out a reform agenda to address the structural inefficiencies and slippages to the macroeconomic framework. Fiscal and monetary policies were implemented to curb liquidity and consumer spending in the economy and the government has engaged in discussion with the international community for technical assistance and financing.

The Year 2015 in Review

National elections were held, and the current administration was re-elected for another 5-year political cycle. Political uncertainties existed for most of 2015, as the electoral climate rolled over from the previous year. The credit rating agencies (Standard and Poor's, Moody's, and Fitch) affirmed the country's sovereign credit rating in April, but made note of the uncertain political environment, macroeconomic slippages and reforms still under way. The elections were held on May 25, and the re-elected administration, led by the Honorable *Desiré Delano Bouterse*, was sworn into office in August. The country operates with a coalition government,[1] but for the first time in Suriname's history, a single political party, the Nationale Democratische Partij (NDP), has obtained majority seats. The government's mandate is to continue its reform agenda, which targets the vulnerability of the Surinamese economy to external shocks and the structural inefficiencies of the public sector.

Suriname's macroeconomic performance was challenged as gold, oil, and bauxite prices stayed low throughout the year. In 2015, oil, bauxite, and gold prices were on average US$50 per barrel, US$1676 per metric ton, and US$1168 per troy ounce, representing a decline in price of 50 percent, 10 percent and 30 percent, respectively, relative to average prices in the previous year (see Figure 1). Lower commodity prices adversely affected government revenues and the monetary reserves, and presented risks to the country's overall macroeconomic stability. Economic growth, which averaged 4.4 percent in the past 15 years, is estimated by the International Monetary Fund (IMF) at 1.5 percent for 2015. The fiscal and current account positions have weakened to levels that require adjustments of the primary fiscal balance and trade balance of more than 5 percent of GDP. Both indicators as a ratio of GDP are estimated at around −9 percent for the year, representing an increase in the deficits of 4 percentage points and 2 percentage points, respectively. The debt to GDP ratio increased by 13 percent to 40 percent at the end of November 2015 compared to the level at the end of 2014. The evolution of the economic downturn should also be reflected in income distribution, unemployment and poverty indicators, but the analysis of trends in poverty and inequality is constrained by data limitations.

Figure 1. Commodity Prices and GDP



Source: IMF.

Fiscal measures were implemented and a structural reform agenda is underway. The Ministry of Finance presented its reform agenda for the next five years in the areas of public finance management; revenue; expenditure, procurement and asset management; and treasury operations. Amidst lower commodity prices, short-term fiscal policy measures were mainly focused on reducing expenditures through a reduction in subsidies to state-owned enterprises.[2] Total subsidies and transfers were about 9 percent of GDP in 2015, with transfers to the electricity company comprising the bulk of this share.

---

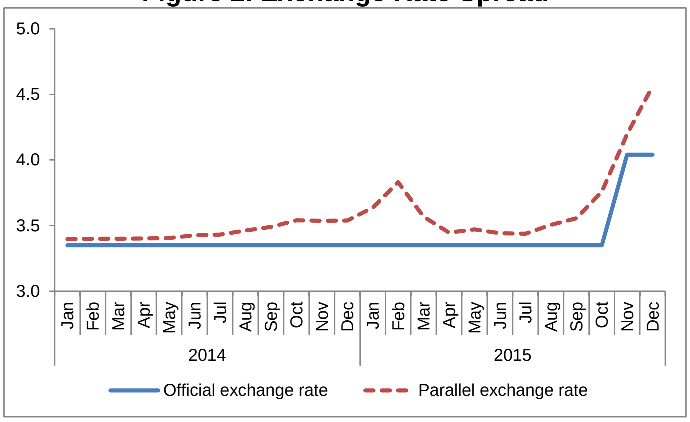
[1] The coalition government consists of the NDP (26 seats), BEP (2 seats), and DOE (1 seat).

[2] Other fiscal measures include: increasing water tariffs and the government take on fuel.

The government implemented the first phase of increased electricity tariffs in October, with the expectation that 60 percent of subsidies to the state-owned enterprise are recovered. The full removal of subsidies for electricity is planned to be completed by October 2016. The pace of reform will play a central role in the macroeconomic stabilization process.

Increased spending and reduced capital inflows placed pressure on exchange rate stability. Liquidity levels, as measured by money supply, increased by about 4 percent in 2015 compared to 2014 while imports on goods increased by 6.2 percent (actual data to September 2015) over corresponding period in 2014, and capital inflows from export and direct investments decreased. The foreign reserve position fell by 47 percent to US$330.2 million at the end of 2015 (estimated at 2.1 months of import cover) compared to the end of 2014. The sharp falling off in reserves was a risk for Suriname given its dollarized economy (greater than 50 percent)[3] and dependence on imports for general consumption and production. The weakened external position also suggested an exchange rate risk, as the spread between the official and reported parallel exchange rate market widened by 20 percent (see Figure 2). The government made attempts to realign the official and the parallel markets by direct central bank intervention and by increasing the reserve requirement ratio. The exchange rate against the US dollar was eventually devalued by 25 percent in November. In light of the devaluation, month-on-month inflation jumped to 20.4 percent in November while it averaged 4 percent in the previous months of the year (see Figure 3).

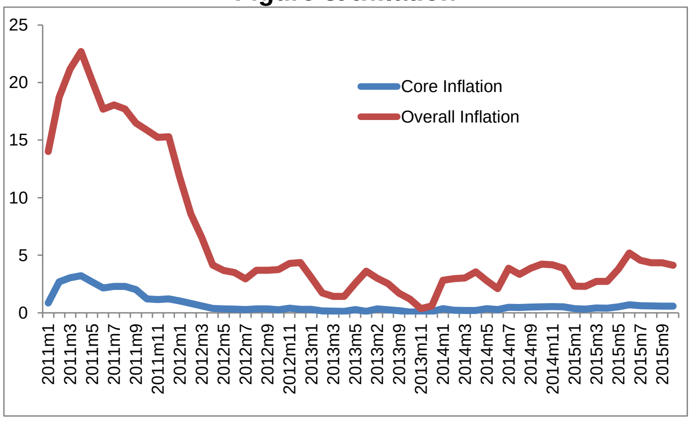
Figure 2. Exchange Rate Spread



Source: IMF.

Suriname's bauxite operations ended. The bauxite industry was once the core of Suriname's economy, contributing 70 percent of total exports, 14 percent of government revenue, and 12 percent of GDP between 1994 and 2007. However, in the past two years, the sector's contribution declined to about 13 percent of total exports, 5 percent of government revenue, and 5 percent of GDP, while employing 2 percent of the total workforce. Alcoa closed its bauxite company, Suralco, at the end of November 2015, citing ongoing energy challenges and limited bauxite supply, combined with unfavourable market conditions.[4]

Figure 3. Inflation



Source: IMF.

Suriname's Macroeconomic Outlook

Commodity prices are projected to remain low in 2016. The outlook for gold and oil prices is expected to be lower in 2016 at US$1156 per troy ounce and US$51 per barrel on average, respectively.[5] The impact of a 20 percent decline in commodity prices is estimated to reduce growth rates by 1 percentage point and increase the fiscal and external deficits to GDP by 4 percentage points, combined. The fiscal outcomes, including debt to GDP, and the external situation are also expected to be adversely affected by the weaker than expected growth performance. The Minister of Finance indicated that the international institutions including the IMF and the World Bank will be providing support to the country's efforts to get the economy on track again.[6]

[3] Adhin, R. 2012. Coping with financial dollarization in Suriname. https://www.cbvs.sr/ccmf/index_files/ccmf_papers/Coping%20with%20financial%20dollarization%20in%20Suriname_Rakesh%20Adhin.pdf.

[4] http://www.alcoa.com/global/en/news/news_detail.asp?pageID=20150914000288en&newsYear=2015

[5] World Bank, Commodity Markets Outlook (October 2015).

[6] DWTonline.com (January 16, 2015).

Robust economic growth is likely in 2017, but the macroeconomic framework should still weaken in 2016 from the sustained reduction in international prices of Suriname's main exports, gold and oil. The IMF's October 2015 World Economic Outlook predicts low economic growth in 2016 and a recovery in 2017. Growth prospects will be hindered by the temporary closure of the bauxite industry; discussions on the future of the industry are ongoing.

Investments in the extractive industry are targeted to stimulate economic activity in 2017. The government expects the continuation of investment in the mining sector through the commercialization of a large gold mining company, and the operation of a new refinery of the state-owned oil company to improve the growth outlook in the medium term. Moreover, the authorities are working on diversifying the economy to more non-mineral sectors, which would reduce macroeconomic sensitivity to commodity price changes.

There is uncertainty in the agricultural sector. Suriname's rice deal with Venezuela to export paddy and rice at a better price than what was offered for exports to other countries is at risk given the macroeconomic context in Venezuela. The banana industry is also facing a serious threat from the so-called Moko disease, which has affected nearly a quarter of the 2,000 hectares of commercial banana plantations. Agriculture is still a relatively important sector for Suriname, contributing 5 percent of GDP and 11 percent of employment. Therefore, challenges faced by the sector will have a noticeable impact on the macroeconomic framework.

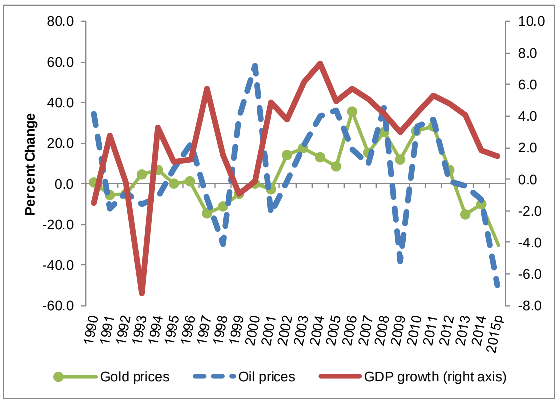
Diversification of the economy away from the extractive industry will be important in the medium term. Suriname's economy boomed during the 2008 financial crisis, given high commodity prices and the subsequent increase in capital investment. However, when prices drop sharply, as they did for six months in 2014, the impact on net commodity exports are seen almost immediately. Therefore, the ability to buffer against these impacts can help stabilize the macroeconomic framework. Effects of this so-called Dutch disease highlight structural gaps that should be addressed to reduce the vulnerability of the economy to external shocks. Diversification of the economy, especially through the development of the private sector, would be important. Additionally, the country could benefit from the creation of a stabilization fund that can be used as a cushion during difficult periods and as a means of protecting external balances. The international community will continue to play a key role in providing technical assistance and financing to the country.

Conclusion

The vulnerability of Suriname's economy from changes in international commodity prices, particularly gold and oil, is evident. The weakened macroeconomic position called for strong fiscal and monetary policies, and the government implemented measures to stabilize the external and fiscal situations. The macro-economy is affected by shocks to the commodity market and domestic factors influencing the core sectors of the economy. Strengthening the institutional capacity and the business environment will assist in directing the country's macroeconomic framework toward a sustainable path.

Low commodity prices restricted economic growth...

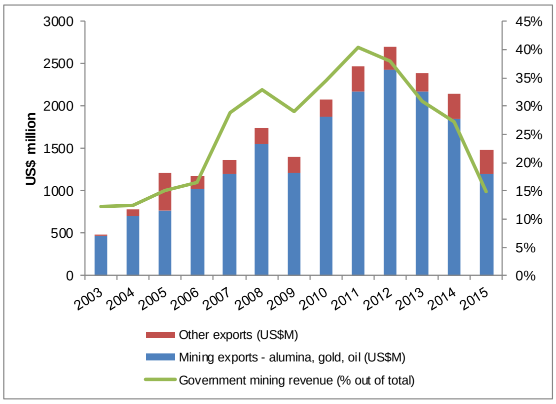
Figure A. Real GDP, and Commodity Prices



Sources: Central Bank of Suriname; and IMF.

… and reduced government revenue and export contributions from the mining and oil sectors.

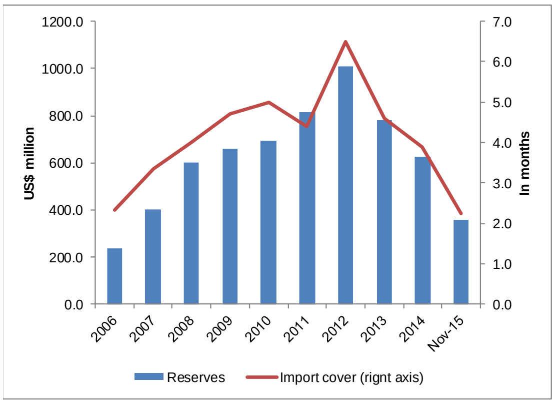
Figure B. Mining Dependence



Source: IMF.

As a result, the international reserve position weakened…

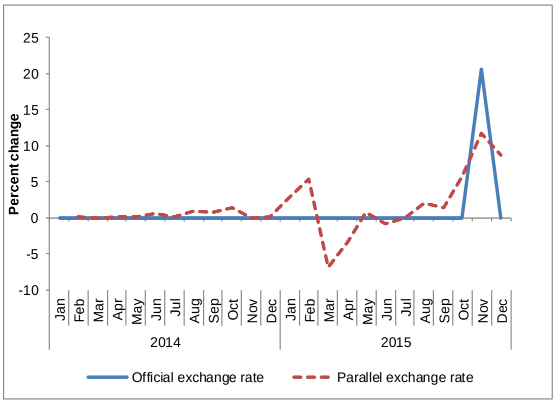
Figure C. International Reserves



Source: Central Bank of Suriname.

… and the spread between the official and parallel exchange rate markets widened.

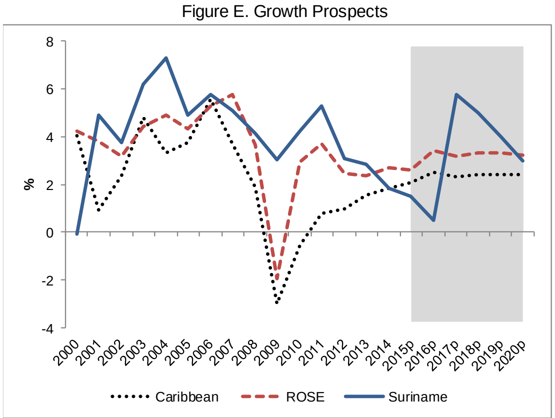
Figure D. Changes in Exchange Rate



Source: Central Bank of Suriname.

Investments in the mineral sectors should stabilize economic growth and return to historical levels …

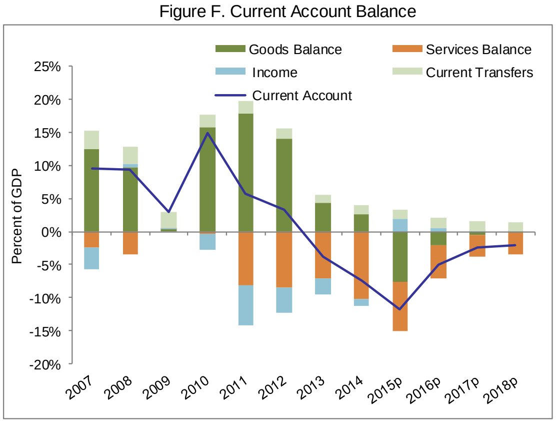
Figure E. Growth Prospects



Source: IMF.
Note: ROSE = Rest of small economies.

… and the current account balance should improve to more sustainable position in the medium term.

Figure F. Current Account Balance



Source: IMF.

Table 2. Suriname: Selected Indicators

	2011	2012	2013	2014	2015 (p)
(Annual percentage changes, unless otherwise indicated)					
Real sector					
Real GDP	5.3	3.1	2.8	1.8	1.5
Nominal GDP	20.5	13.7	3.0	1.5	-3.1
Inflation (end of period)	15.3	4.4	0.6	3.9	5.2
Unemployment	8.0	8.5	8.5	8.9	8.9
Exchange rates (end of period)	3.3	3.3	3.3	3.3	3.4
(In percent of GDP, unless otherwise indicated, on a calendar year basis)					
External sector					
Exports of goods and services	60.3	57.6	50.1	45.2	40.6
Imports of goods and services	50.7	52.0	52.9	52.8	50.5
Current account	9.6	5.7	-2.8	-7.6	-9.4
Gross international reserves (US$ millions)	816.9	1008.4	775.4	621.8	330.2
Central government					
Revenue and grants	26.7	25.1	24.7	23.5	21.2
Commodity-related revenues	10.8	9.6	7.8	6.1	3.1
Total expenditure	26.1	29.0	31.5	28.7	30.2
Primary balance	1.5	-2.9	-5.4	-4.3	-7.8
Overall balance	0.5	-3.9	-6.8	-5.1	-9.1
Debt indicators					
Total government debt	20.1	21.6	30.2	26.9	40.0*
Government debt over revenues	75.4	85.8	122.2	114.6	174.2
External debt	9.4	10.1	15.2	10.9	20.2*
Domestic debt	10.7	11.5	14.9	16.0	19.8*
External debt as percent of exports of goods and services	49.5	49.5	66.0	35.4	-

Sources: Central Bank of Suriname; World Economic Outlook, IMF (October 2015); IDB.

Notes: (P) denotes provisional figures. The impact of the 2015 currency devaluation is not reflected in the projected numbers.

* Data to November 2015

Quarterly Bulletin January 2016

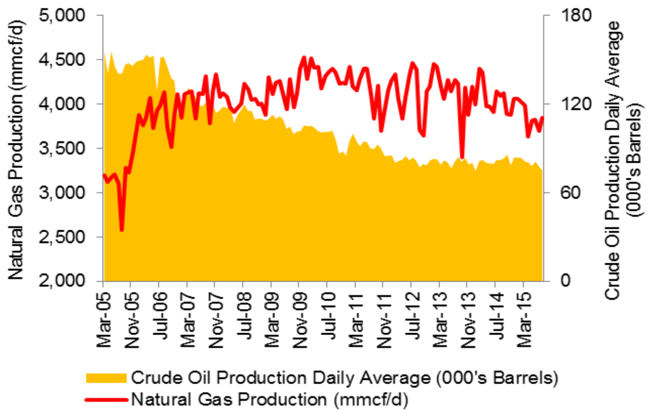
TRINIDAD AND TOBAGO WEAK GROWTH PROSPECTS FOR THE NEW YEAR

Overview of 2015

Global growth remained lackluster in 2015. Global growth for 2015 is projected at 3.1 percent, 0.3 percentage points lower than 2014. The outlook for advanced economies is gradually improving, while downside risks for emerging markets and developing countries have increased, reflecting lower commodity prices, reduced capital flows, currency pressures, and increasing financial market volatility.

Economic growth contracted in 2015. Natural gas production declined by 6.1 percent (year-on-year) in the first eight months of 2015, while crude oil production continued its downward trend (Figure 1). Liquefied natural gas and petrochemicals production also contracted during the same period in 2015. This decline in energy output along with the sharp fall in oil prices significantly reduced the country's growth prospects.

Figure 1. Energy Production



Source: Central Bank of Trinidad and Tobago.

The non-energy sector contracted by 1 percent in the first half of 2015. The decline in the non-energy sector was caused mainly by a slowdown in the construction, distribution, and manufacturing subsectors. Prior to this decline, the non-energy sector recorded 15 consecutive quarters of growth, which supported overall growth in the face of a relatively subdued energy sector.

Inflation remained moderate. Headline inflation slowed to 4.9 percent (year-on-year) in September 2015, down from 7.8 percent for the same period in the previous year. Food price inflation continued to be the main driver of headline inflation, while core inflation remained relatively stable at 1.7 percent.

Unemployment has increased. Unemployment increased slightly to 3.7 percent from 3.3 percent in the first quarter of 2015 and this trend is expected to continue over the next few years. In 2015, job cuts were reported by energy companies and as the recession deepens it is expected that negative pressures on employment would

Highlights

Trinidad and Tobago is in a recession due to the sharp decline in energy prices

Growth for 2016 is projected at -1.5 percent, as downside risks remain.

Monetary tightening by the US Federal Reserve may affect capital outflows.

Downward pressure on foreign reserves will persist amid strong demand for US currency.

rise. As such, the authorities would have to carefully manage the resulting negative effect on incomes and poverty in order to maintain and advance the socio-economic achievements made in the last decade and a half.

Homicides have increased but other serious crimes declined. High levels of violence and crime take a heavy toll on the business sector and citizen welfare. While homicides have increased, other serious crimes declined by 11 percent in 2015. The primary factor driving the increase in murders has been the rise of gang-related murders committed with firearms. Greater effort is needed to strengthen the country's Police Service, particularly its investigative capacity.

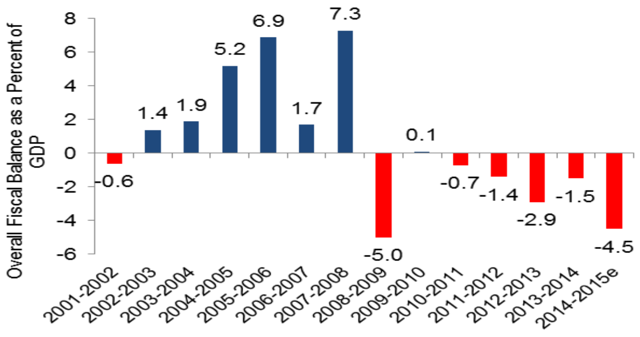
The estimated deficit for fiscal year 2015 was higher than projected. The budgeted deficit for fiscal year 2015 was 2.3 percent of GDP, but the fiscal outturn estimates a deficit of 4.5 percent of GDP, the highest since 2009 (Figure 2). The sharp decline in oil prices in 2015 caused authorities to make fiscal adjustments during the year. Relative to budgeted levels, actual expenditure during fiscal year 2015 declined by 4.4 percent, while actual energy and non-energy revenues fell by 7.8 and 9.9 percent, respectively.

The government is expected to make fiscal adjustments in 2016 as oil prices continue to plummet. Expenditure for 2016 was initially budgeted 2 percent higher than actual expenditure in 2015, but with oil prices continuing to fall the authorities are aiming for a 7 percent reduction in actual expenditure. Revenues over the next few years will depend heavily on the non-energy sector, due to declining energy volume and prices. The 2016 budget projects a deficit of 1.8 percent of GDP, but revised estimates from the Central Bank projects a much higher deficit of 4.2 percent of GDP.

Monetary authorities raised the repo rate for the seventh consecutive time in September 2015. The central bank cited the main reason for this action to be

the need to raise domestic interest rates to mitigate against the risk of capital outflows given the expected liftoff in US interest rates.

Figure 2. Fiscal Balance (% of GDP)



Source: Central Bank of Trinidad and Tobago.
Note: e=estimated.

The ongoing US dollar shortages continued to hurt the business sector. Compared to the previous year, US dollar purchases from the public declined by 9.7 percent in the first half of 2015, while sales to the public increased by 9 percent for the same period. Despite several interventions by the central bank, the foreign exchange market remained relatively tight during the year. The authorities would have to carefully consider available policy options to mitigate the risk of a possible depletion of foreign reserves in the short term.

The government proposed to introduce legislation to separate the Heritage and Stabilization Fund (HSF) into a savings fund and a stabilization fund and subsequently drawdown US$1 billion from the 'new' stabilization fund in 2016. The details are yet to be determined, but the authorities noted that the majority of the HSF resources will go towards the savings component. While the HSF resources could help reduce the primary deficit in the short term, a medium term fiscal consolidation plan that will return the fiscal framework to a sustainable path should be a priority.

The initial public offering of shares in Phoenix Park Gas Processors Ltd. was a success. The initial public offering raised approximately TT$2.2 billion (US$349 million) and was reportedly oversubscribed 1.77 times.

Moody's downgraded the long-term external government bond ratings from Baa1 to Baa2 in May 2015. The rating agency also changed the country's outlook from stable to negative, given persistent fiscal deficits, lower oil prices, limited economic diversification, and a weak macroeconomic framework with inadequate statistics. Although affirming the country's 'A' long-term foreign and local currency sovereign credit ratings in 2015, Standard and Poor's noted that the vulnerable state of public finances could result in a steadily rising debt burden, leading to a downgrade in the next two years.

Trinidad and Tobago's response to ISIS. The authorities in Trinidad and Tobago have increased security as reports have emerged that Trinidadian nationals have emigrated to join the Islamic State of Islam, ISIS. In addition, as the CARICOM chair for Security, Trinidad and Tobago called upon CARICOM leaders to increase collaboration and implement a number of key treaties which relate to security operations at the regional level.

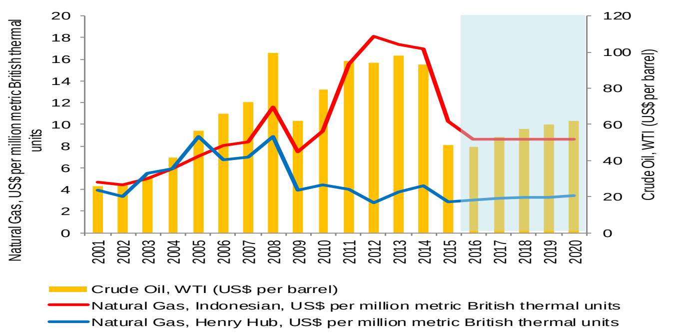
A new government was elected on September 7, 2015. The People's National Movement, which had been in opposition with 13 parliamentary seats between 2010 and 2015, won the general elections by attaining 23 seats. The People's Partnership Coalition won 18 seats.

New central bank governor appointed. Dr. Alvin Hilaire was appointed Governor and Chairman of the Board of the Central Bank of Trinidad and Tobago on December 23rd, 2015, for a term of five years.

Outlook for 2016

Lackluster global economic recovery will weigh heavily on growth prospects for Trinidad and Tobago. The expected gradual slowdown of the Chinese economy and weaker demand for commodities from other countries should continue to put downward pressure on commodity prices. Projections from the IMF for 2016 suggest that West Texas Intermediate (WTI) crude oil price could average US$47 per barrel, Henry Hub gas prices could average US$3 per mmBtu, and Indonesian gas prices US$8.65 per mmBtu (Figure 3). This weak external environment combined with idiosyncratic factors would result in a subdued growth performance for Trinidad and Tobago in 2016.

Figure 3. Commodity Prices



Source: World Economic Outlook, IMF (Oct 2015).

The Central Bank projects another -1.5 percent decline in growth for 2016. Energy sector performance is expected to remain subdued. The country's main challenge in the next few years is to stem the decline in energy output and attract new investments in a low price environment. Growth of the non-energy sectors will also struggle as the authorities manage the effects of fiscal

constraint and monetary tightening. A contracting economy and weaker business sector lending would continue to dampen growth prospects in 2016. On the upside, the opening of the Panama Canal expansion in 2016 can provide Trinidad and Tobago with access to higher priced natural gas markets in East Asia. Overall growth projections indicate that the economy will remain in a low gear over the medium term, influenced by a less favorable external environment.

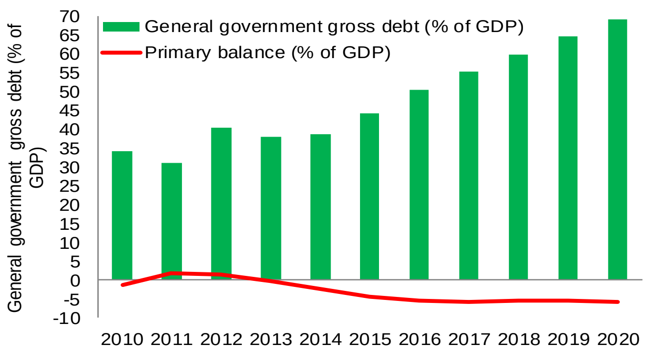
Widespread consultations about the way forward for the energy sector are expected in 2016. The government is expected to engage energy sector stakeholders to map the way forward for the sector. The focus will be placed on energy's fiscal regime and crafting better incentives to encourage investments in small and medium-sized fields. A renewable energy program is high on the government's agenda to achieve its target of generating at least 10 percent of total energy from renewable sources by 2021.

Higher fiscal deficits expected. Energy revenues in 2016 are projected at a record low—9 percent of total revenues. Several measures to enhance non-energy revenues have been outlined in the budget, which could help to improve the fiscal balance over the medium term. The 2016 budget proposes a deficit of 1.8 percent of GDP in 2016 and a target to achieve an approximate fiscal balance by 2018. The IMF, however, projects that the primary fiscal deficit would average 5.5 percent of GDP in 2016–2017 and will gradually worsen in the medium term (Figure 4).

Preliminary projections indicate that debt as a percent of GDP will rise to 47 percent of GDP in 2016, from 45 percent in 2015. With a relatively rigid structure of public expenditure, lower energy revenues, and weak growth prospects, the debt-to-GDP ratio should continue its upward trend over the medium term. The IMF estimates that Trinidad and Tobago's general government gross debt should approach 70 percent of GDP by 2020 (Figure 4).

Monetary tightening by the US Federal Reserve may affect capital outflows. Trinidad and Tobago adopted an accommodative monetary policy stance to support the domestic economy after the global financial crisis. The repo rate was reduced from 8.75 percent in September 2008 to 2.75 in September 2012, where it remained until August 2014. Given the expected increase in US policy rates that could prompt disruptive capital outflows, the monetary authorities have raised the repo rate seven consecutive times, to 4.5 percent in September 2015. As monetary tightening is expected to continue in 2016, authorities would have to carefully balance mitigating the risk of potential capital outflows and maintaining an accommodative environment to support the non-energy sector.

Figure 4. Primary Balance and Public Debt



Source: World Economic Outlook, IMF (October 2015).

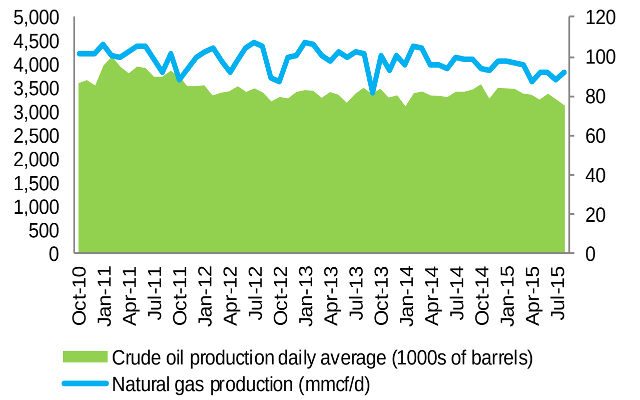
The current account is expected to worsen. The current account balance deteriorated from 19 percent GDP in 2010 to 5.6 percent of GDP in 2014. Projections indicate a current account deficit of -0.8 percent of GDP for 2016 which could deteriorate to -1.75 percent of GDP by 2020. The energy price downturn along with a decline in non-mineral exports weighed heavily on export receipts, which were the main cause of the deteriorating current account balance. However, as CARICOM countries benefit from cheaper energy, Trinidad and Tobago's non-energy exports can improve.

New measures will be taken to achieve food security and reduce challenges facing the tourism sector. The authorities will exempt all duties and taxes on inputs into the agriculture sector and outline a tourism growth strategy in 2016. These measures should support growth of both industries. Tax incentives to promote infrastructure projects are expected to be rolled out in 2016. Other key reforms to expect in 2016 include transfer pricing legislation, a gambling control bill, property tax legislation, reestablishment of the platform for a revenue authority, and improved legislation governing the financial sector.

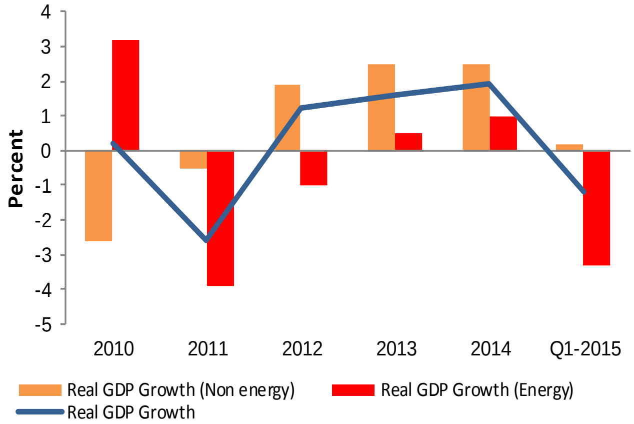
Conclusion

Trinidad and Tobago had a subpar macroeconomic performance in 2015. The country recorded negative growth in both the energy and the non-energy sectors for the first half of 2015. The external environment will continue to present challenges for the economy in 2016. Lower energy prices, the slowdown in emerging markets, and the expected rise in US interest rates are the major external headwinds facing the country in 2016. Trinidad and Tobago should take advantage of this situation to catch up on much-needed reforms to raise productivity and strategically advance economic diversification.

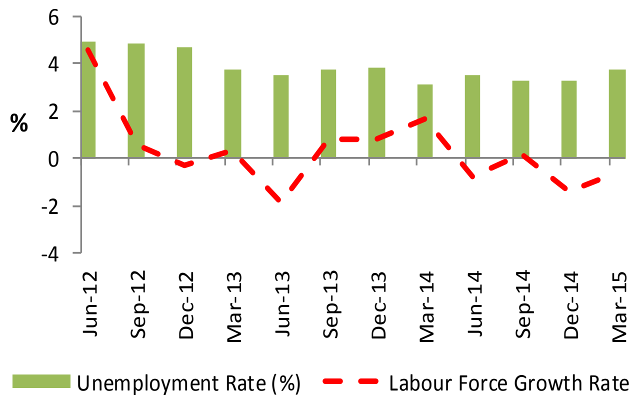
Energy production is on the decline...



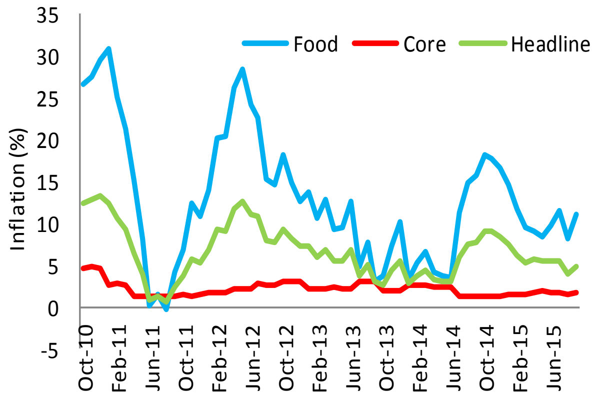
Real economic growth has contracted ...



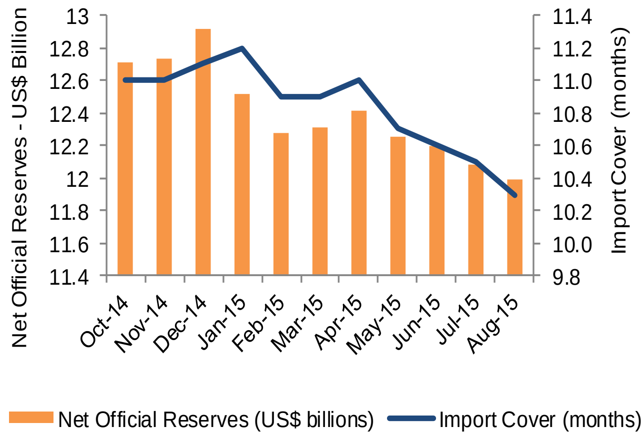
Unemployment has increased slightly



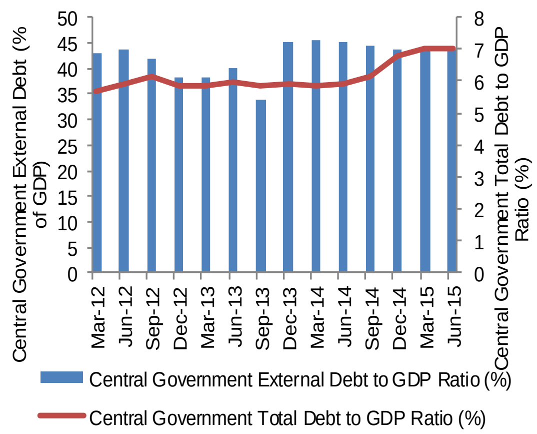
...while food inflation has slowed



Reserves have declined



...debt has increased slightly



Source: Central Bank of Trinidad and Tobago.

Trinidad and Tobago: Selected Indicators

	2010	2011	2012	2013	2014
(Annual percentage changes, unless otherwise indicated)					
Real sector					
Real GDP	-0.1	-1.6	1.4	1.7	1.9
Nominal GDP	10.6	16.6	1.0	11.1	5.4
Inflation (end of period)	10.5	5.1	9.2	5.3	5.7
(In percentage of GDP, unless otherwise indicated, on a fiscal year basis)					
External sector					
Exports of goods and services*	21.9	33.0	-13.1	-1.6	-7.5
of which: oil and natural gas*	18.8	34.7	-16.8	2.7	-7.6
Imports of goods and services*	-6.8	46.2	-4.7	-2.1	-5.5
Current account (percentage of GDP)	19.7	11.9	3.3	7.0	4.8
Central government**					
Revenue and grants	34.0	34.2	33.5	33.4	31.2
of which: energy revenues	17.6	18.8	16.0	15.0	15.8
Current expenditure	28.9	28.6	26.7	27.5	28.9
Capital expenditure and net lending	5.0	4.8	4.2	4.7	4.3
Primary balance	-2.3	-3.0	-3.4	-4.5	-3.3
Overall balance	-5.0	-0.7	-1.4	-2.9	-1.5
Debt indicators					
Public sector debt^	35.3	32.6	41.2	38.6	40.0
Public sector debt over revenues	103.4	94.5	121.4	116.8	125.7
External public debt (end of period)	7.5	7.0	6.1	7.2	7.0
External debt service as percentage of exports of goods and services	0.2	0.3	0.3	0.4	0.3

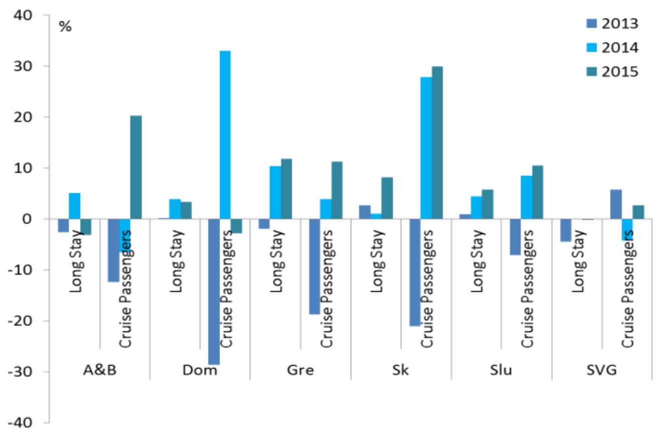
* refers to annual change in value (US$ Million); ^ represents balances (revised) at the end of the fiscal year and excludes all securities issued for open market operations (OMOs) including: Treasury Bills and Notes, Debt Management Bills and Liquidity Absorption Bonds.

Source: Central Bank of Trinidad and Tobago; World Economic Outlook, IMF (October 2015).

Recent Developments in 2015[1]

The tourism sector gradually recovered in 2015. While performance varied across countries, both long-stay arrivals and cruise passengers increased in the first half of the year in the Eastern Caribbean (See Figure 1). Long-stay tourists returned to the Eastern Caribbean from the main source markets, namely the US and the UK. The union positioned itself as an important cruise destination, with 8 percent growth in the number of cruise ship calls and 15 percent increase in cruise-passenger arrivals. Overall, tourist arrivals boosted economic activity with a 5 percent increase in spending per tourist during the first half of the year.

Figure 1. Long-stay and cruise passenger arrivals (growth year-over-year)



Source: Eastern Caribbean Central Bank (ECCB).

The fiscal position improved as a result of consolidation. A rise in tax revenue in Antigua and Barbuda (8.4 percent), Grenada (6.4 percent), and St. Lucia (7.2 percent) saw fiscal balances improve over the first half of 2015: Antigua and Barbuda moved from -1.5 percent of GDP in 2014 to 1.9 percent of GDP in 2015, Grenada from -3.4 percent to -0.5 percent, and St. Lucia from -3.5 percent to -1.2 percent. Moreover, current expenditure declined in Grenada (9.8 percent) and St. Lucia (3.1 percent) largely on account of reductions in the public sector wage bill, by 18.5 percent in Grenada and 6.4 percent in St. Lucia. Public finances deteriorated in Dominica and St. Vincent as a result of weak revenue outturns and spending pressures: Dominica's fiscal deficit worsened from 3.2 percent of GDP at June 2014 to 8.8 percent of GDP in June 2015, while St. Vincent's deficit grew from 1.4 percent of GDP to 2.4 percent over the same period. St. Kitts saw a smaller surplus, from 9.4 percent of GDP in 2014 to 5.2 percent in 2015, as transfers and subsidies increased current expenditure by more than 10 percent.

[1] This bulletin focuses only on developments in the independent countries of the OECS: Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Vincent and the Grenadines, and St. Lucia. Figures exclude territories that are members of the OECS.

Highlights

Tourism gradually recovered during 2015.

Across the union, the fiscal position improved as a result of consolidation.

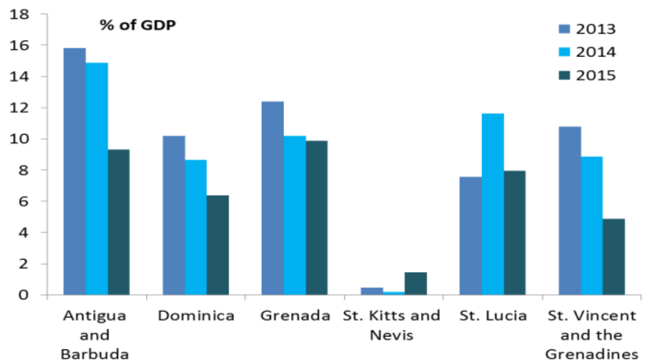
Mr. Timothy Antoine was appointed Governor of the Eastern Caribbean Central Bank.

Private sector credit growth remains subdued, contracting by 4.1 percent.

Dominica's Tropical Storm Erika caused significant

Lower oil prices contributed to containing imports and inflation over the first half of 2015. Fuel imports declined across member states, with the exception of St. Kitts (see Figure 2). The fuel import bill declined in Antigua and St. Vincent by more than 5.6 and 4 percentage points of GDP, respectively. Inflation was subdued for the first half of the year on account of lower international commodity prices. (See Figure 2).

Figure 2. Fuel Imports (% of GDP)

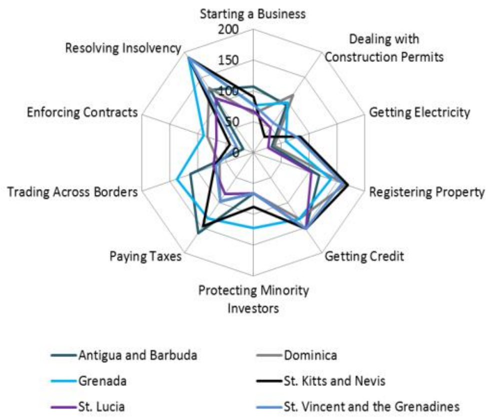


Source: ECCB.

The OECS continued on a path towards greater reliance on renewable energy. In October 2015, the Caribbean Development Bank and the Inter-American Development Bank signed a US$71.5 million Sustainable Energy Facility for the Eastern Caribbean aimed at contributing to the diversification of the energy matrix. This facility will support the six independent OECS states to: develop the installation and implementation of energy efficient technologies and programs across the public sector; enhance the regulatory, legal, and policy framework; strengthen technical, institutional, and environmental capacity; and implement public sector renewable energy projects related to wind, solar, geothermal, and waste to energy. The loan supplements ongoing efforts to improve renewable energy generation in the Eastern Caribbean.

The OECS ranking slipped slightly in the World Bank's Doing Business 2016. Each member state saw a slip in its relative standing for the 2016 Doing Business rank. It is reflective of an improvement in the relative standings of neighboring countries, such as Jamaica, rather than of actual developments in the union: Antigua and Barbuda fell five places to 104, Dominica slipped two places to 91, Grenada was five places lower at 135, St. Kitts fell to 124 from 122, St. Lucia (the highest ranked) dropped four places to 77, and St. Vincent's ranking declined by five places to 111. The OECS performs relatively well in getting electricity, enforcing contracts, and dealing with construction permits, but lags in resolving insolvency, providing access to credit, and registering property. (See Figure 3).

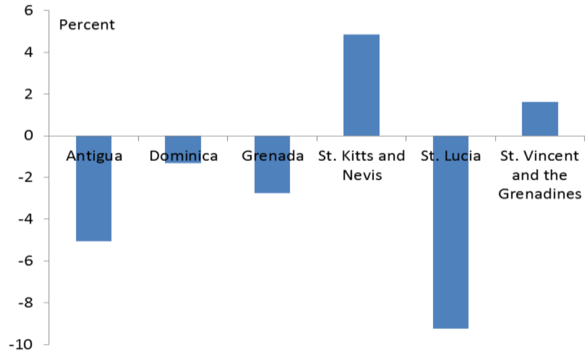
Figure 3. 2016 Doing Business Indicators, OECS



Source: World Bank.

Private sector credit contracted amid uncertainty and high numbers of non-performing loans. Credit to the private sector contracted by 4.1 percent by end of the third quarter of 2015 relative to the same period in 2014. Over this period, only St. Kitts saw a 4.8 percent increase in credit. (See Figure 4). At the same time, the elimination of the minimum savings deposit rate meant the average lending rate declined slightly, from 9 percent in September 2014 to 8.8 percent by the same period in 2015. However, the costs of service across the banking sector remain unchanged. Nevertheless, the commercial banks, particularly indigenous banks, have been affected by the economic downturn. The rising credit risks and tighter liquidity have had a negative impact on profitability.

Figure 4. Growth in Commercial Bank Credit



Source: ECCB.

Mr. Timothy Antoine was appointed Governor of the Eastern Caribbean Central Bank. Following the retirement of former Governor Sir Dwight Venner, who served since 1989, Mr. Antoine's tenure would start on February 1, 2016. He is a Grenadian citizen who served as Permanent Secretary in the Ministry of Finance for fourteen years. In addition, he was a member of the ECCB Board, Chairman of the Grenada Authority for the Regulation of Financial Institutions, and Chairman of the Technical Core Committee on Insurance for the Eastern Caribbean Currency Union.

Country-Specific Developments

Antigua and Barbuda opened a new international airport in 2015. The V.C. Bird International Airport opened in August 2015. A new 3 megawatt solar photovoltaic farm was built to supply its electricity, which is part of a larger initiative aiming to generate 10 megawatts of the airport's energy needs from renewable sources. Meanwhile, the ABI Bank Ltd. ceased operations, and deposits up to EC$500,000 per person were transferred to the Eastern Caribbean Amalgamated Bank Ltd. Deposits above this threshold were transferred to a special fund to be managed and distributed over time.

Tropical Storm Erika caused Dominica economic losses of US$483 million (or 96 percent of GDP). Transport and agricultural infrastructure were severely damaged, the international airport suffered, and some communities were left uninhabitable. Prior to the storm, Dominica's fiscal position was declining—a trend only exacerbated by this natural event that affected revenue collection and increased public expenditure because of recovery efforts.

Strong demand for tourism services in Grenada and recovery in agriculture supported robust growth. By June 2015, the country met its International Monetary Fund (IMF) Extended Credit Facility targets. A primary surplus of 1.4 percent of GDP was achieved for the first seven months of the calendar year, ahead of the 1.3 percent target. Arrears to suppliers declined from 3.1 percent of GDP in December 2014 to 1.6 percent by June 2015. EC-dollar bondholders and a majority of US-dollar bondholders agreed to a debt exchange, which resulted in a 50 percent reduction in value with an extended maturity from 2025 to 2030. As a result, public debt declined from 102.5 percent of GDP in 2013 to 90 percent in 2015.

A new administration took office following the February 18, 2015 general elections in St. Kitts. On the agenda of Prime Minister Timothy Harris was the reform of the Citizenship by Investment program to reinforce controls and address security issues, in collaboration with Canada and the US. Reforms include using at least three different companies to perform due diligence, upgrading IT, increasing the staffing of the Citizenship by Investment Unit, and enhancing transparency of operations. The administration is also seeking to repeal the debt-for-land swaps that have directly contributed to US$261.9 million reduction in public debt following the swaps in 2013 and 2014. According to the IMF's September 2015 Article IV Consultation, "reversal of the debt-land swap would increase public debt by 33 percent of 2015 GDP and could entail some additional fiscal penalties for unwinding agreements already in place." The removal of VAT from certain foods and all medicines and funeral expenses in April had an adverse fiscal impact. Growth continues to be robust and moderated below the 7 percent mark reported in 2014.

The St. Lucia economy rebounded in 2015 with a favorable external environment. Following output contraction in 2012 and relative stagnation in 2013–2014, growth rebounded in St. Lucia mainly on account of higher tourist arrivals and lower oil prices. Construction activity was buoyed by reconstruction and rehabilitation following the 2013 floods. Yet private-sector credit growth declined by 9.3 percent year-on-year in September 2015, continuing to drag down economic growth. The fiscal position improved over the first half of 2015 with the increase in tax revenue, especially from the VAT.

Construction of the Argyle International Airport contributed to growth in St. Vincent. Work to complete the airport, along with other public sector projects, boosted construction sector figures over the first half of 2015. Agriculture also recorded a modest recovery over the first half of the year, with an expansion in banana and plantain production. However, tourist arrivals declined as cruise-passenger arrivals fell by 5.1 percent during the same period, which offset the increase in long-stay arrivals from the US, the UK, and Canada. On the fiscal side, the deficit grew for the first six months of the year, reflecting higher capital expenditures to accommodate the airport's construction and the reconstruction efforts associated with the 2013 floods.

Economic Outlook

The OECS growth outlook is positive. According to the IMF's October 2015 *World Economic Outlook,* growth in St. Kitts would be dynamic and close at around 5 percent in 2015 then moderate to 3.5 percent in 2016, as activity in the construction sector tempers. Grenada would close 2015 at 3.5 percent and 2016 at 2.4 percent, with increases in agricultural output, tourism arrivals, and spending per visitor. Output in Antigua and Barbuda, St. Vincent, and St. Lucia would be more modest: In light of weaker construction activity, Antigua is expected to grow by 2.2 percent in 2015, below the 4.3 percent growth attained in 2014; St. Vincent is expected to grow by 2.1 percent, and St. Lucia is expected to overcome stagnation to grow by 1.8 percent.

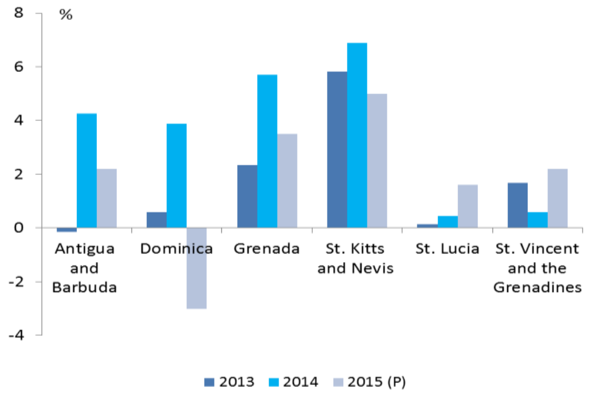
Economic activity in Dominica is expected to contract by 3 percent in 2015 as a result of Tropical Storm Erika.[2] The downward revision is a reflection of the extensive storm damages and losses equaling 96 percent of GDP. However, rehabilitation and reconstruction efforts are expected to drive economic recovery in 2016, to reach around 3.9 percent growth. Public-sector reconstruction costs are estimated at 65 percent of GDP, which the Government of Dominica aims to fund through a grant appeal. Furthermore, reconstruction along with higher food imports would drive a higher import bill, while tourism arrivals and exports are expected to decline. A larger current account deficit in 2015 was expected.

Additional fiscal consolidation would be required to reduce debt to sustainable levels. Four countries have debt-to-GDP ratios in excess of 80 percent. In Grenada, levels still remain above 90 percent of GDP after debt restructuring. The risk of debt distress is more moderate in St. Kitts and St. Vincent, but overall the union would need to sustain tighter fiscal positions and greater consolidation if it aims to achieve the Eastern Caribbean Currency Union's public debt target of 60 percent of GDP by 2030.

[2] Request for Disbursement Under the Rapid Credit Facility, IMF (November 2015).

Growth is returning to the OECS countries…

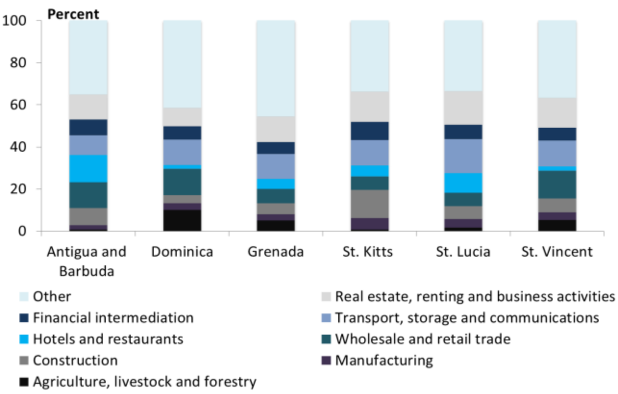
Figure 1: Real GDP Growth



Source: ECCB

…with tourism, construction, and agriculture leading the way.

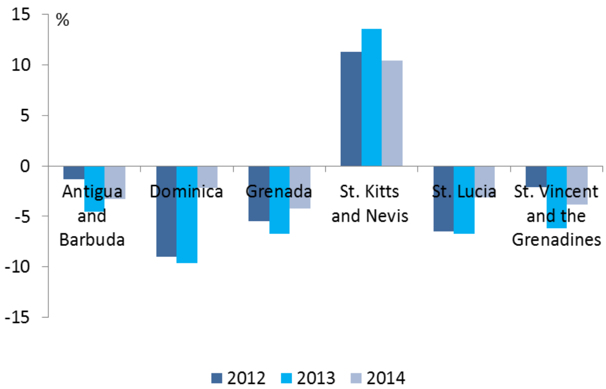
Figure 2: Contribution to GDP, 2014



Source: ECCB

Large fiscal deficits …

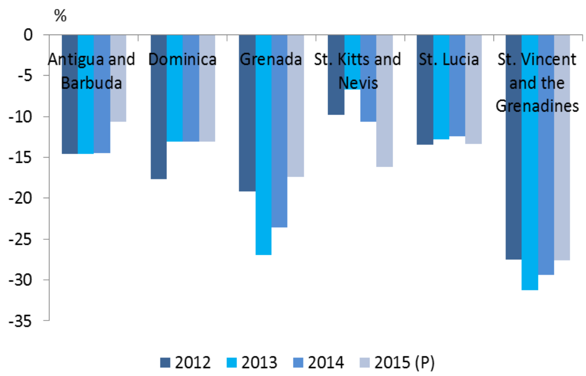
Figure 3: Fiscal Deficit (% of GDP)



Source: ECCB

…and sustained current account deficits

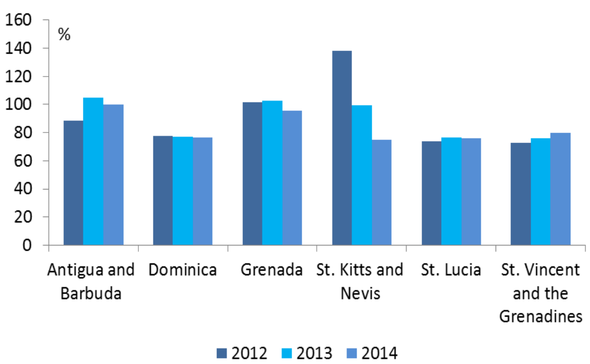
Figure 4: Current Account Balance (% of GDP)



Source: ECCB

…have led to a rapid accumulation of debt…

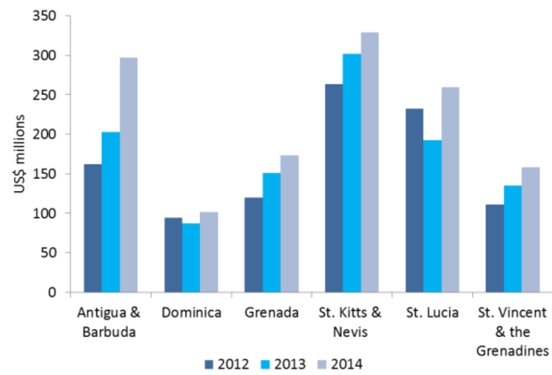
Figure 5: Central Government Debt (% of GDP)



Source: ECCB

…but reserves have improved over time.

Figure 6: Gross International Reserves (US$ millions)



Source: ECCB

	Antigua and Barbuda				Dominica				Grenada			
	2012	2013	2014	2015 (P)	2012	2013	2014	2015 (P)	2012	2013	2014	2015 (P)
Real Sector												
Real GDP (% change)	4.0	(0.1)	4.3	2.2	(1.3)	0.6	3.9	(3.0)	(1.2)	2.3	5.7	3.5
Nominal GDP (% change)	6.6	(0.3)	3.5	3.2	1.2	0.4	1.8	1.6	2.8	4.4	3.1	2.4
Inflation (end of period)	1.8	1.1	1.3	1.0	1.2	(0.4)	(0.1)	0.9	1.8	(1.2)	(0.7)	(1.0)
External Sector												
Exports of goods and services (% change)	(0.2)	-	(0.1)	2.3	(15.9)	14.1	3.3	9.2	(7.4)	(4.0)	15.3	5.3
Imports of goods and services (% change)	17.2	(7.5)	2.2	2.3	(5.0)	(1.2)	4.7	15.1	2.4	23.9	(0.4)	1.5
Current account (% of GDP)	(14.6)	(14.6)	(14.5)	(10.7)	(17.7)	(13.1)	(13.1)	(13.1)	(19.2)	(27.0)	(23.6)	(17.4)
International reserves (USD millions)/1	162.0	202.6	297.0	N/A	94.6	87.1	101.7	N/A	119.5	150.6	173.5	N/A
International reserves cover (weeks)/1	2.6	3.1	4.9	N/A	4.1	3.9	4.9	N/A	3.3	4.0	5.2	N/A
Public Sector												
Total revenue (% of GDP)	19.9	18.4	18.6	N/A	27.1	28.6	29.9	N/A	20.6	21.3	27.1	N/A
Current expenditure (% of GDP)	20.6	21.6	20.3	N/A	23.6	26.2	25.5	N/A	21.1	21.0	21.5	N/A
Capital expenditure (% of GDP)	0.6	1.3	1.7	N/A	12.6	12.0	6.6	N/A	5.0	7.0	9.9	N/A
Central government primary balance (% of GDP)	1.1	(2.4)	(0.6)	N/A	(7.5)	(7.6)	(0.4)	N/A	(2.1)	(3.5)	(0.4)	N/A
Central government overall balance (% of GDP)	(1.3)	(4.5)	(3.3)	N/A	(9.0)	(9.6)	(2.2)	N/A	(5.5)	(6.7)	(4.2)	N/A
Debt Indicators												
General government debt (% of GDP)	88.6	104.9	99.9	N/A	77.8	77.0	76.3	N/A	101.4	102.5	95.6	N/A

Notes:

(P) - denotes projected figures; the Storm

(P) - GDP growth projections are from the World Economic Outlook, October 2015. Dominica's projection has been revised.

/1 - ECCB and IADB staff estimates for 2014

Source: Eastern Caribbean Central Bank

	St. Kitts and Nevis				St. Lucia				St. Vincent and the Grenadines			
	2012	2013	2014	2015 (P)	2012	2013	2014	2015 (P)	2012	2013	2014	2015 (P)
Real Sector												
Real GDP (% change)	(1.2)	5.8	6.9	5.0	(1.1)	0.1	0.5	1.8	1.4	1.7	0.6	2.1
Nominal GDP (% change)	0.5	5.8	8.7	5.8	1.0	2.5	1.0	4.0	2.5	2.3	3.7	3.1
Inflation (end of period)	0.1	0.4	2.0	2.0	5.0	0.7	1.7	3.1	1.1	-	0.6	0.1
External Sector												
Exports of goods and services (% change)	-	-	12.1	3.1	(3.9)	(0.7)	3.2	8.8	1.4	(1.1)	4.6	6.6
Imports of goods and services (% change)	(3.8)	7.7	17.8	6.8	(8.5)	(0.7)	2.4	13.2	7.1	6.6	1.3	12.0
Current account (% of GDP)	(9.8)	(6.7)	(10.7)	(16.2)	(13.5)	(12.8)	(12.4)	(13.4)	(27.5)	(31.3)	(29.4)	(27.6)
International reserves (USD millions)/1	263.5	302.0	329.1	N/A	232.0	192.2	259.1	N/A	111.0	135.1	158.1	N/A
International reserves cover (weeks)/1	8.4	9.1	9.8	N/A	3.4	3.1	4.4	N/A	3.2	3.7	4.6	N/A
Public Sector												
Total revenue (% of GDP)	42.6	47.0	43.1	N/A	23.9	24.6	26.5	N/A	27.0	26.9	27.5	N/A
Current expenditure (% of GDP)	27.7	26.7	26.9	N/A	23.5	23.6	23.6	N/A	26.1	25.3	25.6	N/A
Capital expenditure (% of GDP)	3.7	6.7	5.8	N/A	6.9	7.7	6.0	N/A	2.9	7.8	5.7	N/A
Central government primary balance (% of GDP)	17.2	17.3	13.7	N/A	(3.0)	(3.0)	0.8	N/A	0.3	(3.7)	(1.5)	N/A
Central government overall balance (% of GDP)	11.3	13.5	10.4	N/A	(6.5)	(6.7)	(3.1)	N/A	(2.1)	(6.2)	(3.8)	N/A
Debt Indicators												
General government debt (% of GDP)	137.9	99.5	75.1	N/A	73.7	76.5	76.3	N/A	72.8	75.9	80.1	N/A

Notes:

(P) - denotes projected figures; the Storm

(P) - GDP growth projections are from the World Economic Outlook, October 2015. Dominica's projection has been revised.

/1 - ECCB and IADB staff estimates for 2014

Source: Eastern Caribbean Central Bank

REGIONAL SUPPLEMENT: THE FED LIFTOFF – ARE YOU SCARED YET?

Introduction

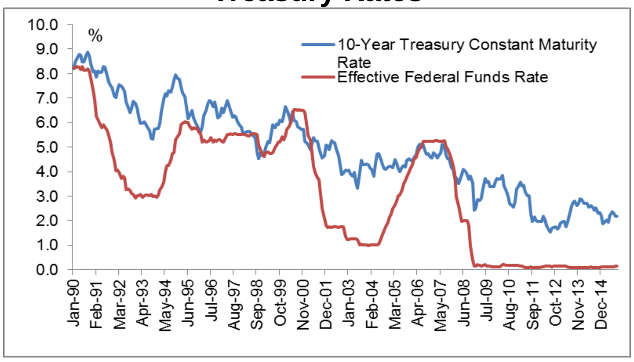
The outlook for the world economy is mixed. While some major economies are experiencing solid growth, several economies, including major emerging markets are facing challenges. The US, the UK, India, and some European countries are projected to continue to perform well, while the outlook for countries such as China, Brazil, and Japan remains uncertain. Similarly, the Latin American and Caribbean region has experienced a marked slowdown in 2015, and challenges have increased. The fall in commodity prices has been a major driver, but weak policies and a failure to build sufficient buffers have also contributed to uncertainty and economic challenges. Additionally, political tensions are creating uncertainties in regions including the Middle East and Europe. Finally, the expected increase in world interest rates discussed below is creating additional challenges.

The normalization of interest rates by the US Federal Reserve (Fed) will be a central theme of the world economy in 2016. As is often the case, one solution to a problem can produce a new problem. Such is the case with the monetary stimulus that the Fed used during the world economic recession. Reduction in policy rates and quantitative easing brought a situation of ultra-low interest rates in the US (Figure 1) that also had far-reaching effects on global interest rates, capital flows, and asset valuations. However, at some stage monetary policy has to be adjusted and normalized to avoid an overheating of the economy and inflation. In the US, this moment has arrived, and it could have far-reaching effects as monetary policy in the US influences the rest of the world. Channels for the influence include exchange rate adjustments as well as potential upward pressure in interest rates and capital outflows from emerging economies.

The liftoff was anticipated. International financial markets experienced high volatility in 2013 when the Fed announced that it would discontinue its quantitative easing program, raising fears of a fast increase in long-term interest rates. Long-term interest rates increased rapidly in May 2013 (red line in Figure 2) even though the Fed target rate remained low and even declined. Global markets went into turmoil, and emerging economies experienced capital flight and volatility in their exchange rates. By December 2013, US rates started to decrease again, but bond yields of several emerging economies have been increasing since May 2015 (Figure 3). Because of the strong responses, the episode was labeled the 'taper tantrum.'

A major reason for the strong reactions during the taper tantrum is that the announcement had been unexpected, which led to a rapid change in expectations about long-term interest rates. Conversely, the current situation, in which interest rates are expected to increase over the next few years, has been anticipated and priced in for a while. In addition, the quantitative easing had lowered long-term interest rates, resulting in expectations of fast increases of long-term interest rates once the program was stopped or reversed. Conversely, the Fed fund rate is a short-term rate. Nevertheless, the interest rate normalization also coincides with ongoing weaknesses and risks in several major economies, introducing stress to an already vulnerable global economy. At the same time, not all countries are equally exposed to higher US interest rates. The following explores how, and to what extent, a normalization of US interest rates could affect emerging markets, particularly the countries of the Caribbean Country Department of the IDB.

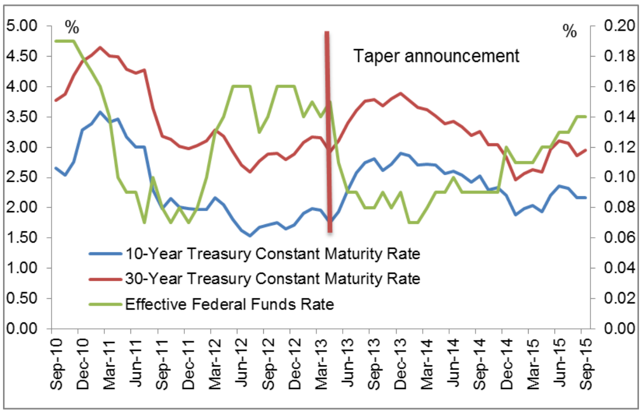
Figure 1. Effective Federal Fund and 10-Year Treasury Rates



Source: FRED Economic Data.

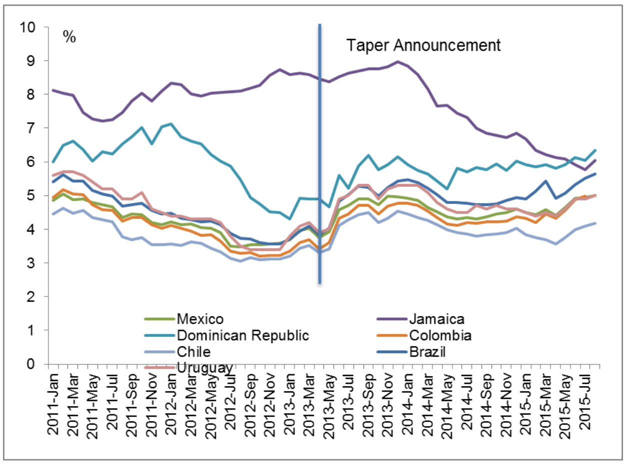
REGIONAL SUPPLEMENT: THE FED LIFTOFF – ARE YOU SCARED YET?

Figure 2. Effective Federal Fund and Treasury Rates During the Taper Tantrum



Source: FRED Economic Data.

Figure 3. Emerging Markets Bond Index Yields (monthly average)



Source: Latinwatch, IDB.

The Liftoff and Potential Consequences

Consensus forecasts suggest a continuous increase in the target Fed fund rate in 2016. Following eight years of monetary easing, the effective Fed fund rate declined from 5.26 percent in 2007 to below 0.25 percent in December 2008—and it has been there since. The Federal Open Market Committee increased the target rate by 0.25 percent in December 2015, and further increases are expected in 2016 and 2017. Facing similar challenges to control their local economies, other central banks pursued a similar policy of extremely low interest rates, including the European Central Bank and the central banks in the UK and Japan. These economies also introduced quantitative easing to drive down long-term interest rates. Policy rates and bond yields also declined in several emerging economies even though they remained at a higher level, reflecting structural differences in inflation and risk ratings.

The Fed has an inflation target of 2 percent. Inflation has been lower than targeted in several advanced economies, including the US. However, as monetary policy only influences the economy with a lag, the Fed uses economic growth and employment as the main proxies for slack in the economy. As GDP growth increases and unemployment falls, the economy reaches a level where salaries and prices will start to rise. The decline in US unemployment to 5.1 percent as of September 2015, a level which the Fed saw as the natural level of employment, was thus a strong signal that monetary tightening should begin. However, there are also factors that cautioned against increasing interest rates too early and too quickly. First, part-time employment and the number of persons out of the labor force have increased in the US and remain above the levels seen before the financial crisis, pointing to more slack in the economy than the unemployment rate alone would indicate. Second, risks in the world economy remain elevated and may increase as a result of a Fed policy liftoff. As a result, even though policy rates were raised in the December 2015 Fed meeting, the speed of future increases remains uncertain.

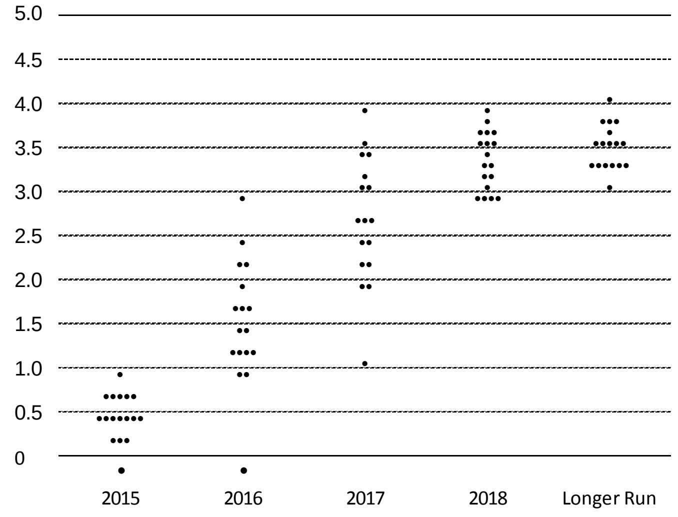
Further rate increases seem imminent. The current consensus of the Federal Open Market Committee is a stepwise increase in the Fed rate to 3.25 percent by 2018, just below the long-term consensus of 3.5 percent (Figure 4). The difference of over 300 basis points (3 percent) to the current rate indicates how low current interest rates are.

The policy change by the Fed could influence emerging economies through different channels. Interest rates abroad would have to increase in line with US interest rates. Higher returns available in

REGIONAL SUPPLEMENT: THE FED LIFTOFF – ARE YOU SCARED YET?

the US and other advanced economies could also lead to withdrawals of capital from emerging markets and a strengthening of the US Dollar. The latter two effects depend on the interest rate reaction of the respective monetary authorities. The consequences of the capital outflow from these emerging markets depend on the level of buffers and could be challenging if countries have high financing needs, especially from maturing external debt.

Figure 4. Fed Funds Rate Target Range and Level Midpoints



Source: Press release from the September 16–17 meeting of the Fed.
Note: End of calendar year figures.

The increase in interest rates has different effects. Depending on the level of countries' debt portfolios and their characteristics, deficits could increase with higher interest rates. In addition, in some emerging markets, the private sector has accumulated significant liabilities in US dollars. A re-pricing of these securities or a need to roll them over at higher interest rates could have adverse effects for some businesses and, through them, the financial sectors. Finally, as countries would have to align their monetary policy to that of the US, they might be forced to tighten monetary policy too early, suppressing investment and thus economic growth.

The liftoff signals a strong recovery. While the higher interest rates can cause disruptions, they also reflect the strength of the recovery in the US, which has important linkages to the Caribbean through trade, tourism, and remittances. This is an important point because monetary policy changes can be made for different reasons. Expected adjustments in the policy rate signify normalization from ultra-low interest rates in order to avoid inflationary pressure as the economy strengthens versus runaway inflation. The effects from the interest rate increase could be small as the Fed moves from near-zero interest rates to normal interest rates. Inflation currently remains low, which should permit the Fed to gradually raise interest rates.

Conclusion

Increases in US interest rates are likely to be a major factor for the world economy in 2016. Following the December 2015 increase—the first in nine years—further rate increases in the US seem likely even though other advanced economies continue to provide monetary stimulus. The divergence of their monetary policies could create new challenges in an already weak economic environment.

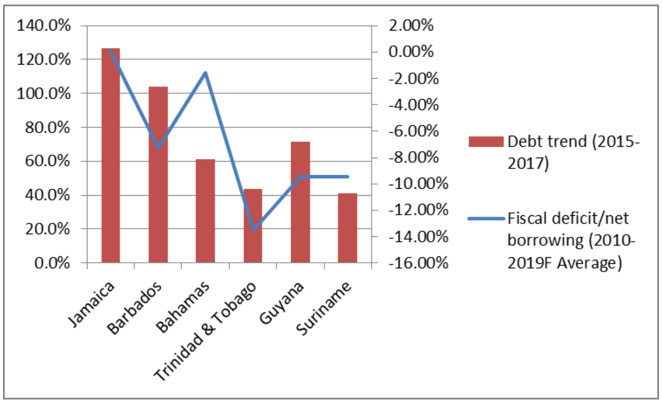
CCB countries do not seem to be especially vulnerable to increases in US interest rates. Countries with high levels of US-denominated debt, private or public, with weak fiscal and/or external positions, and countries that are highly integrated into the international financial system face the biggest challenges. In addition, their vulnerabilities strongly increase when several of these characteristics are present at the same time. However, private capital flows are relevant for CCB countries, especially in the form of foreign direct investment, but less in terms of foreign investors holding domestic securities or direct lending of foreign banks to companies in the Caribbean. External debt is relevant in the Caribbean, but there is no strong reliance on short-term debt.

Several countries rely on variable rate debt. Interest payments will increase in countries that depend on variable rate debt or debt that matures in the short term. For CCB countries, variable rate debt mostly plays a role as interest rates from multilaterals, including the IDB, which are based on libor.[1]

Buffers across the region need boosting. Buffers such as international reserves and fiscal savings are weak in the Caribbean (Figure 5 and Figure 6).

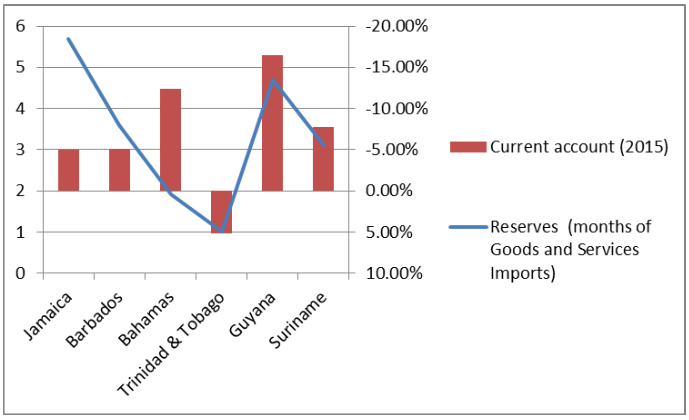
The Fed normalization should not distract from other risks. The Caribbean is highly dependent on the performance of the US economy. Current projections for US economic growth are positive, but downside risks arising from a marked slowdown of the global economy remain. Commodity producers in the Caribbean also face low prices and weak global demand. Moreover, the region is vulnerable to extreme weather, including hurricanes.

Figure 5. Fiscal Buffers



Source: World Economic Outlook, IMF (2015).

Figure 6. External Buffers



Source: World Economic Outlook, IMF (2015).

[1] The share of external debt on total debt in Jamaica is around 50 percent. Of this, one third is from multilaterals. Most of Guyana's debt is external, of which over 50 percent is from multilaterals.

The Caribbean Quarterly Bulletin

The Caribbean Quarterly Bulletin was prepared by the Caribbean Economics Team, Inter-American Development Bank.

The contributors were Cherran O'Brien, Chrystol Thomas, Mark Wenner, Juan Pedro Schmid, Camilo Gomez, and Jeetendra Khadan.

The section on the **Organization of Eastern Caribbean States** was prepared by Camilo Gomez.

This issue's **Regional Supplement** was prepared by Juan Pedro Schmid.

The Quarterly Bulletin's production team is headed by Inder Ruprah (director) and Juan Pedro Schmid (editor and coordinator). Desiree Mitchell (coordinator), Dana Payne (editor and distributor), Sarah Dotson (editor). Dillon Clark, Xavier Malcolm and Kimberly Waithe also contributed.

For questions or comments please email CET@iadb.org

For questions or comments please contact email CET@iadb.org

Caribbean DEVTrends
blogs.iadb.org/caribbean-dev-trends

IDB