Caribbean Region Quarterly Bulletin

2016:II

Debt: The Dark Side

Volume 5, Issue 2 | June 2016

IDB Country Department Caribbean

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Debt: The Dark Side

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Introduction

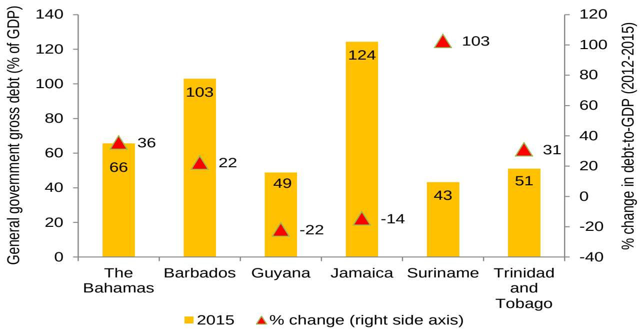
A moniker often invoked to describe the Caribbean is: "high debt, low growth." It was never completely true. Today it may have become so. The tourism countries, Jamaica, Barbados, and The Bahamas, are still in distress from the tailwinds from the world crisis of 2009. The commodity-exporting countries, Guyana, Suriname, and Trinidad and Tobago, relatively unscathed by that crisis, face strong headwinds as the international commodity boom wanes.

In this overview of the region we explore answers to four questions: Is public debt too high? If so, what should be the change in the fiscal stance? How would higher economic growth help? Are fiscal buffers adequate in case downside risks in the world economy materialise?

Is Debt Too High?

Excessive debt brings several problems. When the debt level is too high, downward pressure on economic growth occurs, and, combined with a low credit rating, this implies high interest rates hence interest payments that squeeze out governments' investment and social expenditure. A steep rise in public debt could place a country into a vicious unsustainable cycle of increasing debt and rising interest payments.

Figure 1. Debt-to-GDP Ratio (2012 and 2015)

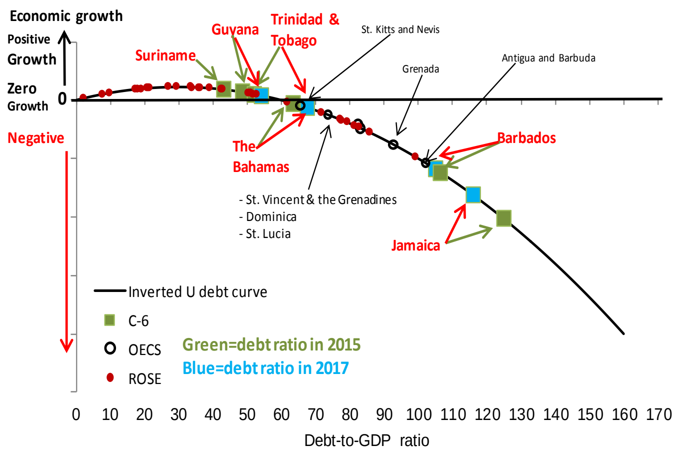


Sources: Staff calculations and World Economic Outlook, IMF, April 2016.

In all but two countries, debt to GDP in 2015 is higher than it was in 2012 (Figure 1). Suriname recorded the largest increase—103 percentage points—although its debt-to-GDP ratio is still low (43%). The Bahamas' debt rose by 36 percentage points, and Trinidad and Tobago's debt ratio increased by 31 percentage points. Jamaica's and Guyana's debt ratios fell by 14 and 22 percentage points, respectively.[1]

Whether fiscal policy is adequate requires a benchmark to determine whether debt is, or is forecasted to become, too high. One possible debt benchmark is derived from the estimated relation between debt and economic growth. This is shown in Figure 1. The inverted "U" shape relation captures that for a debt-to-GDP ratio lower than 30%, any increase has a positive marginal and average effect on economic growth. However, above that level (the turning point on the inverted U curve), any further increase has a negative marginal effect, and above 60%, the impact (marginal and average) becomes negative.[2]

Figure 2. Debt-to-GDP Ratio and Economic Growth (2015 and 2017) in Percentages



Source: Staff calculations and World Economic Outlook, IMF, April 2016.
Note: C6 = The Bahamas, Barbados, Guyana, Jamaica, Suriname, and Trinidad and Tobago; OECS = Organisation of Eastern Caribbean States; ROSE = Rest of small economies (economies with populations of less than 3 million).

How close are Caribbean countries to the negative debt-growth threshold? Three tourism-dependent countries and the OECS countries are in the negative region of the debt-growth relation. However, the

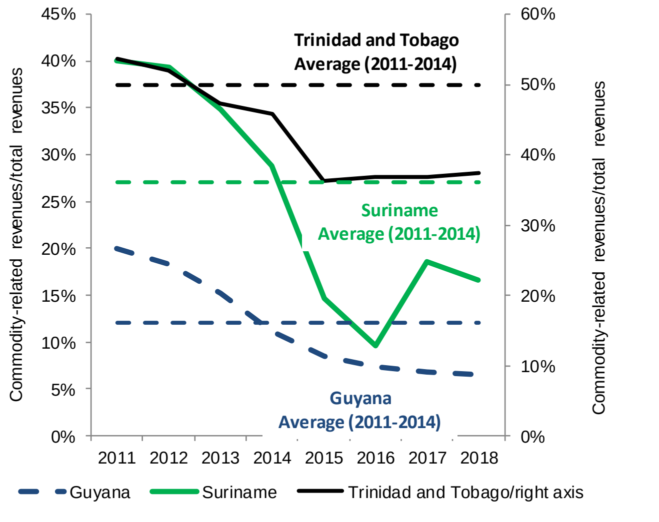
[1] In the country specific reports the main drivers of the debt changes are estimated, i.e., decomposed into the primary fiscal balance, economic growth, inflation, interest, and exchange rates.

[2] Greenidge, R., and R. Craigwell, et al. 2012. "Threshold Effects of Sovereign Debt: Evidence from the Caribbean." IMF Working Paper no. WP/12/157. Washington, DC, United States: International Monetary Fund. https://www.imf.org/external/pubs/ft/wp/2012/wp12157.pdf

commodity exporters are still below the 60% threshold. This is likely to change. The IMF's medium-term projections show that the debt ratio for Guyana and Trinidad and Tobago will exceed the threshold at 61 and 92% of GDP, respectively. Suriname's debt ratio is expected to stabilise at less than 60% of GDP under the auspices of an IMF program. Jamaica and to a lesser extent Barbados are forecasted to reduce their debt ratios, but remain in the negative region of the debt-growth relation.

Expectations of a rise in public debt in commodity countries stems from the sharp fall in commodity-related fiscal revenues that is forecasted to persist. Commodity-related revenues averaged 16%, 36%, and 50% of total revenues for Guyana, Suriname, and Trinidad and Tobago, respectively, during the period 2011-14. This helped to boost their expenditures on infrastructure, education, and other social programs. These revenues have dived and are expected to remain depressed over the short term (Figure 3). The forecasted rise in debt reflects that there will be insufficient fiscal retrenchment to compensate for the revenue loss.

Figure 3. General Government Commodity-related Revenues (% of total revenues)

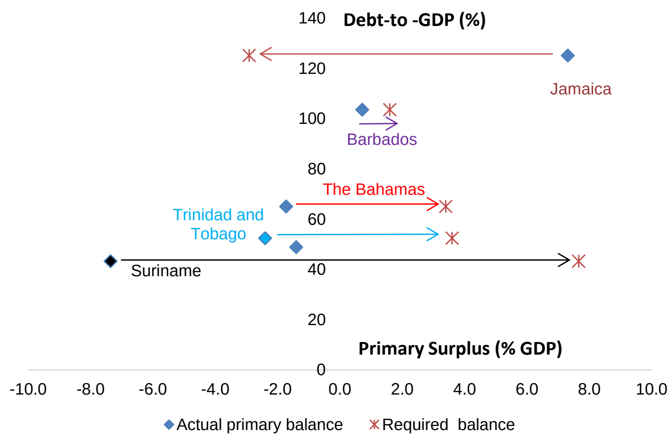


Source: Staff calculations and World Economic Outlook, IMF, April 2016.

What Fiscal Stance?

Significant fiscal effort is required to stabilise the debt. Comparing the actual primary balance, i.e. the fiscal deficit minus interest payments, with the required primary balance to stabilise the debt ratio gives an indication of the direction and size of fiscal adjustments needed.[3] Figure 4 shows the estimated fiscal adjustment, drawn in terms of percentage points of GDP. With the exception of Jamaica, the required fiscal adjustment to stabilize the debt ratio averages 4 percentage points of GDP for Caribbean countries.[4] Suriname's adjustment is the largest (7 percentage points), followed by Trinidad and Tobago (3.6 percentage points), and The Bahamas (3.4 percentage points). Jamaica's actual primary balance, a surplus of 7% of GDP, derives from the country's fiscal rule of reducing debt-to-GDP ratio to 100% of GDP by 2020, while the simulated 6% shown in Figure 4 is to reach that target by 2021.[5]

Figure 4. Actual and Required Fiscal Balance (2015)



Source: Staff and WEO April 2016

This is easier said than done. Adjustments, as many of the country-specific reports suggest, should be accompanied by a review and reform of the budgetary processes. Most countries have budget outruns (either in expenditure or revenue) greater than the 5% benchmark. Other than Trinidad and Tobago none are included in the Open Budget Index[6]. The latter would reveal the areas where improvement can be made such that national

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[3] A primary fiscal deficit implies that the government is incurring more debt to pay interest on existing debt.

[4] This figure excludes Guyana, which is a HIPC country for which a different criterion is used. See the section on Guyana.

[5] The country-level analysis suggests a high difference between budgeted and actual fiscal outcomes. This implies that the countries' budgetary processes may need to be strengthened.

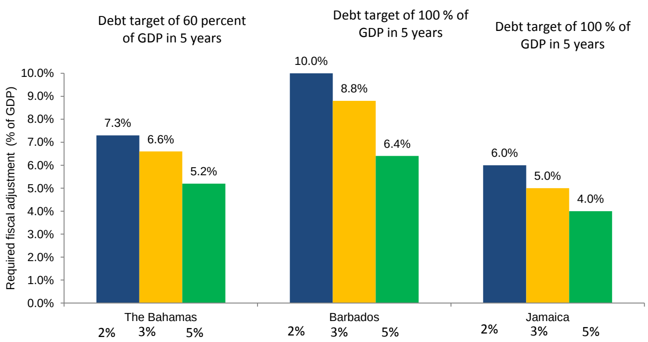
[6] See: http://www.internationalbudget.org/opening-budgets/open-budget-initiative/open-budget-survey/

budgets are more accountable, efficient, and effective. The adoption of fiscal rules, perhaps based on structural fiscal budgets, accompanied by institutional strengthening of budgetary institutions may be in order.[7] Such would increase the credibility of fiscal policy and perhaps reduce the cost of financing.

How Would Economic Growth Help?

The required fiscal adjustment is very sensitive to economic growth. Figure 5 shows the degree to which the required fiscal adjustment falls for higher economic growth rates for a given debt target for a given year**.** The estimations reinforce the argument that any fiscal adjustment should be pro-growth and complementary growth-enhancing policies should be simultaneously implemented.

Figure 5. Required Adjustment and Debt Reduction at Different Economic Growth Rates



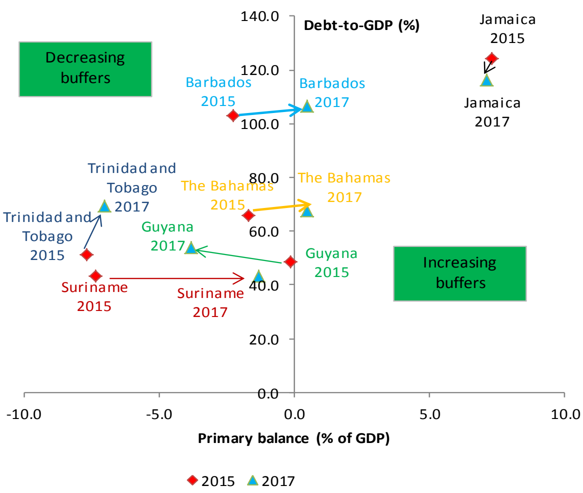
Source: Staff calculations and World Economic Outlook, IMF, April 2016.

Caribbean Countries Lack Fiscal Buffers

The latest World Economic Outlook (IMF, April 2016) announced "a pronounced increase in downside risks." In addition, it stated that: "Perceptions of limited policy space to respond to negative shocks, in both advanced and emerging market economies, are exacerbating concerns about these adverse scenarios (WEO: 23).[8] These are: "(1) the threat of a disorderly pullback of capital flows and growing risks to financial stability in emerging market economies, (2) the international ramifications of the economic transition in China, (3) growing strains in countries that are heavily reliant on oil exports, (4) the possible impact of tighter financial conditions and bouts of financial market volatility on confidence and growth if they persist, (5) more protracted recessions in emerging market economies that are currently experiencing distress, (6) geopolitical risks, and (7) the United Kingdom's potential exit from the European Union. Materialisation of any of these risks could raise the likelihood of other adverse developments." (WEO: 24). So a key question is whether the Caribbean has adequate fiscal buffers if the downside risks materialise.

For all countries, fiscal buffers are inadequate and for most countries they are forecasted by the IMF to worsen by 2017. The levels in 2015 and the forecasted levels of debt to GDP and the primary fiscal balance to GDP (Figure 6) reveal that, other than Jamaica, no country is forecasted to have an unambiguous improvement in its fiscal buffers. Therefore, there is a deteriorating limited policy space to respond to negative external shocks.

Figure 6. Fiscal Buffers (2015 and 2017)



Source: Staff calculations, and World Economic Outlook, IMF, April 2016.

Conclusions

Barbados, The Bahamas, and Jamaica are on the "dark" side of the debt-growth relation, that is, with debt levels that put negative pressure on economic growth. Guyana and Trinidad and Tobago are expected to join them. Only Jamaica and to a lesser extent Barbados are expected to reduce their debt levels in the

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[7] See S. Kahn and I. Ruprah, "To Bind or not to Bind: A Fiscal policy Dilemma in the Caribbean", IDB, November 2014.

[8] IMF. 2016. "Too Slow for Too Long." IMF Report. Washington, DC: International Monetary Fund. http://www.imf.org/external/pubs/ft/weo/2016/01/

next two years, albeit remain on the dark side of the growth- debt relation. Suriname, with the steepest recent rise in debt, is expected, under the auspices of an IMF program, to stabilise its debt ratio below the dark side value. Thus, for many countries fiscal adjustment, that is, a greater primary fiscal surplus, is required to stabilise and reverse the rise in the debt to GDP ratio and to follow the debt reducing path adopted by Jamaica. Where the economic growth is higher, the required fiscal adjustment would be less. Increasing economic growth thus has to be an integral part of the strategy to reduce debt.

Worldwide downside risks have increased. The recent World Economic Outlook not only reduced world growth forecasts to 3.2% and 3.5% in 2016 and 2017 respectively but also emphasised pronounced increased downside risks combined with reduced policy space to respond to negative shocks. In the Caribbean, the present levels of fiscal buffers are inadequate and are forecasted, other than for Jamaica, to worsen, thus reducing policy space to respond to any external shocks.

Contributor: Jeetendra Khadan

Overview

The Bahamas' economy performed at a modest pace during the first quarter of 2016. Growth in air arrivals was offset by subdued performance in sea arrivals. Inflation remained low due to the fall in global commodity prices. However, double-digit unemployment remains a cause for concern. With respect to fiscal developments, the overall deficit declined in the seven months of FY2015/16, led by a boost in VAT revenue, while debt grew to 68% of GDP at the end of 2015.[1] The current account benefitted from lower oil prices and reduced construction-based outlays.

Highlights

Real GDP growth continued at a moderate pace.

Standard and Poor's affirmed The Bahamas BBB-/A-3 credit ratings.

The fiscal deficit declined by 1% of GDP in the first seven months of FY 2016.

Tourist arrivals have slowed considerably.

External risks are high but they should decline over time.

The Bahamas has moved up two positions on the Ease of Doing Business ranking in 2016.

Recent Developments

Domestically, the economy is in a slow-growth trap. Real GDP growth slowed to 0.5% in 2015, from 1% the previous year. The deceleration in growth was largely due to weaker domestic demand related to the uncertainty around the opening of the Baha Mar resort. The International Monetary Fund (IMF) has projected an improvement in growth to 1.5% for 2016–17, supported by an uptick in the tourism sector.

The Bahamas is likely to remain in a low-growth trap according to two credit rating agencies. Moody's placed The Bahamas at the bottom of its low-growth category, while Standard and Poor's forecast that the economy will remain in a low-growth cycle over the medium term. The main factors driving these projections include structurally high unemployment, high household debt, and high loan arrears in the banking system, along with emerging risks to the competitiveness of the tourism sector.

Standard and Poor's affirmed The Bahamas' BBB-/A-3 foreign and local currency sovereign credit ratings, but the country's outlook remains negative. This ratings decision was predicated on fiscal reform measures undertaken to reduce the fiscal deficit and an improved external outlook. Standard and Poor's, however, noted that its rating could be lowered if there is further uncertainty about the opening of the Baha Mar, if the primary balance projections are not met, or if there is a deterioration in the external liquidity position.

Inflation remained relatively subdued. The retail price index increased by 70 basis points to 1.9% in December 2015 based on the latest available data. Average price increases of 15.4 percentage points and 10.8 percentage points were reported for health and recreation, and culture, respectively. Other sectors recording price increases of roughly 5% include clothing and footwear, furnishing, household equipment and maintenance, communication, food and non-alcoholic beverages, and restaurants and hotels. Education, alcoholic beverages, tobacco and narcotics, and miscellaneous goods and services showed more modest price increases of less than 3%. The fall in global oil prices also affected domestic transportation costs, which declined by 5.4%.

Fiscal deficit narrowed. The fiscal deficit declined by almost 1% of GDP in the first seven months of fiscal year 2016. The authorities noted that a better-than-expected VAT intake contributed to the improved fiscal outturn-VAT collections, which was estimated to be about 6% of GDP for the first year since it was introduced in January 2015. On the expenditure side, current outlays increased by 18%, largely due to transfer payments, but were slower than revenue growth, which was 28.4%. The fiscal balance is expected to improve to a primary surplus of roughly 1.7% of GDP by 2019 assuming fiscal consolidation reforms continue.

Central government debt continues to rise. Gross debt (excluding contingent liabilities) increased to almost 68% of GDP in December 2015, from 65% in the previous year, and 48% in 2011. Forecasts over the medium term suggest that strong value-added tax (VAT) revenue combined with other fiscal reforms and expenditure restraint should help to reduce the primary deficit and stabilise the central government debt.

[1] The fiscal year runs from July to June.

External risks are high but they should decline over time. The country's current account deficit moved from 23% of GDP in 2014 to 15% of GDP in 2015. It is forecasted to further improve to 9% of GDP by 2017. The reduced deficit is attributable to lower oil prices and a decline in construction-related imports. The external sector is expected to improve with new tourism capacity, and a mild recovery in remittances, which is linked to the better outlook of the U.S. economy. External reserves expanded to $980.5 million at the end of March 2016.

The banking sector remains well capitalised. The weighted average capital of banks (measured by the ratio of regulatory capital to risk-weighted assets) was 32.7% at the end of 2014. The sector's performance, however, will remain constrained by high non-performing loans (14.2% of total loans), weak credit demand, and high loan arrears.

The Bahamas has moved up two positions (from 108 to 106) on its ranking in the Ease of Doing Business Index in 2016. The two areas where improvements were made are paying taxes and cross-border trading. However, deterioration in the ranking was observed for starting a business, dealing with construction permits, getting electricity, registering property, getting credit, and protecting minority investors. No change was reported for enforcing contracts and resolving insolvency.

Tourist arrivals have slowed considerably. Total tourist arrivals in The Bahamas declined by almost 0.5% in 2015, compared to an almost 3% increase the previous year. A turnaround is expected in 2016, as tourist receipts should be boosted by lower oil prices and stronger growth in the United States and Europe.

The stalled Baha Mar Resort casino project is officially up for sale. According to Deloitte & Touche, the receivership of the unfinished $3.5 billion project, the Toronto-headquartered Colliers International, was appointed to market the property to prospective buyers. Hiring a high-profile firm like Colliers should instill a sense of confidence that the project will soon be back on track toward completion.

The Government announced an expected increase in air traffic to The Bahamas during the year. In its 2015/16 Mid-Year Budget Statement, the Government noted that The Bahamas remains an attractive destination. Beginning in August, British Airways will deploy its larger and modern Boeing 777 jet on its Nassau route from London's Heathrow Airport. Moreover, Southwest Airlines has announced that it will increase flights to The Bahamas with non-stop service from Ft. Lauderdale to Nassau. Air traffic has also grown in the Family Islands with biweekly non-stop service to Abaco and Eleuthera from Atlanta via Delta Air Lines, and from Miami to San Salvador via American Airlines.

Cash payouts of $16 million have been promised to CLICO policyholders. The Minister of Finance announced on March 7, 2016 during the mid-year budget debate that the seven-year wait for resolution is nearly at an end. The plan involves creation of a special purpose vehicle to assume the CLICO's insurance operations and pay the policyholders. Under the plan, surrendered policies, death benefits, medical claims, and staff pensions will be paid in full. Executive Flexible Premium Annuities holders and surrendered pension policies will be settled in cash up to a maximum of $10,000 per person, and the balance will be supported by seven-year promissory notes with interest at the prime rate of 4.75%, payable quarterly.

PharmaChem Technologies broke ground on its $120 million multiproduct manufacturing plant on March 31. The multi-product facility will take 2.5 years to build and is expected to boost industrial growth and economic development. The expansion project is expected to boost employment levels and is projected to involve over 100 local contractors and expand the PharmaChem staff from 120 to 220 employees. The project is the result of collaboration between PharmaChem and US-based Gilead Sciences, Incorporated.

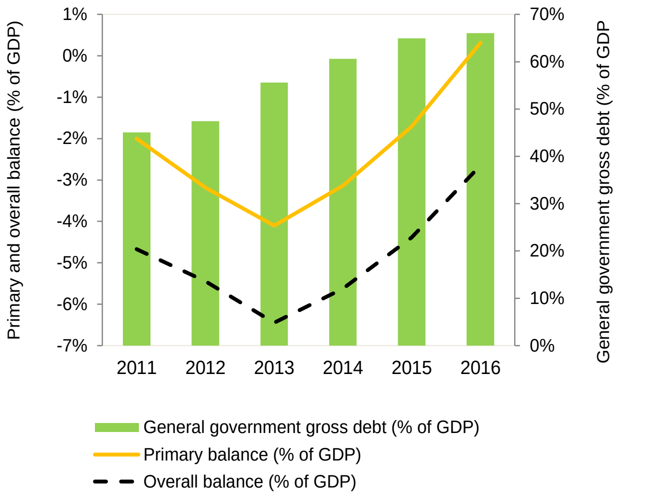
High-Frequency Macroeconomic Indicators				
	Last data	**Period**	**Prior data**	**Period**
Annual GDP growth (%)	1.5	2015	1.5	2014
Tourist arrivals	-0.5	2015	2.8	2014
Exports (12-month growth)	-1.7	2015	-11.1	Q4-2014
Imports (12-month growth)	2.0	2015	3.2	Q4-2014
Private sector credit growth (%)	-0.2	Mar-16	-0.3	Mar-15
Inflation (% yoy change)	2.0	2015	0.2	2014
Exchange rate (end of period)	1.0	Sep-15	1.0	Sep-14
Unemployment rate (%)	13.0	2015	15	2014

Fiscal Consolidation amid Low Growth

The Bahamian economy was characterised by low growth and worsening fiscal and external imbalances since the 2008 global financial crisis. The country's fiscal balance deteriorated sharply and there was a corresponding rise in the ratio of debt to GDP. The IMF's 2015 debt risk rating also classified The Bahamas under the category of "higher scrutiny." As concerns remain elevated about the country's fiscal and debt sustainability, The Bahamian authorities have outlined a medium-term fiscal consolidation strategy to consolidate public finances and reduce the debt burden.

Despite sharp deterioration in the fiscal balance, reforms can improve the outlook over the medium term. The primary fiscal deficit as a percent of GDP increased from 0.1% in 2008 to 4.2% in 2013. In the five years leading up to FY2013, expenditure growth averaged 4% annually, compared to a decline in revenue of 0.9% on average each year. The fiscal balance gradually improved in FY2014, largely due to an increase in tax revenues and the government's implementation in FY2015 of the VAT. (Figure 1).

Figure 1. Fiscal Balance and Public Debt (% of GDP)



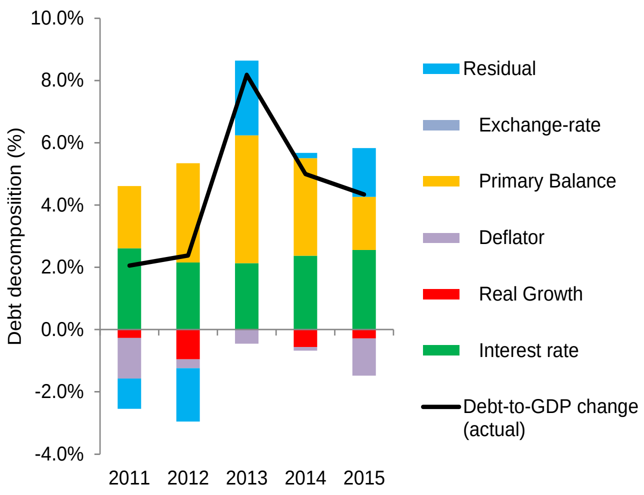
Source: IMF World Economic Outlook (April, 2016).

Public debt has risen. Public debt levels grew by 40% during the period 2011–2015. Debt as a percent of GDP (excluding contingent liabilities) increased from 48.2% in 2011 to 67.7% in 2015. Contingent liabilities guaranteed by the government account for 8.6% of GDP and are held in both Bahamian and foreign currency by public corporations. External debt and domestic debt were estimated at 18.7 and 48.9% of GDP, respectively, at the end of 2015.

Debt Drivers in The Bahamas

The primary fiscal deficit is the main factor driving the growth in public debt. The decomposition of the public debt into its determinants-exchange rate, primary balance, deflator, real growth, and interest rate is shown in Figure 2. The annual change in debt to GDP over the period 2011-2015 averaged 4.4% and was determined largely by the primary balance. For the same period, the annual growth in the primary deficit averaged 2.8%. High domestic interest rate is also an important contributor to the change in debt. Other debt determinants such as the exchange rate, growth rate and deflator have had a negligible effect on changes in the debt-to-GDP ratio (Figure 2).

Figure 2. Decomposition of General Government Debt



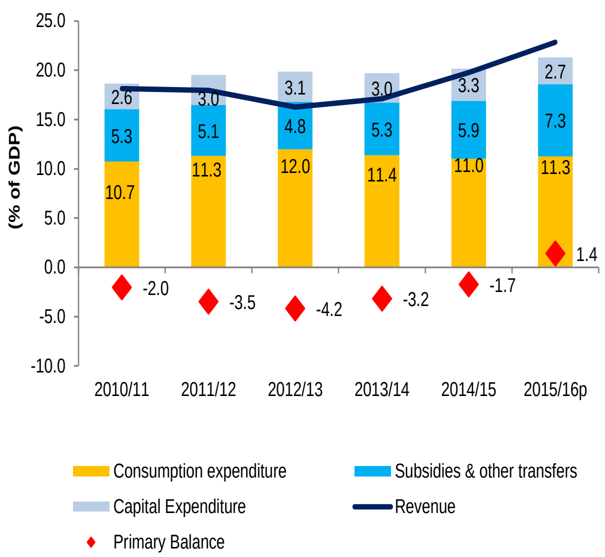
Source: Staff estimates from IMF World Economic Outlook (April, 2016).

Primary Deficit Drivers in The Bahamas

Stabilising the debt-to-GDP ratio and subsequently putting it on a sustainable path would require the central government to generate primary surpluses over an extended period of time. In The Bahamas, current spending is rigidly focused on subsidies and transfers, and personal emoluments—almost 60% of current expenditure. In particular, transfers and subsidies as a share of GDP increased from 5.3% in 2011 to 7.3% in 2016, and this accounts for 34% of current expenditures. Personal emoluments account for a similar share of GDP (7.5%), but have been relatively steady over the same period. Capital expenditure has remained stable, averaging 3% of GDP. On the revenue side, tax revenue is roughly 20% of GDP, an increase from 16.3% in FY2013. The Bahamas still has room to increase tax revenues as it is presently well below that of other tourism-dependent Caribbean countries, such as Barbados at 25% of GDP, and Jamaica at 25%. Non-tax revenue has been relatively stable over 2011–2015, averaging 2.1% of GDP.

Primary fiscal balance is improving due to better revenue inflows (Figure 3). The primary deficit (of 3.5% of GDP) deteriorated in FY2012 due to increased capital outlays of 16%, transfers to public corporations by 280% and purchases of goods and services (by 12%). In FY2013, the deficit further declined to 4.2% of GDP. This was caused mainly by an 8% fall in tax revenue, attributed mainly to a 17% drop in international trade receipts and transactions. Revenue increases from both tax and non-tax sources supported a recovery in the primary balance in FY2013/14 and 2014/15.

Figure 3. Primary Balance Components (% of GDP)



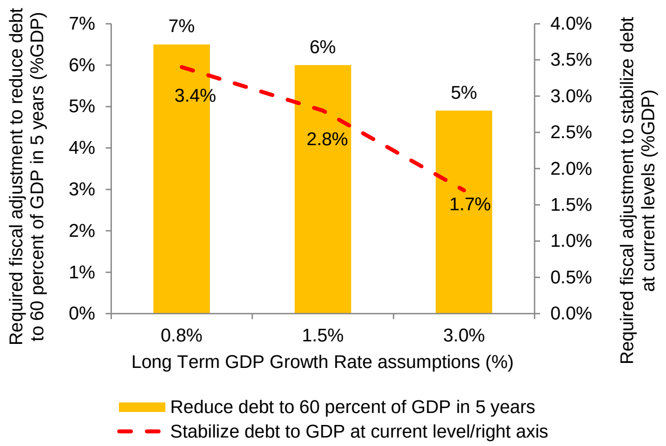
Source: The Central Bank of The Bahamas.

Debt Reduction with Weak Fiscal Institutions in a Low-Growth Cycle

The primary fiscal deficit was identified as one of the main drivers of public debt. The standard approach used to assess debt sustainability is to first estimate the fiscal adjustment required to stabilise the debt at its current level, and then reduce the debt to 60% of GDP in the next five years under different GDP growth rate assumptions. The baseline assumptions include a long-run average growth rate of 0.8%, real interest rate of 3.2%, inflation rate of 1.3%, and primary deficit of 1.7% of GDP.[2]

The Bahamas requires a fiscal adjustment of 3.4% of GDP to stabilise the debt ratio at its current level. Simulation results show that with a debt stock at 76% of GDP including contingent liabilities, the government would need to adjust fiscally by 3.4% percentage points of GDP to stabilise the ratio of debt to GDP. Debt reduction, however, is an even greater challenge given that the economy is projected to remain in a low-growth trap. The simulations show that with a GDP growth rate of almost 1%, a 7% fiscal adjustment would be required to reduce the debt to 60% of GDP in the next five years (Figure 4). Higher GDP growth rate assumptions of 1.5% and 3% reduce the required fiscal adjustment marginally to 6 and 5% of GDP, respectively.

Figure 4. Required Fiscal Adjustment to Stabilise and Reduce Debt (% of GDP)

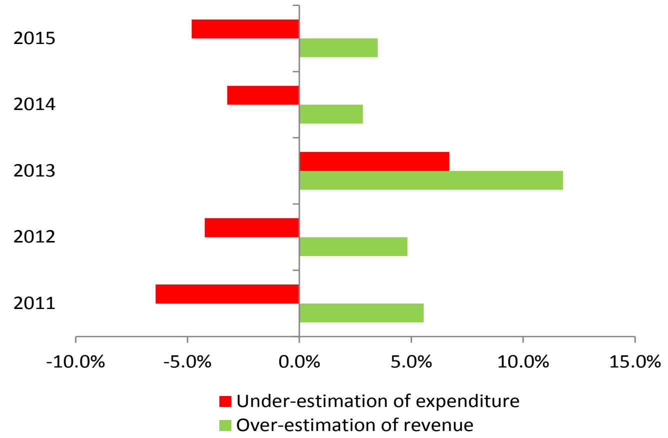


Source: Staff estimates from IMF World Economic Outlook (April, 2016).

Budget preparation and execution in The Bahamas could be improved. Prudence in budget preparation and execution are important determinants of the fiscal outturn and can provide insights about the quality of institutions involved in the budgetary process. A partial indicator (Figure 5) examines the difference between budgeted and actual revenues and expenditure. The estimates indicate a systematic overestimation of fiscal revenues and an underestimation of expenditure in most fiscal years.

[2] These assumptions were derived from the IMF's World Economic Outlook (April, 2016).

Figure 5. Difference in Expenditure and Revenue (actual vs. budgeted, %)

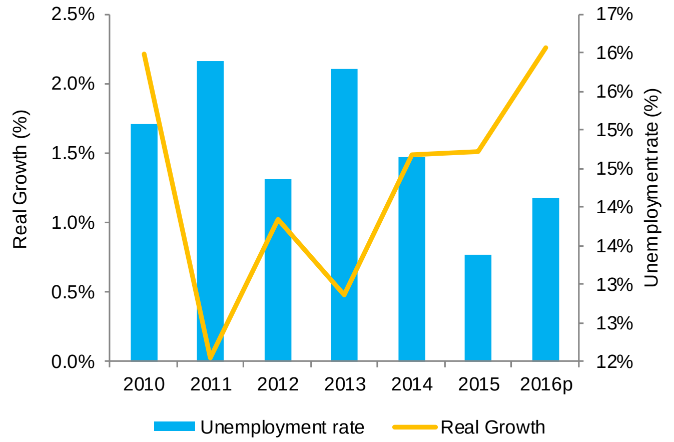


Source: Staff estimates from The Central Bank of the Bahamas.

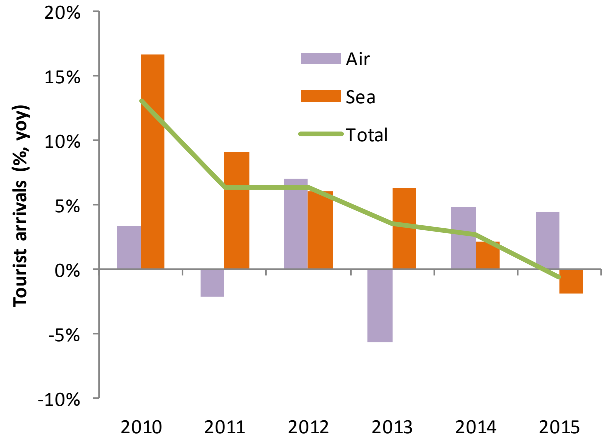
Conclusion

Fiscal reforms identified in the medium-term fiscal framework may reduce the primary deficit and stabilise public debt at current levels, but they will not be sufficient for debt reduction over the medium term. The main findings from this section suggest that the primary balance and interest rate are the main drivers of changes in public debt. Primary expenditure is rigidly focused on transfers, subsidies, and personal emoluments, which were important contributors to the rise in the primary deficit. The fiscal imbalance is further amplified by what appears to be weaknesses in the fiscal institutions and/or technicalities of budget preparation and execution. Moreover, fiscal adjustment measures outlined in the country's medium-term fiscal framework should be supported with complementary growth-enhancing policies to support the country's debt reduction efforts and growth prospects over the medium term. In this vein, the IMF's recommendations for The Bahamas include increasing efforts to strengthen revenue intake, such as further measures to boost VAT revenues; continued focus on spending restraint; and reforms to state-owned enterprise, which would reduce costs and increase efficiencies. The task is not only fiscal consolidation but to increase economic growth. The IMF suggests a number of supply-side measures: improve education and training programs to increase productivity; further strengthen the business environment and reduce the cost of doing business; and invest in infrastructure that will stimulate economic growth.

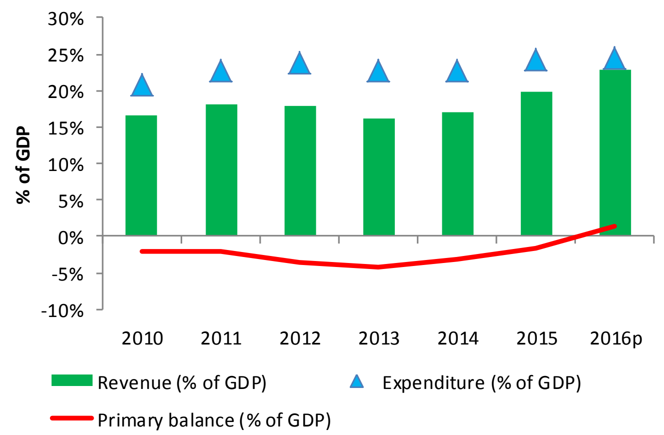
Growth outlook is better, but unemployment remains high



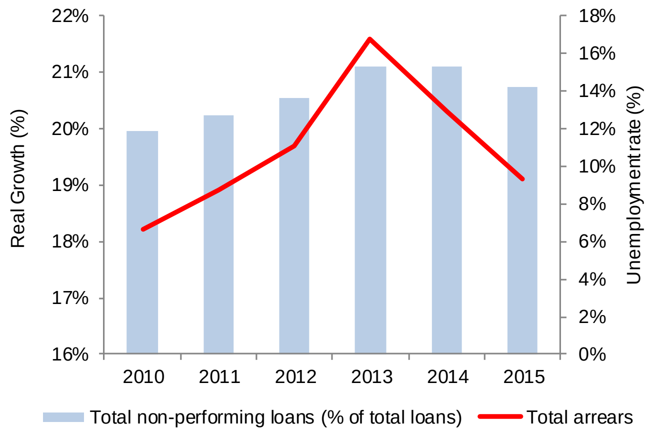
Sharp decline in tourist arrivals



Fiscal balance is improving...

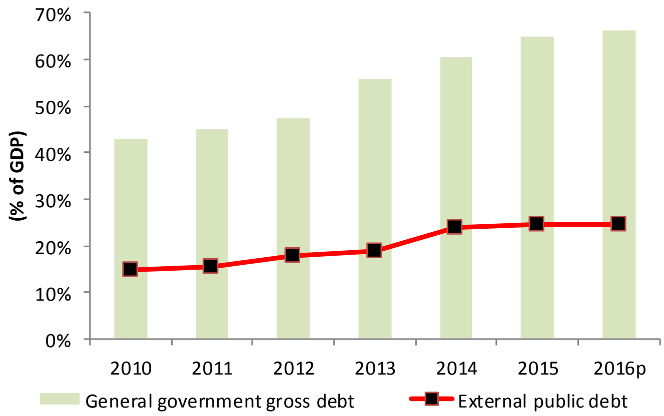


Non performing loans remain high



Current account deficit is improving ...

...and debt is expected to stabilize



Source: The Central Bank of The Bahamas and the International Monetary Fund's World Economic Outlook (April 2016).

The Bahamas: Selected Economic Indicators

	2012	2013	2014	2015	2016p
(Annual percent changes unless, otherwise indicated)					
Real Sector					
Real GDP	2.2%	0.0%	1.0%	0.5%	1.5%
Nominal GDP	4.4%	2.4%	0.9%	2.3%	2.4%
Inflation rate	0.7%	1.0%	0.2%	2.0%	0.8%
External Sector					
Exports of goods and services	8.4%	-0.5%	0.6%	-1.7%	5.1%
Imports of goods and services	0.7%	1.0%	0.2%	2.0%	0.8%
Current account (percentage of GDP)	-18.3%	-17.7%	-22.3%	-11.7%	-9.8%
(In percentage of GDP, unless otherwise indicated, on a fiscal year basis)					
Central Government					
Revenue and grants	17.9%	16.3%	17.1%	19.8%	22.9%
of which: tax revenue	15.8%	14.6%	14.7%	17.4%	20.8%
Current expenditure	19.4%	18.6%	18.8%	19.9%	21.7%
Capital expenditure	3.0%	3.1%	3.0%	3.3%	2.7%
Primary balance	-3.5%	-4.2%	-3.2%	-1.7%	1.4%
Overall balance	-5.8%	-6.6%	-5.7%	-4.4%	-1.6%
Debt Indicators					
Public sector debt[1]	47.4%	55.6%	60.6%	65.0%	66.1%
External public debt (end of period)	17.9%	19.0%	24.0%	24.6%	24.5%

Source: The Central Bank of The Bahamas, and International Monetary Fund, World Economic Outlook April 2016)

[1]Excludes contingent liabilities

BARBADOS Closing the Fiscal Year with Mixed Results

Contributors: Camilo Gomez Osorio and Kimberly Waithe

> ### *Highlights*
>
> *A more dynamic tourism sector and an upward growth revision, from 0.5 to 0.8% in 2015.*
>
> *Greater fiscal effort would stabilise the increasing trend in public debt.*
>
> *Reserves stood at 2.8 months of imports or US$463.4 million.*
>
> *Moody's downgraded Barbados' sovereign credit rating from B3 to Caa1 with a stable outlook.*

Recent Developments

A favourable external environment eased macroeconomic management in FY 2015/16, ending in March**.** The recovery in the United States and the United Kingdom led the double-digit growth in tourist arrivals that—with lower international fuel prices—improved Barbados' external position. The lower import bill and contained inflation eased pressures on the fixed exchange rate and contributed to more stable reserves. On the domestic side, greater fiscal effort would be required to stabilise public debt. Growth is projected at 1.6% in 2016 with construction and greater private inflows from tourism projects.

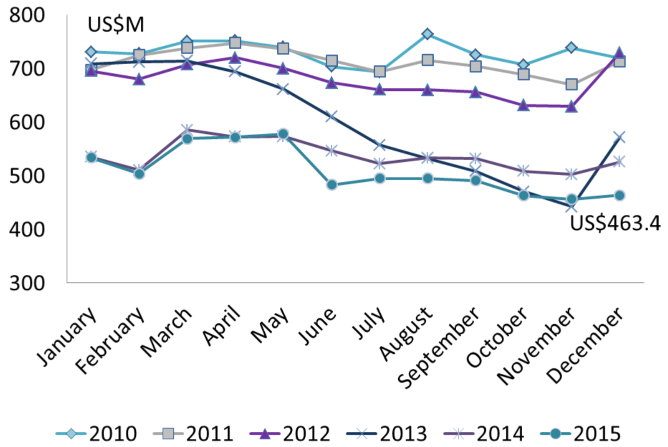
Barbados' tourism sector is leading the recovery in the Caribbean region. Long-stay tourist arrivals grew by 13.5%, reaching almost 527,000 visitors. The double-digit growth in arrivals came from the three main source markets: the United States (27.2%), Canada (8.2%), and the United Kingdom (22.1%). The length of stay declined, however, so growth in spending per tourist was more modest, at 4.9%. Domestic demand was weak and overall non-tradable sectors were less dynamic, growing marginally by 0.4%. Construction activity fell by 1.9% by the end of December 2015. As a result, output at the end of 2015 saw a slight upward revision from 0.5% to 0.8%.

The economy witnessed deflation at the end of December 2015. Prices fell by 1.1%, compared with 1.9% a year earlier, because of lower fuel prices and weak domestic demand. The fiscal consolidation efforts and layoffs in both the public and private sectors affected disposable incomes, which—along with higher country risk—brought uncertainty to private investment flows. Unemployment remained in double-digits at 11.3% at the end of 2015, a slight decline from the 12.3% registered a year earlier.

The external position improved and the current account deficit narrowed to 6.9% of GDP at the end of 2015. This was a positive development when compared with the 10.1% of GDP in 2014, and it reflected a 7% decline in imported goods and higher travel receipts; fuel imports alone reduced by 31%, or US$190 million.

Reserves stood at US$463.4 or 2.8 months of imports at the end of 2015 (Figure 1). This represents a slight decline when compared with US$526.2 in 2014 due to lower foreign direct investment and large external debt payments that came due, including the subscription to the Andean Development Bank (Corporación Andina de Fomento, or CAF), and a loan from Barclays. Lower commodity prices and weaker domestic consumption continue to restrain imports.

Figure 1. International Reserves 2010–2015



Source: Central Bank of Barbados

Barbados' fiscal deficit rose to 7.5 of GDP by the end of February 2016. The latest expenditure figures suggest the fiscal position widened even with the introduction of new tax measures in FY2015/16, ending in March. Total revenue reached 23.2% of GDP at US$1.037 billion. Revenue-declining factors included the decline in VAT receipts (by 4.8%) and personal income tax (by 3.2%),[1] the removal of the municipal solid waste tax, and lower excises from fuel imports. On the other hand, total expenditure grew by 2.5% to reach US$1.373 billion. Interest payments continued to rise by 2.1% and grants to public institutions by 4.5%, respectively. The fiscal deficit is likely to close the FY2015/16 at over 7.9% of GDP. However, the actual cash figure may be lower, and a share of these liabilities could accumulate as arrears.

[1] The current income tax rate of 17.5% was reduced to 16% and the higher rate of 35% dropped to 33.5% during the June 2015 Financial and Budgetary Statement.

Fiscal consolidation has not stabilised an increasing trend in public debt, which reached 141.3% of GDP, including National Insurance Scheme (NIS) holdings at the end of 2015, up from 134.5% a year earlier.

Moody's downgraded Barbados' sovereign credit rating in April 2016 from B3 to Caa1 with a stable outlook. (Table 1). This move was justified based on slow progress toward achieving fiscal consolidation, consistent with a sustainable debt trajectory, and low level of foreign exchange reserves, and weak funding conditions. This development would affect the country's future debt service, as downgrades may trigger higher interest rates for certain external loans; this is true of the Credit Suisse loan agreement.[2]

Table 1. Moody's Credit Rating History for Barbados

Date	Government bonds		Outlook	Status
	Foreign currency	Local currency		
Oct-09	Baa3	Baa2	Stable	Investment
Jun-11	Baa3	Baa3	Negative	Investment
Dec-12	Ba1	Ba1	Negative	Below investment
Dec-13	Ba3	Ba3	Negative	Below investment
Jun-14	B3	B3	Negative	Below investment
Jul-15	B3	B3	Negative	Below investment
Apr-16	Caa1	Caa1	Stable	Below investment

Source: Moody's Investor Service.

Lower commodity prices continue to ease pressure on the exchange rate peg, while benefitting households and businesses. Lower fuel prices led the reduction in electricity tariffs, as electricity generation is heavily dependent on imported diesel. Barbados Light and Power, through its fuel adjustment clause,[3] reduced electricity tariffs by 33.4%, from 25.4 cents/kilowatt hour to 16.9 cents/kilowatt hour, between May 2015 and April 2016. Lower energy costs contributed to the stability of reserves and would boost the competitiveness of businesses by reducing input costs at a time of low inflation.

Drought would have an adverse impact on the 2016 sugar harvest. According to the Barbados Sugar Industry Limited (BSIL), 85,000 thousand tons of sugar would be produced in 2016, a significant drop from the more than 100,000 thousand tons recorded a year earlier. The drier weather conditions reported across the Caribbean in recent months will likely reduce yields in 2017 and 2018.

Barbados and China signed legal assistance and extradition treaties in March 2016. The Mutual Legal Assistance Treaty and the Extradition Treaty will improve ties and strengthen cooperation across their respective criminal justice systems. These treaties enhance cooperation in investigations, prosecutions, and information sharing, with a particular emphasis on cross-border crime, cybercrime, financial crime, human trafficking, and smuggling. Acting Attorney General Michael Lashley and China's Vice Foreign Minister Wang Chao were on hand for the signing.

Outlook

Barbados' medium-term growth outlook is positive and modest. The IMF World Economic Outlook (April 2016) estimates growth at 2.1% in 2016, while the Central Bank suggests 1.6% by the end of the year. This positive outlook is informed by the gradual tourism recovery, the benefits of lower fuel prices, and a correction to GDP figures that may have been underestimated. If tourism-related projects materialize as planned, construction could be a more dynamic sector. The recent increase in air transport operations with more frequencies and destinations would contribute to dynamic tourist arrivals.

Inflation would remain low in the medium term. Low oil and commodity prices would continue to contain inflation at below 2% and support household consumption. With weak economic conditions and fiscal consolidation efforts, the unemployment rates would likely remain at the current two-digit level.

High-Frequency Macroeconomic Indicators				
	Last Data	Period	Prior Data	Period
Annual GDP growth (%)	0.8	Dec-15	0.3	Sep-15
Tourism arrivals (annual % change)	13.5	Dec-15	14.5	Sep-15
Nonperforming loans (%)	10.6	Dec-15	10.8	Sep-15
Private sector credit growth(%)	0.1	Jan-16	-0.5	Dec-15
Foreign Exchange Reserves cover,weeks	13.7	Dec-15	14.4	Sep-15
Inflation	-1.1	Dec-15	-0.7	Nov-15
Unemployment rate (%)	11.3	Dec-15	12.0	Sep-15

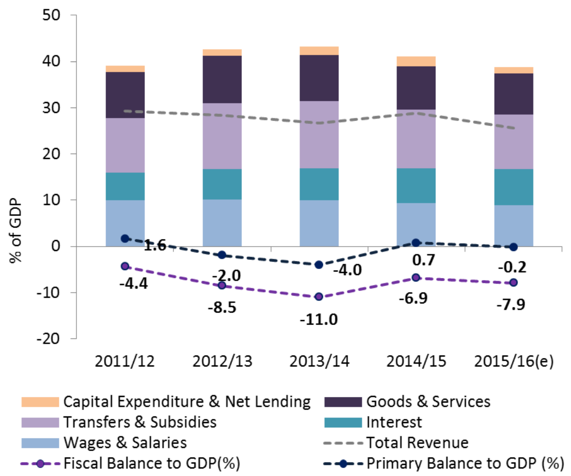
Source: Central Bank of Barbados

[2] This refers to a government loan from Credit Suisse for US$225 million with disbursement of US$150 million in December 2013 and US$75 million in March 2014.
[3] The fuel clause adjustment changes the price of electricity per kilowatt hour for consumers according to changes in the costs of generating electricity from imported fuel.

Macroeconomic Stability is Challenged by Primary Deficits and High Levels of Public Debt

Barbados has made progress with fiscal consolidation. The home-grown programme launched in August 2013 reduced the deficit from 11% of GDP in 2013/14 to 6.9% of GDP by 2014/15. It would likely close FY2015/16 higher at around 7.9% of GDP. Efforts have focused on new taxes and austerity measures, reducing spending through public sector retrenchment and lower subsidies and transfers. During 2014, around 3,000 public sector jobs were rationalised, comprising about 10% of the civil service.

Figure 2: Public Finances (% of GDP)



Source: Ministry of Finance and Central Bank of Barbados.

Revenues over the last five years have been hit by the contraction of GDP and recently by lower excises from fuel imports. Compared to other Caribbean countries, and for Barbados' income level, revenues above 26% of GDP are not particularly low, but they are insufficient to cover expenditures. At the same time, tax incentive legislation in the form of concessions, waivers, and reduced rates, eroded Barbados' revenue base. During 2011–2015, total revenue collection declined from 29.3% to 25.7% of GDP, mostly driven by lower VAT collection and declining personal and corporate tax receipts.

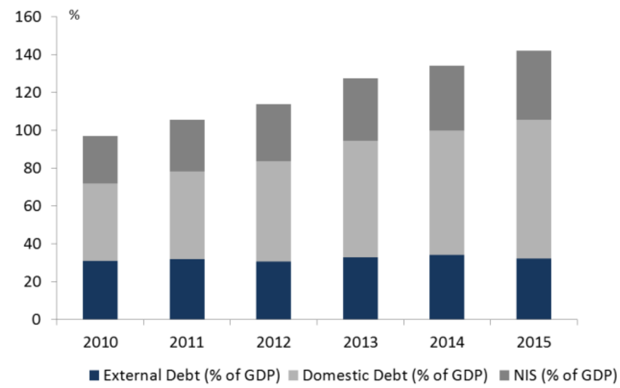
Higher recurrent spending led to sustained primary deficits. Current spending crowded out capital spending over the last five years. During 2011–2015, current spending averaged almost 34% of GDP, while capital spending halved, representing 2% of GDP. The largest budget items in FY2015/16 are the public sector wage bill at 9% of GDP, interest payments at 7.8% of GDP, and transfers and subsidies at 11.8% of GDP.

The budget is highly rigid. Wages and salaries and interest payments combined account for 50% of total expenditure, and after paying for transfers and subsidies, only 15% of total spending remains discretionary (Figure 2).

Greater Fiscal Effort to Stabilise Public Debt

Fiscal consolidation has not stabilised an increasing trend in debt. In FY2015/16, while undergoing consolidation, Barbados accumulated over 8% percentage points of GDP in debt. Currently, indebtedness stands at 141.3% of GDP when holdings from the NIS are included (Figure 3). Obligations accumulated at a rate of around 8 to 9 percentage points per year. Two-thirds of the liabilities are domestic debt with short-term maturity that are exposed to rollover risk. Debt service at over 18% of GDP has become the largest budget item. In FY2015/16, interest payments alone reached 7.8% of GDP, 30% of revenue collection, and 23% of total spending.

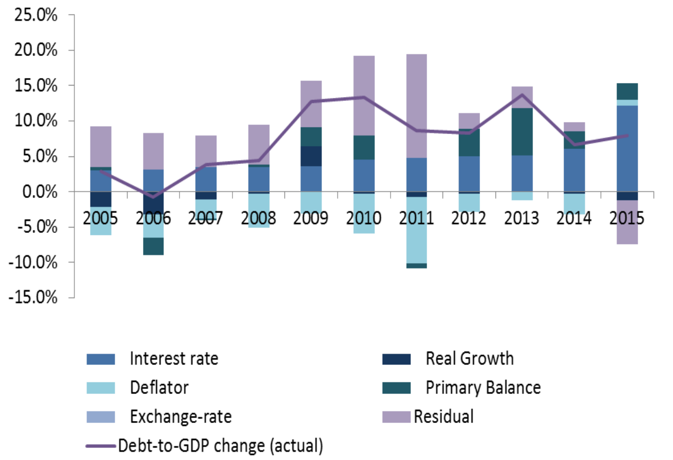
Figure 3. Composition of Public Debt



Source: Central Bank of Barbados.

The factors contributing to higher debt were primary deficits and interest rates (Figure 4). A decomposition of Barbados' debt shows that interest rates, particularly domestic rates, accounted for over half the debt growth since 2009. The primary balance followed closely as a driver of debt-creating flows. In contrast, prices up to 2011 had been an important debt-reducing factor that moderated over recent years. Growth averaging 0.9% from 2005 to 2015 had a more neutral impact.

Figure 4. Debt Decomposition (2005–15)

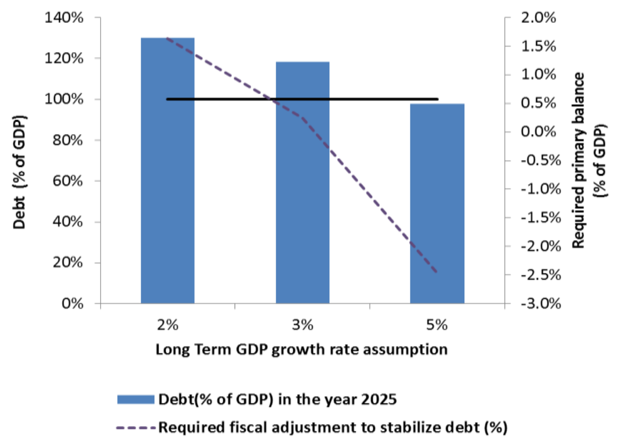


Source: WEO April 2016 and Central Bank of Barbados.

Reducing Debt to Below 100% of GDP Would Require Fiscal Adjustment and a Higher Growth Path

A simulation to bring debt levels below a target of 100% of GDP by 2025 suggests significant fiscal effort. Barbados would need to grow at an average rate of 5% over the long term, while sustaining a 4% annual primary surplus. This is quite a challenge considering that the growth path more than doubles the current 2% long-term projection. Under a more feasible and conservative growth path of 2%, while sustaining the same 4% primary surplus, debt levels would reduce to around 125% of GDP.

Figure 5. Required Fiscal Adjustment to Stabilise and Reduce Debt (% of GDP)



Source: Staff and WEO April 2016

Credibility of the Budget

Budget deviations at the aggregate level are not large given the difference between approved and actual estimates. Variance for FYs 2012/13–2014/15 shows that actuals are close to budget estimates and have been lower than 5% over the last three years. This would suggest the budget is a credible tool of policy intent at the aggregate level; these variances appear to be driven by factors on the revenue side. Barbados receives the highest score (A) from the Public Expenditure and Financial Accountability Indicators (PEFA) for overall budget outturns. At the same time, there are wider variances within the budget composition that have not exceeded 10% of budgeted primary expenditure (Table 2).

Table 2. Variance in Aggregate Primary Expenditure ($BDS Millions)

	2012/13			2013/14			2014/15		
	Budget	Actual	Var	Budget	Actual	Var	Budget	Actual	Var
Total	2651	2629	0.8%	2559	2685	4.9%	2475	2443	1.3%

Table 3. Variance in Expenditure Composition

	2012/13	2013/14	2014/15
Deviation in distributed expenditure excluding contingency reserves	13.1%	8.1%	8.0%

Source: Barbados Estimates and Ministry of Finance.

Reforms that Could Bring Public Finances on a Path Toward Fiscal Sustainability

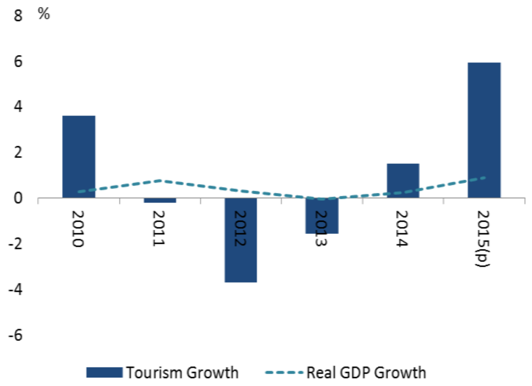
On the expenditure side, improving the monitoring of fiscal risk and accountability of public enterprises (PEs) would require strengthening financial reporting and the timely preparation and audit of financial statements. This would inform policy decisions and enable cost recovery for services. Better targeting of subsidies could ease the burden on the budget and improve the efficiency of public spending for service delivery. Comprehensive monitoring of arrears would strengthen fiscal discipline.

On the revenue side, the IMF suggested broad-based tax reforms focusing on tax policy and tax administration. This would involve addressing the buoyancy and equity of the tax system by expanding the base, particularly of the VAT. Revising exemptions and waivers for both VAT and customs could lead to higher revenue collection.

Barbados' Economy at a Glance

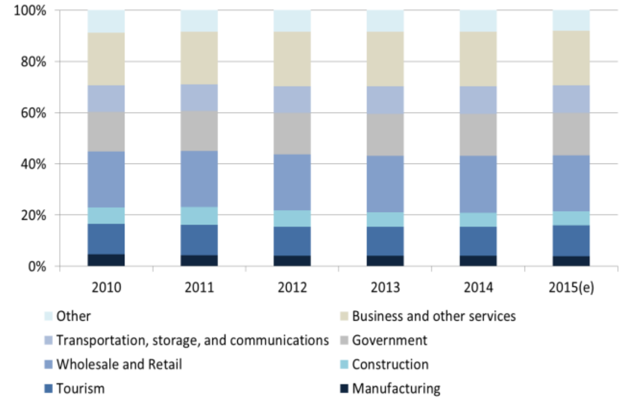
Gradual tourism recovery with weak domestic demand

Figure A. Real growth and Tourism growth



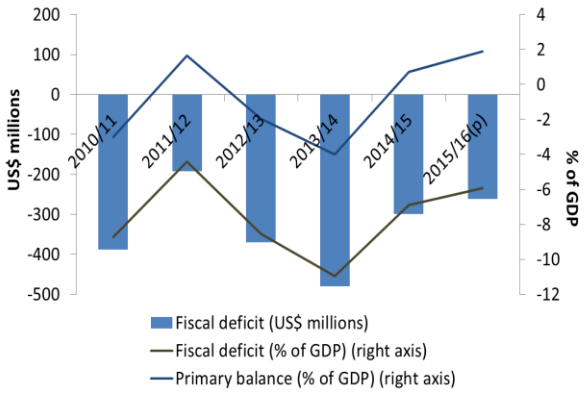
… which are the drivers of growth.

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



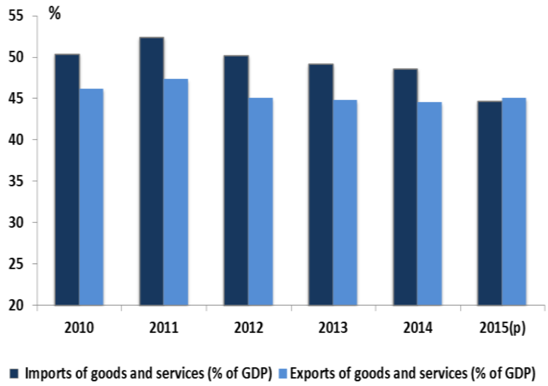
Fiscal consolidation reduced the deficit.

Figure C. Revenues and Expenditures (% of GDP)



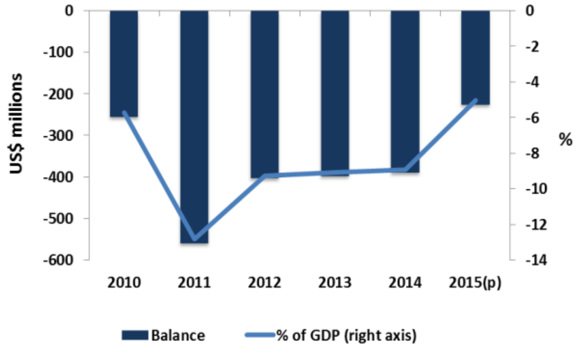
With lower oil and commodity prices imports declined

Figure D. Exports and Imports (% of GDP)



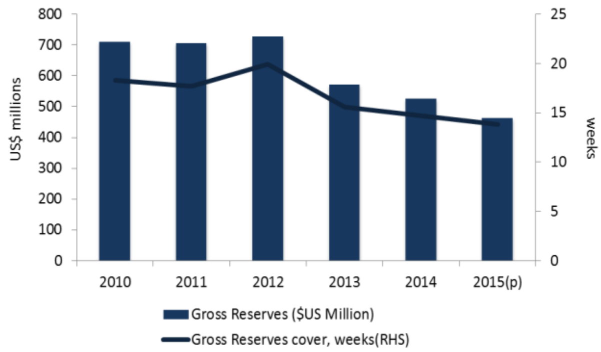
…and improved the current account balance

Figure E. Current account balance (% of GDP)



…which stabilized reserves.

Figure F. Gross reserves (US$ millions)



Sources: Central Bank of Barbados; World Economic Outlook, IMF (April 2016); 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	0.8
Nominal GDP	-3.4	-2.0	-0.6	0.9	-0.4	0.3
Inflation (end of period)	5.8	9.4	4.5	1.8	1.9	-1.1
Unemployment	10.3	11.2	11.5	11.6	12.3	11.3
External sector						
Exports of goods and services (% change)	7.9	0.4	-5.3	0.2	-1.0	0.5
Imports of goods and services (% change)	9.5	1.9	-4.8	-1.2	-1.5	-7.3
Current account (percent of GDP)	-5.7	-12.7	-9.6	-10.6	-10.1	-6.9
International reserves (US$millions)	711.9	707.4	728.9	572.1	526.1	463.4
International reserves cover (months)	3.8	3.7	4.0	3.2	3.0	2.8
(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	25.7
Total expenditure	34.3	33.7	36.9	37.7	35.7	33.6
Central government primary balance	-3.0	1.6	-2.0	-4.0	0.7	-0.2
Central government overall balance	-8.7	-4.4	-8.5	-11.0	-6.9	-7.9
Debt indicators						
General government debt	71.9	78.0	83.5	94.4	100.1	105.3
General government debt (inclusive of NIS holdings)	96.8	105.3	113.6	127.3	134.5	141.3
Central government debt over revenues	280.6	266.7	294.5	353.4	347.8	406.4
External debt service as percentage of exports of goods and services	10.2	6.9	7.3	6.9	7.4	12.4

Sources: Central Bank of Barbados; World Economic Outlook, IMF (April 2016); Ministry of Finance.

Note: (p) projected figures for 2015.

Quarterly Bulletin June 2016

GUYANA BEST OF BOTH WORLDS: SLUMPS & BOOMS

Contributors: Mark Wenner and Dillon Clarke

Highlights

The extractive sector—gold and oil—is expected to be a critical engine of growth amidst generally lower commodity prices.

Severe El Niño-related drought is expected to reduce agricultural yields and lower agricultural export earnings.

The Government is pursuing a fiscal stimulus plan to bolster growth and compensate for weaknesses in productive sectors.

Overview

Guyana's economy shows resilience amid a low-commodity price environment. Economic growth was 3% in 2015 and is projected to be in the 3.4 to 4% range in 2016. The increased growth rate is driven by expansionary fiscal policy—partly related to the country's 50th Anniversary of Independence—and increased production in the mining sector, along with a reduction in fuel input costs. Lower oil prices contributed to an improvement in Guyana's current account deficit. However, there are rising levels of non-performing loans that are tied to weaknesses in several productive sectors. Nonetheless, commercial banks remain well capitalised.

Growth Outlook

In the 2016 Budget presentation, Guyana's Ministry of Finance forecasted that real GDP growth would be 4% in 2016, while the IMF forecasts 3.4%. The four main drivers of growth are expected to be: (1) increased government spending; (2) increased visitor expenditures and remittances associated with the 50th Anniversary of Independence in May; (3) the ramping up of two large gold mines, Guyana Goldfields Inc. and Troy Resources Limited, whose combined outputs are expected to be 150-180,000 ounces, or one third of the total expected declared gold output of 550,000 ounces; and (4) the continued investment spending of ExxonMobil associated with the fast-tracking of the development of an off-shore oil reserve that was discovered in May 2015.

Inflation

After deflation in 2015 of 1.8%, inflation is expected to remain low in 2016 at 2.1%. Deflation reflected lower oil prices, the removal of the VAT on a range of consumer items, and a 20% reduction in electricity tariffs. Unfortunately, neither monthly nor quarterly inflation statistics are published. Further, the current yearly index is applicable only to the Greater Georgetown Metro area and does not capture the sharp urban-rural differences in the cost of living.

External Developments

Low oil prices continue to provide a buffer for a weak export performance. The current account deficit improved from 12.6% to 4.8% of GDP in 2015, well below its five-year average. Export performance is expected to remain sluggish because of moderate commodity prices and lower agricultural yields due to an El Niño related drought. The most affected agricultural activities are rice, sugar, and cattle. While drought conditions are expected to abate by May-June, it is not likely that production in the latter half of the year will offset the poor first harvests for main crops. Meanwhile, rising public and private spending are expected to create an increase in imports of consumer and capital goods. Thus, deterioration is projected in the current account deficit to 5.2% in 2016.

Fiscal and Monetary Policy Developments

Low primary balance and public debt underline fiscal space that facilitates counter-cyclical fiscal policy. The expected fiscal deficit in 2016 is 4.7% of GDP, a third of which is programmed to be financed by external borrowing. Significant increases in transfers, social, and capital expenditures were approved in the 2016 Budget. The aim of the expansionary fiscal programme is to compensate for weaknesses in the key productive sectors—non-gold mining, agriculture, fisheries, and forestry—that account for 28% of GDP. Total public debt declined to 48.6% of GDP in 2015 from 51.9% in 2014.

Monetary policy continues to be accommodative with a de facto semi-fixed exchange rate. Money aggregates of reserve and broad money (M2) grew by 9.7 and 1.5%, respectively, in 2015. Narrow money (M1) fell slightly, 0.7%, because of declines in demand deposits and cashiers' cheques and acceptances. The exchange rate fluctuated over the period of 2015 from GY$206.2/US$ to GY$207.2/US$, closing the year at GY$206.5. Monetary authorities attempt to manage inflationary expectations by anchoring the exchange rate through frequent sterilisation exercises.

Financial Markets

Commercial banks are well capitalised, despite increased non-performing loans. The average capital adequacy ratio was 25.57% compared to the prudential benchmark of 8%. Private credit growth decelerated to 6.2% in 2015 due to reduced lending to consumer and business retail sectors (note that mining and agriculture sectors have little direct access to formal credit). Non-performing loans increased to 11.5% from 7.8% recorded in 2014.

Other Developments

A telecommunications bill is expected to be passed in May. Passage of the bill will bring an end to the monopoly of several telecommunication services by GT&T and pave the way for more service providers in the market. In response, GT&T has launched Guyana's first-ever 4G data service. The new platform offers faster mobile datalinks and the ability to stream on–the-go.

Parliament passed the Anti-Money Laundering and Countering of Financing of Terrorism (AML/CFT) bill. Guyana is grey-listed as a jurisdiction with strategic AML/CFT deficiencies that had made insufficient progress in addressing the deficiencies, or had failed to comply with its action plan developed with the CFATF to address the deficiencies. Passage of the AML/CFT bill creates the foundation for Guyana's removal from the grey list.

High-Frequency Macroeconomic Indicators

	Last	Period	Prior	Period
Annual GDP growth (%)	3.0	2015	3.0	2014
Exports (12-month growth)	0.2	2015	-15.1	2014
Imports (12-month growth)	-17.7	2015	-5.1	2014
Private sector credit growth (%)	6.2	2015	9.1	2014
Inflation	-1.8	2015	1.2	2014
Exchange rate (e.o.p)	206.5	2015	206.5	2014

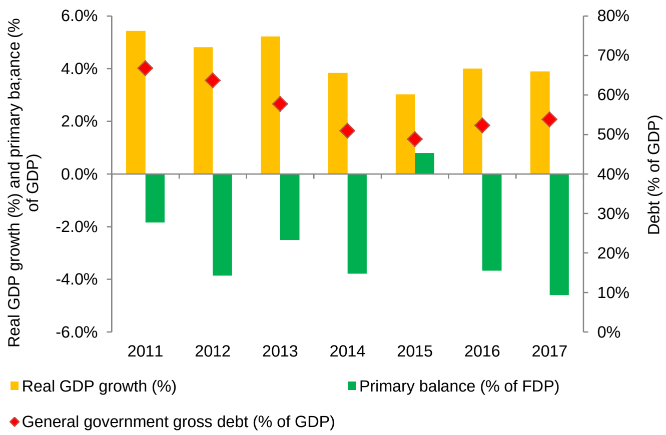
Source: Staff and WEO April 2016

Prudent Debt Management

There has been a marked decline in debt-to-GDP ratio despite a high primary fiscal deficit. The reduction in debt was mainly due to debt relief and the PetroCaribe oil scheme that more than compensated for the fiscal deficit. Debt is expected to rise, however, in FY2016/17, as the country follows counter-cyclical fiscal policy led by an increase in public investment, but, in which–simultaneously—debt relief and PetroCaribe both taper down.

2015 is a turning point. High economic growth occurred on average of 4.8% in 2011 to 2014, but it slowly decreased to 3% in 2015. Nonetheless, it is expected to increase to about 4% in the next two years (Figure 1). The primary fiscal deficit of about 3% of GDP during 2011 to 2014 fell to a surplus of 0.8% of GDP, but it is projected to rise to an average deficit of 4.5% of GDP in the next two years. Debt-to-GDP ratio fell from 63.7% of GDP to 48.5% in 2015 and is expected to increase to 52% and 54%, respectively, of GDP in the next two years.

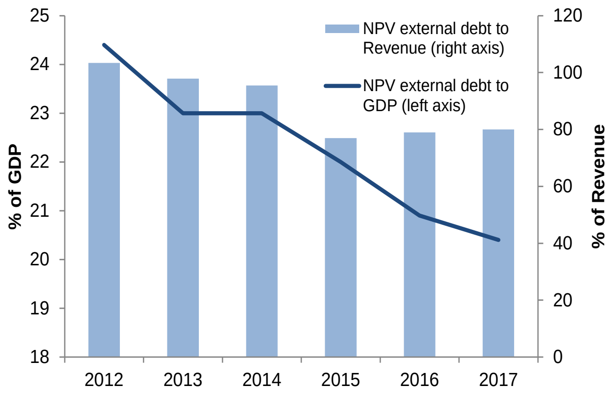
Figure 1. Real GDP Growth, Fiscal Balance and Public Debt (% of GDP)



Source: Staff and IMF World Economic Outlook (April 2016).

It is important to note that, unlike other countries in the region, Guyana is a Heavily Indebted Poor Country (HIPC), an initiative supplemented by the Multilateral Debt Relief Initiative (MDRI). This implies that Guyana received and is receiving debt relief. A large proportion of its debt, although representing a declining share that fell from a peak of 79% of external debt in 2005 to 42% in 2014, is concessional. Given that concessionality is an important element in budget financing, the debt sustainability concept used is the net present value of debt, with benchmarks conditional upon policy performance categories derived from the World Bank's Country Policy and Institutional Assessment. So instead of the benchmark debt-to-GDP ratio of higher than 60% being too high a debt level, the benchmarks are that the net present value of external debt-to-GDP must be lower than 40% and that the net present value of debt-to-revenue must be less than 250%. Guyana, which is categorised in the World Bank's Country Policy and Institutional Assessment as having a median policy framework, satisfies both criteria and is expected to do so in both 2016 and 2017, despite an increase in its fiscal deficit and debt-to-GDP ratio.

Figure 2. Debt Sustainability Indicators

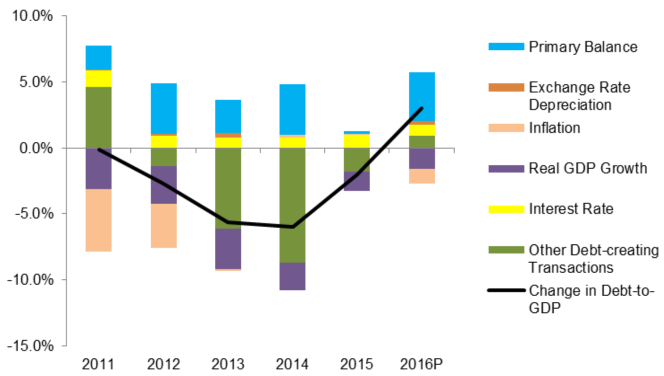


Source: Staff and WEO (April 2016).

Drivers of Public Debt

The main driver of the reduction in debt has been HIPC and MDRI debt service relief plus savings derived from PetroCaribe commodity–debt swap schemes. High growth and low inflation also contributed to a reduction in debt. Together, they more than compensated for the debt-increasing factors of primary fiscal deficit and interest (Figure 3).

Figure 3. Decomposition of General Government Debt



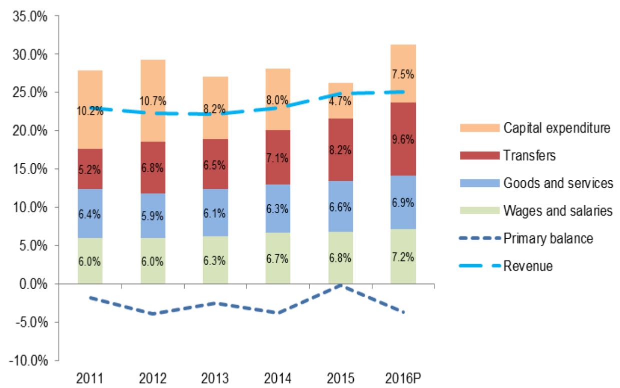
Source: Staff estimates from IMF WEO (April, 2016).

Fiscal Policy

Guyana's fiscal policy is expected to reverse direction from its 2015 contractionary stance to an expansionary one. The primary fiscal balance is expected to move from a surplus in 2015 of 0.8% of GDP to a deficit of 4.5% in the next two years. The increase is driven by 4% of GDP in investment expenditure and a 2% increase in current expenditure but with marginal increase in revenue-to-GDP. The reversal seems large, but it partly reflects a normalisation of government functions that slowed during 2015 as a result of the suspension of Parliament in November 2014 until the general elections of 11 May. During this period, capital spending dropped by one half. The combination of less spending and the transfer of monies held by various agencies to the Consolidated Fund after the general election accounts for the sharp reduction in the fiscal deficit in 2015.

On the expenditure side, while wages and salaries and goods and services have grown minimally, transfer payments remain the largest outlay of current expenditures, accounting for 8.2% of GDP (Figure 4). In 2015, capital expenditures dropped to 5.7% of GDP from 8% of GDP in 2014 due to several procurement issues and the electoral cycle.

Figure 4. Primary Balance Components (% of GDP)



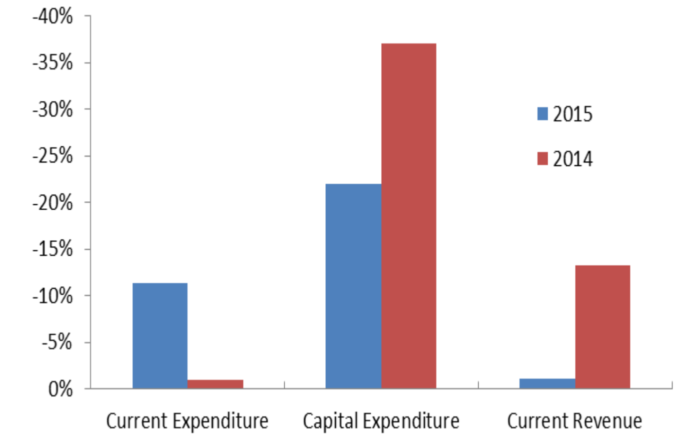
Source: Ministry of Finance.

Current revenue collections for 2015, net of inflows from the Guyana REDD + Investment Fund (GRIF), amounted to GY$162.7 billion, or US$787.8 million , 11.6% over 2014 (Figure 5), reflecting strong performance across several tax categories. Tax revenue collections, which accounted for 87.7% of total current revenue collections, contributed GY$142.9 billion, a 5.2% increase over 2014. Compared to other developing countries, Guyana's government revenue at 25% of GDP in 2015 is above average; however, whereas the amount of taxes collected from individuals has steadily increased, the amount of revenue captured from commodities (i.e., royalties on mined minerals) was in decline well before the commodity boom ended in 2013, signifying problems due to smuggling. Moreover, while VAT and excise taxes represent a 37.2% share of total government revenue compared to an 11.8% share for personal income taxes in 2015, in 2014, the VAT share was 40%, and the personal income tax share was 14.4%, indicating heavier reliance on consumption taxes.

Budget Credibility and Budget Processes

Variance exists between budgeted and actual figures in Guyana's annual budgets, indicating underlying issues with forecasting and/or execution capacity. Figure 5 shows the variance of greater than 5%—which is the internationally accepted benchmark for current expenditures—in 2015, current revenue in 2014, and capital expenditures for both 2014 and 2015.

Figure 5. Variance of Budgeted vs. Actual Spending



Source: Budget Estimates 2015 and 2016.

Budget preparation in Guyana is centralised. In Guyana, the Ministry of Finance is responsible for preparing the budget and organising consultations with private sector actors and representatives of the opposition political party prior to formal presentation in the Parliament. Once the budget is submitted, there is a two-week period of reading and debates and then a vote for approval. If the government deems supplementary allocations and emergency spending powers necessary, requests for approval can be submitted to Parliament.

The process can be improved in a number of ways. Some of the OECD budgeting principles that can be more thoroughly applied are the five following:

(1) Closer alignment with medium-term strategic priorities (for example, the 2016 Budget announced several “green measures”, but there is no overarching energy matrix transition and conservation policy or approved comprehensive land use plan that would guide the transition to a low carbon economy over the medium term).

(2) More independent analysis of fiscal stance and budgetary choices. At present, the Parliamentary discussions are largely pro forma because Parliament only has the right to accept or reject, but not modify budget items. Some independent analysis of the budget occurs contemporaneously by private analysts but no third party or institution has emerged as a respected and impartial entity that evaluates budget assumptions, forecasts, and stance with more lead time to influence the Parliamentary debates and inform the general public.

(3) Budget execution should be more actively planned, monitored, and disclosed. At present, there is at least a year’s gap in reporting actual versus planned expenditure and revenue figures.

(4) While the budget is published and available on a website, more accessibility and transparency could be obtained by presenting a layperson’s synopsis of the budget, its assumptions, and its implications.

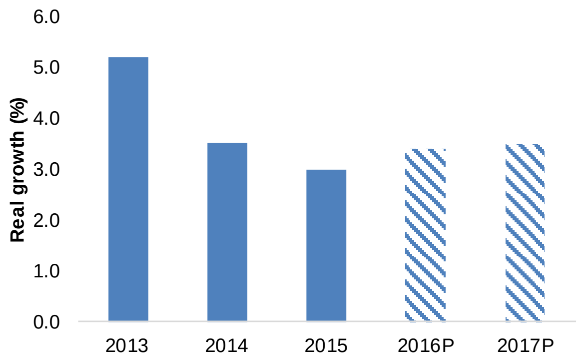
(5) Evaluation and value for money should be integral to the process. At present, the large delays in programme execution and the variable levels of efficiency in the delivery of public services are not discussed or analysed to improve future performance.

Conclusion

Guyana, compared to many of its Caribbean neighbours, enjoys sufficient fiscal space to pursue a fiscal stimulus to counter weak demand conditions in the economy. However, large and prolonged fiscal deficits will lead to a substantial increase in public debt, only partially mitigated by the falling proportion of concessionality of the debt. Given limited access to international capital markets as a former HIPC country, vulnerabilities to external shocks, and rigidities in current expenditures stemming from wages/salaries and public debt service requirements, the following efforts would be helpful: endeavours to limit transfers that do not enhance productivity, rationalisation of tax incentives, better targeting of subsides, engagement in tax reform, and improvement in the efficacy of public investment expenditures.

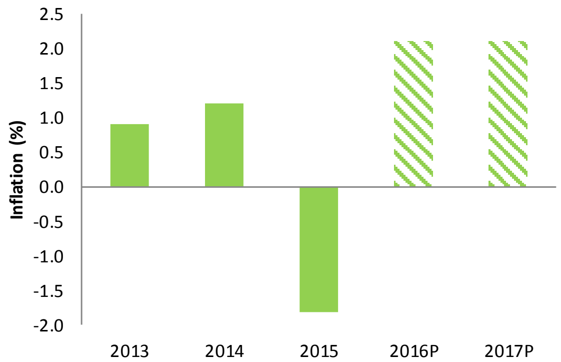
Real growth to improve marginally...

Figure 1: Real GDP growth



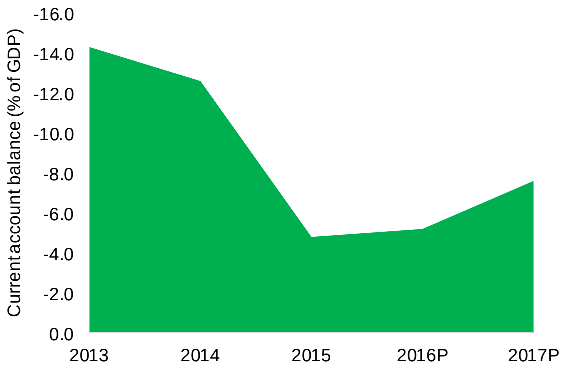
...while inflation remains contained

Figure 2: Inflation (e.o.p)



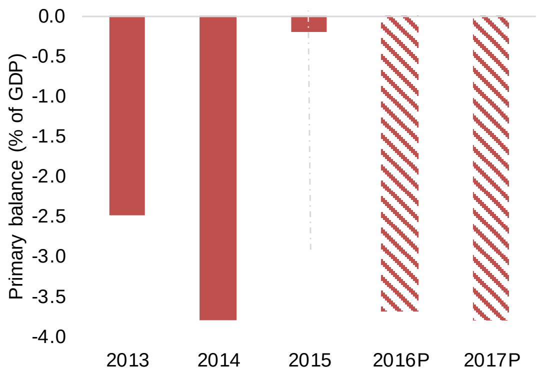
Current account balance expected to improve…

Figure 3: External current account balance



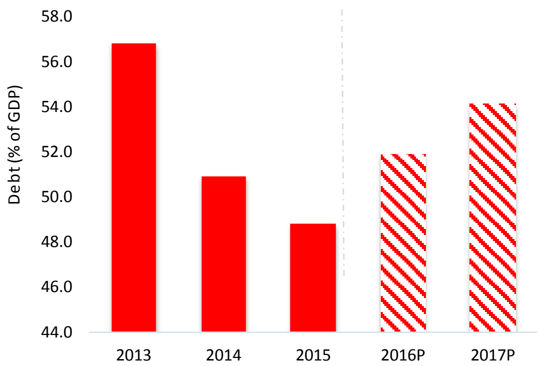
While the primary deficit is expected to deteriorate

Figure 4: Primary fiscal balance



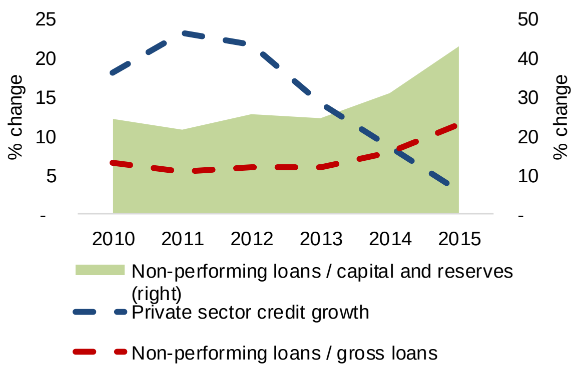
…and public debt levels to increase in the short term

Figure 5: Public debt



private sector credit sharply declined

Figure 6: Private sector credit and non-performing loans.



Source : Bank of Guyana, IMF Western Hemisphere Regional Economic Outlook, April 2016.

Guyana: Selected Indicators

	2012	2013	2014	2015	2016(P)
(Annual percentage changes, unless otherwise indicated)					
Real sector					
Real GDP	4.8	5.2	3.8	3.0	4.4
Nominal GDP (GYD millions)	511337	537428.0	555837.0	N/A	N/A
Inflation (end of period)	3.5	0.9	1.2	-1.8	2.0
External sector					
Exports of goods and services	20.1	-10.7	-12.4	0.2	2.5
Imports of goods and services	14.4	-7.0	-6.7	-17.7	2.7
Current account (percentage of GDP)	-15.7	-14.2	-14.4	-5.2	-4.2
Remittances (percentage of GDP)	16.7	11.7	17.0	15.0	15.7
FDI (percentage of GDP)	10.8	7.3	9.8	4.6	9.2
(In percentage of GDP, unless otherwise indicated, on a fiscal year basis)					
Central government					
Revenue and grants	27.9	22.1	26.7	28.3	30.1
Current expenditure	21.1	19.8	21.8	23.8	29.7
Capital expenditure and net lending	11.1	8.2	13.13	5.3	9.1
Overall balance	-4.7	-4.4	-5.5	-1.4	-4.7
Debt indicators					
Central government debt	72.1	57.4	N/A	N/A	N/A
Central government debt over revenues	N/A	N/A	N/A	N/A	N/A
External public debt (end of period)	54.2	41.5	45.3	39.5	N/A
External debt service as percentage of exports of goods and services	N/A	N/A	N/A	N/A	N/A

Source: Central Bank of Guyana, and Ministry of Finance.

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

Contributor: Juan Pedro Schmid

Highlights

Elections were held on 25 February 2016, with the Jamaica Labour Party coming out as the winner.

The tabling of the budget clarified the new government's policies.

The IMF will combine the eleventh and twelfth review of the Extended Fund Facility, both to be completed in June 2016.

Overview

The Jamaican Labour Party won a majority, by one seat, of the 63 seats in the House of Representatives on February 25th 2016. Part of the party's ten-point electoral manifesto, Partnership to Prosperity, included the exemption from income tax of those earning less than J$1.5m (approximately US$12,000) and promised to create 250,000 jobs.

The new Government committed to fiscal consolidation. In the tabling of the budget, the new Minister of Finance and Public Service, Audley Shaw, raised the income tax threshold, but also ensured a budget in line with the IMF's programme targets. The new administration created a new ministry of Economic Growth and Job Creation.

Recent Developments

The FY2016/17 budget, which was tabled late to give the new administration time, brought more clarity to the government's programme. [1] The budget increased the tax threshold for the personal income tax Pay As You Earn. The threshold increased to JM$1 million (around US$8,000) as of July 1, 2016 with plans to increase it further to JM$1.5 million in the next fiscal year in April 2017.

Additional tax measures compensate for the loss of revenue from the change in the income tax threshold. The revenue loss from the increased tax threshold is estimated to be JM$12.5 billion – equivalent to 0.7% of GDP. New revenue measures should yield an additional JM$13.78 billion through an increase in the special consumption tax on petrol (JM$6.5 billion) and an increase in the departure tax (JM$5.3 billion), with the remainder from adjustments of taxes on liquid natural gas and heavy fuel oil as well as higher taxation on cigarettes and alcohol.

The new budget targets a primary fiscal surplus of 7% of GDP. The budget foresees 28.1% of GDP in revenue against 29.1% of GDP in expenditures. The major expenditures comprise wages and salaries at 10.5% of GDP and interest payments at 8% of GDP. The budget also includes capital expenditure of 2.4% of GDP (compared to 1.8% in FY2015/16) and social expenditure at 1.6% of GDP (unchanged as a share of GDP from FY2015/16).

Financing needs have declined. Financing needs for FY2016/17 amount to 5.2% of GDP, required to amortise debt (4.5% of GDP), finance the deficit (1% of GDP) and increase cash balances in preparation of high amortisation needs in the next fiscal year (0.5% of GDP). The PetroCaribe Development Fund will also contribute 0.8% of GDP for interest payments related to the debt buyback.

Even financing is expected from domestic and external sources. The government anticipates receiving 2.4% of GDP financing for the budget from the recently re-opened domestic debt market and 2.7% of GDP from external sources (bilateral and multilateral lenders). External commercial debt issuance is not foreseen in the current fiscal year. Financing requirements will increase in FY2017/18 to over 12% of GDP due to a spike in both domestic and external debt redemptions.

Growth is projected to recover. Growth was estimated at 0.7% in 2015 and projected at 1 to 1.4% for FY2015/16, which is below the initial projection of 1.9% but still an improvement over the 0.2% growth recorded in FY2014/15. Projections for FY2016/17 currently stand at 1.8 to 2.5%, driven by tourism, business process outsourcing, and agriculture, as well as increased private investment.

Business and Consumer Confidence continued to increase in 2016. The Jamaica Chamber of Commerce Business and Consumer Confidence Surveys indicate that the levels of confidence for both groups have increased to the highest levels ever recorded during the 15-year history of the surveys. The indices are likely to decrease in the next two quarters, as consumer and business confidence generally rises during election periods.

Inflation remained subdued as a result of lower oil prices. For FY2015/16 that ended on March 2016, year-

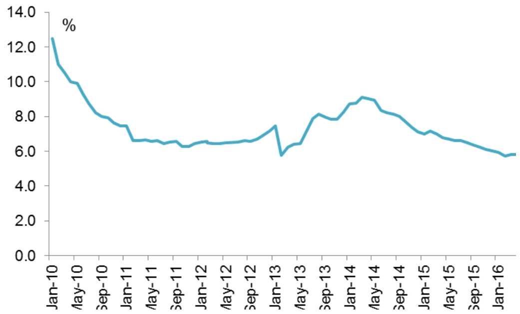
[1] The FY2016/17 budget coincides with the fourth and final year of the Extended Fund Facility.

over-year inflation was 2.9%; a sharp decline compared to the 4.0% experienced the year before (and 8.3% in FY2014/15). As the year-over-year decline in oil prices fades, inflation is expected to increase to around 6%. The recently introduced tax measures on petrol are expected to increase inflation by 0.2%.

International reserves remain above prudent levels. At the end of April 2016, net international reserves were US$2.3 billion dollars, while gross international reserves amounted to US$2.8 billion, the equivalent of 23 weeks of imports of goods and services. The current account deficit of the balance of payments of 6.6% of GDP in 2014/15 is expected to fall to 3.6% of GDP in 2015/16.

Treasury bill and repo rates continue to decline. Since 2010 the 180-day T-bill rate has been on a downward path, reaching 5.8% as of April 2016 compared to 9.1% in May 2014 and over 12% in January 2010. In addition, the Bank of Jamaica benchmark 30-day Certificate of Deposit rate was reduced to 5% in May 2016, down from 5.12% in October 2015 and 5.50% in July 2015.

Figure 1: 180 days T-Bill Yield, January 2010 to January 2016

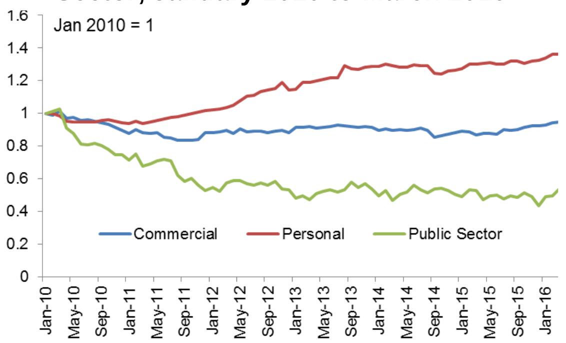


Source: Bank of Jamaica.

Credit has expanded in 2015. Between December 2014 and December 2015, credit by commercial banks increased by 3.4% in real terms. However, since 2010 personal credit has grown much stronger than credit for companies, becoming the dominant form of private credit for commercial banks at 47% of total credit, compared to commercial credit at 46%. Credit to the public sector has been decreasing as a result of the fiscal consolidation and stands currently at only 7% of total credit of commercial banks.

Employment growth remains weak. The unemployment rate at end January 2016 was 13.3%, a decrease from 14.2% one year earlier. The decline in the unemployment rate occurred in spite of an increase in the labour force by 1.6% compared to one year earlier.

Figure 2: Credit for Personal, Commercial and Public Sector, January 2010 to March 2016



Source: Bank of Jamaica.

Jamaica is bracing itself for the Zika virus. Given the outbreak in neighbouring countries and the spread in Jamaica of the main carrier of the virus, the Aedes Aegyptus mosquito, the authorities have been taking action to suppress a potential Zika outbreak. The Centers for Disease Control and Prevention (CDC) included Jamaica in the list of countries that pregnant women and women who intend to become pregnant should avoid.

Conclusion

The newly formed government has expressed its commitment to continue the Extended Fund Facility. The targeted 7% of GDP of primary fiscal surplus has been maintained. Delivery on the electoral promise regarding tax exemption for lower-income earners led concurrently to additional compensatory tax measures and a shift to more indirect tax revenue.

After ten successful EFF reviews, challenges in employment generation and economic growth remain. The slight easing of the required primary surplus will help to open up a small amount of space for capital expenditure, however more concerted efforts are needed to show concrete returns for the population.

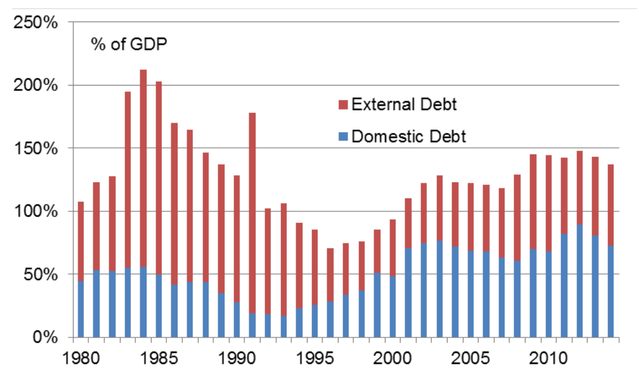
High Frequency Macroeconomic Indicators				
	Last data	Period	Prior data	Period
Real GDP Growth (y/y)	0.7	2015 Q4	1.5	2015 Q3
Inflation (y/y)	2.9	Mar-16	3.7	Dec-15
Net international Reserves (US Mil)	2336.0	Apr-16	2415.0	Mar-16
Exchange Rate (end of period)	123.6	Apr-16	120.4	Dec-15
Unemployment Rate (%)	13.3	Jan-16	13.5	Oct-15

Sources: Bank of Jamaica and Statistical Institute of Jamaica.

Introduction

Jamaica has been characterised as high debt low growth. Over the last three decades, the debt-to-GDP ratio has rarely been below 100% (Figure 3). The high level of debt brings several challenges. There is evidence that high debt causes lower economic growth, that high debt makes a country more vulnerable in times of crisis, and that high debt combined with a low credit rating implies high interest rates, and, thus, a high share of revenues that must be allocated for debt servicing, reducing the amount governments can spend on productive investment in social and physical capital.

Figure 3: Debt Composition, 1980-2015



Source: Own calculations based on Ministry of Finance and Public Service.

Interest payments and public sector salaries are the main challenge for fiscal sustainability. Interest payments have fallen to 7% of GDP in 2015/16 from 9.8% of GDP in 2011/12. The wage bill remains high in spite of some reduction—from 11% of GDP four years ago to currently just above 10% of GDP. Taken together, over two-thirds of revenues have to be allocated for interest payments and salaries alone.

Fiscal Evolution

Jamaica was hit hard by the world recession. The economic downturn led to a quick deterioration of an already weak fiscal situation. As a result, between FY2007/08 and FY2009/10, the overall deficit increased from 3.8% to 10% of GDP and debt jumped from 113.5% to 140% of GDP. Starting in 2010, however, the authorities embarked on a fiscal consolidation programme centred on addressing the longstanding debt overhang problem.

Jamaica has maintained high fiscal targets for the last three years. The first IMF programme stalled after four reviews, but the 2013 IMF-supported EFF has been successful. In line with the targets, Jamaica's primary surplus was 7.5% in FY2013/14 and FY2014/15 and 7% in FY2015/16. The overall balance has been in a deficit of between -0.1 and -0.5% of GDP over the same period. Going forward, the targets for the primary surplus remain at 7%, while the overall balance is projected to become a surplus as debt continues to decrease and, thus, interest payments decline too.

Jamaica's fiscal effort is almost unique. Few countries in the world achieve a primary surplus of 7% of GDP, and virtually all of them are commodity producers. However, high primary surpluses have become engrained in Jamaica–via the IMF programme and from 2017 onwards by the fiscal rule- as a reaction to the chronically high debt levels. The combination of a low credit rating, and thus high interest rates, with high debt levels, forced the authorities to produce high primary surpluses or face an explosive debt trajectory.

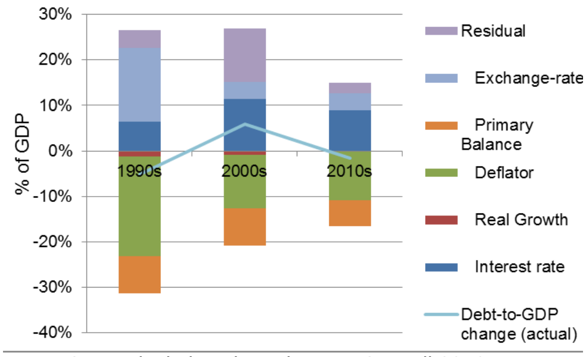
Debt has decreased from high levels. The debt-to-GDP ratio as of March 2016 is estimated at 125% of GDP, a decline of 21.6% of GDP in the three years of the EFF. Part of the decline is the result of a debt exchange of PetroCaribe debt, which reduced the debt-to-GDP ratio by 10%.[2] Debt reduction will remain a main pillar of economic policy, reflected in the recently introduced legally binding fiscal rule that targets debt-to-GDP at 60% by 2026.

Drivers of Debt

Historically, high interest payments and exchange rate movements have been the main contributors to the debt build up leaving aside debt absorption from SOEs and the resolution of the banking crisis and other asset-liability operations. At the same time, debt was contained by high primary surpluses and inflation, while low growth rates have restricted the effects of economic growth on the debt-to-GDP ratio (Figure 4). This situation is quite unique, as countries with high primary surpluses usually have low fiscal deficits or even surpluses. However, the Jamaican case is special. The high level of debt led to high interest payments, which were only partly compensated by the primary surpluses, leading to a vicious cycle of interest payments fuelling debt, which in turn fuelled higher interest payments.

[2] See September 2015 Quarterly Bulletin for details on the debt exchange.

Figure 4: Debt Decomposition, by Time Periods

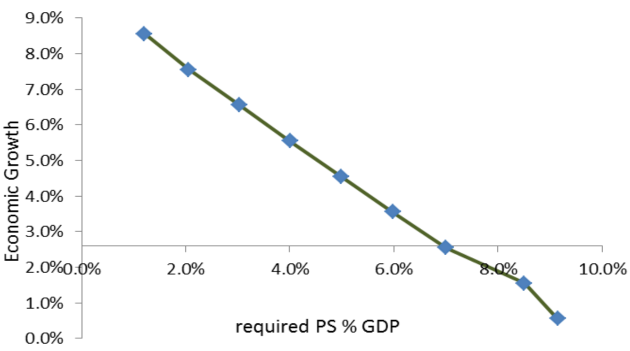


Source: Own calculations based on WEO, April 2016.

Jamaica's debt is projected to decrease. Under current projections, a primary surplus of 4.0% would suffice to keep debt-to-GDP at the current level of 125.1% of GDP. In the absence of any significant changes, debt-to-GDP is therefore projected to decrease.

Jamaica will need to keep up the fiscal consolidation for an extended time period to reach its debt targets. The EFF envisages debt-to-GDP at 100% by 2020, and Jamaica's fiscal rule has a debt target of 60% of GDP by 2026. These targets should be reached with a primary surplus of 7% as long as GDP growth accelerates as projected and the macroeconomic environment does not change fundamentally.

Figure 5: Required Primary Surplus and Growth to Reach 100% debt-to-GDP in 2020



Source: Schmid and Malcolm (2016).

To reach the debt targets while lowering the fiscal targets requires acceleration in economic growth. Between now and the EFF target date, average growth is projected at 2.6%, which will result in a debt-to-GDP ratio of 100% with a primary surplus of 7% of GDP. A doubling of the growth rate to 5.2% would allow the same debt target to be reached with a primary surplus of 4.5% of GDP (Figure 5). Similarly, reaching the debt-to-GDP target of 60% by 2026 requires a primary surplus of 7.1% between 2020 and 2026 under the baseline growth rate of 3%. A doubling of the growth rate during this period would allow the primary surplus to be reduced to 5% of GDP. Conversely, a slower than projected GDP growth would require a stronger fiscal effort.[3]

Fiscal Framework

Jamaica's fiscal framework centres on expenditure containment while stabilising tax revenues. Revenues as a share of GDP at over 25% are high in international comparison, not providing much room for further increase. At the same time, expenditures are highly rigid, with over 80% of central government expenditure for interest payments and public sector salaries alone. As such, efforts with regard to revenues are aimed at stabilising them, while removing distortions. In this respect, Jamaica introduced comprehensive tax reform in 2014. The reform replaced many of the distortionary tax incentives—including discrete tax waivers and industry-specific special tax treatments—with tax incentives linked to employment and capital investment. Such incentives are less distortionary as they do not give preference to a company or sector but support growing and investing in firms.

Sustainable expenditure reduction requires deep reforms. Interest payments are a function of the debt level and the terms at which debt has been contracted. In this respect, the 2010 and 2013 domestic debt exchanges were central to reducing expenditures. Ultimately, reducing interest payments requires a decline in the level of debt, creating a virtuous circle of lower interest payments, leading to lower debt, leading to lower interest payments. The lower level of debt can also have positive effects on economic growth, reinforcing the virtuous circle. However, this process is slow, with debt-to-GDP still projected at 100% and 60% for 2020 and 2026, respectively.

Reducing public sector salaries is similarly challenging. It is uncertain the percentage of public employees that provide basic services with little possibility for substitution, including police, education, and health care. However, automation, i.e. the use of technology, and more efficient processes would create room for increased productivity in these and other parts of the public sector.

[3] See Schmid, J.P. and X. Malcolm. 2016. "Debt, Fiscal Adjustment and Economic Growth in Jamaica." IDB Policy Brief no. 249. Washington, DC: Inter-American Development Bank.

The reduction of public sector salaries must be addressed under the umbrella of public sector modernisation. While fiscal challenges from public sector salaries are evident, there are other issues related to insufficient and ineffective service delivery, problems related to red tape and corruption (as evidenced by information in the World Economic Forum of 2015), and potentially huge efficiency gains from a more modern and efficient public sector. Public health, education, and safety as well as businesses depend on the public provision of services, making it undesirable to simply make ad hoc cuts in the public sector but to do so within a strategic approach.

Budget credibility is a central part of the fiscal framework. Jamaica has met its fiscal targets in the three years of the EFF programme. This is in contrast to the eight years prior to the IMF programme, in which the primary balance has been, on average, 1.8 percentage points of GDP lower than projected in the budget, and the fiscal balance was 2 percentage points of GDP below budget projections, implying that, measured against the budget expectations, the debt-to-GDP ratio in 2013 could have been at least 16% of GDP lower than it was.[4]

Conclusions and Policy Implications

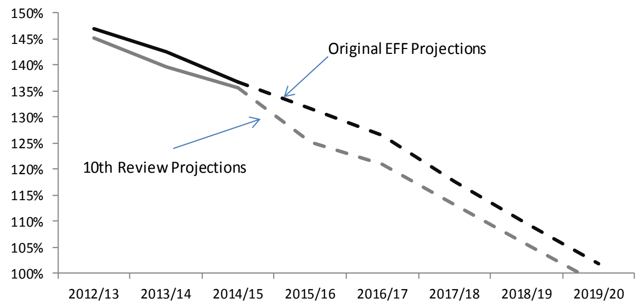
A moniker for Jamaica's economic development is low growth and high debt. For Jamaica, debt, economic growth, and development are closely interlinked. As such, Jamaica's macroeconomic policies for several years will remain focused on reducing the debt burden.

Jamaica has made important advances over previous years. Jamaica has reached its fiscal targets in FY2015/16 for the third year in a row, also accompanied by a reduction of debt-to-GDP from 145.3% in March 2013 to 125.1 in March 2016. Continuation of a similar fiscal effort is expected to reach 100% of debt-to-GDP by 2020, and 60% of debt-to-GDP by 2026.

[4] For details on Jamaica's budget credibility before the EFF, see Schmid, J.P. 2014. "Fiscal Unruliness: Checking the Usual Suspects for Jamaica's Debt Buildup." IDB Policy Brief no. IDB-PB-213. Washington, DC: Inter-American Development Bank.

Petrocaribe deal supports reaching the debt target …

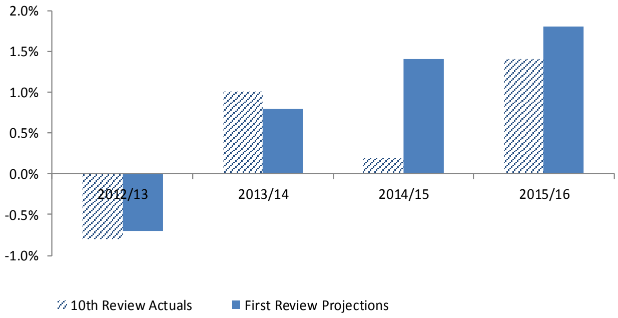
Figure A. Debt-to GDP 2011/12 - 2019/20



Source: International Monetary Fund

Despite Dissapointing growth figures

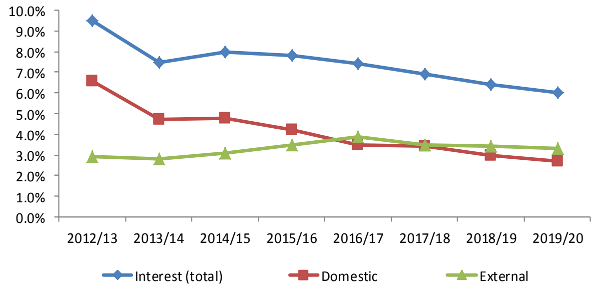
Figure B. Annual GDP growth rate



Source: Statistical Institute of Jamaica

Interest Payments are on a downward path

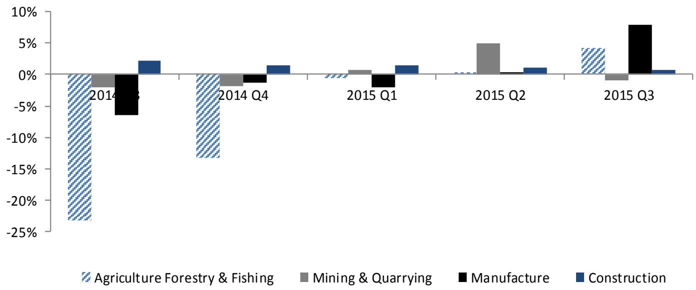
Figure C. Interest payments on Government Debt (% of GDP)



Source: International Monetary Fund.

While the non- service sectors are improving

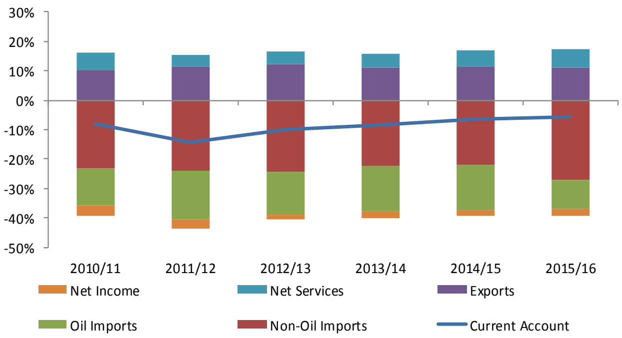
Figure D: % change in Gross value added by Industry



Source: Statistical institute of Jamaica

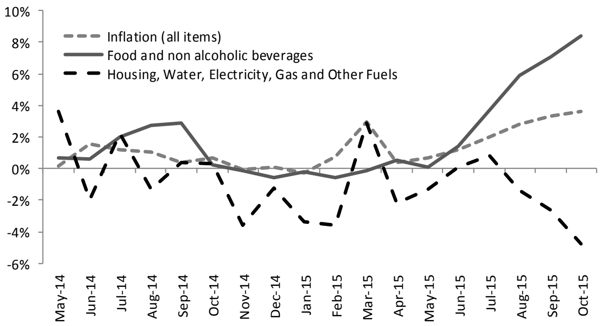
The Current Account has benefitted from low oil prices

Figure E. Contributors to current account deficit (% of GDP)



…Which has helped to keep inflation 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 peri	6.5	6.2	5.8	8.0	7.0	6.0
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, %	527%	562%	567%	521%	475%	453%
Foreign currency public debt (end of period)	83.3	81.4	92.0	87.53	86.4	78.6
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

Source: International Monetary Fund and country authorities.

Contributor: Chyrstol Thomas

Overview

The outlook for international gold and oil prices is expected to weaken Suriname's macroeconomic framework for the short term. The government's macroeconomic stabilisation and reform agenda is to be supported by an International Monetary Fund (IMF) 24-monthg Stand-by Arrangement (SBA), approved on 27 May. To strengthen the country's international reserve position, after adopting a system of foreign currency auctions, the Central Bank of Suriname (CBvS) has adopted a floating market determined exchange rate regime.

Highlights

The Government of Suriname and the IMF reached an agreement for a US$478 million Stand-By Arrangement (SBA) on the 27 May 2016.

Macroeconomic stabilisation and institutional strengthening are at the forefront of the home-grown program supported by the SBA.

Suriname's fiscal situation is highly exposed to movements in commodity prices, and the primary balance is the main contributor to higher debt.

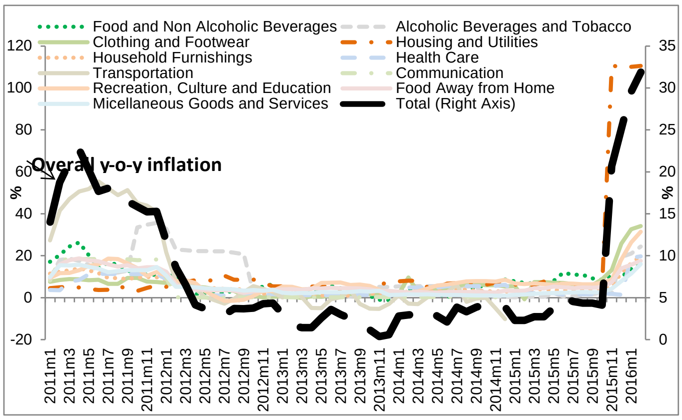
Recent Macroeconomic Developments

Suriname's economic growth rates for 2015 and the medium term have been revised downward. Economic growth slowed significantly to 0.1% in 2015, compared to 1.8% in 2014 and 2.8% in 2013.[1] The extractive industries, which generally account for most of Suriname's economic activity[2] were hindered by lower commodity prices. The IMF forecast a contraction in economic growth to −2% in 2016. The closure of Suralco's alumina refinery in late 2015 helped push the economy into a severe recession in 2016.[3] In the past five years, economic growth averaged 2.6%, primarily reflecting expansion in the extractive industries and increases in commodity prices (mainly gold and oil). Although negative growth is expected in 2016, economic activity is projected to pick up by 2.5% in the medium term due to commencement of operations of Merian, the new gold mine, in late 2016, and the increased oil refinery capacity of the state-owned company Staatsolie.

Inflation was high in the first quarter of 2016 compared to more recent years. For the first three months of 2016, inflation averaged 33% compared to 2.4% in 2015 and 2.9% in 2014 (Figure 1). Consumer prices were mainly affected by increased electricity tariffs and the depreciation in the exchange rate. Average inflation is projected to remain in the double digits in 2016, at 36.8%, but should decline in the medium term to an average of 6.7%.[4]

The reduced unit value of exports of mining goods weakened the external situation, but the medium-term outlook is likely to improve with the IMF SBA programme (Figure 2**)**. International reserves fell by 16% at the end of March 2016 to US$276.4 million, estimated at 1.4 months of import cover, over the level recorded at the end of 2015. Suriname's dependence on commodity exports enhances the need to maintain adequate reserves, as reserves are highly correlated to the volatility in international oil and gold prices. The current account balance worsened in 2015 by 7.6% of GDP to −15.6% of GDP, given a decrease in export values due to lower commodity prices on the international market. Implementation of the structural programme should provide a bridge to the reserve position to 2017/18 when new productive capacity in the commodity sector will materialize. International reserves are projected at an average of 4 months of import cover in the next three years; this compares to 2.6 months import cover without an IMF programme. Moreover, the current account balance is expected to improve in 2016 to −8.7% of GDP, while averaging −0.7% in the medium term.

Figure 1. Inflation (Annualised) By Category



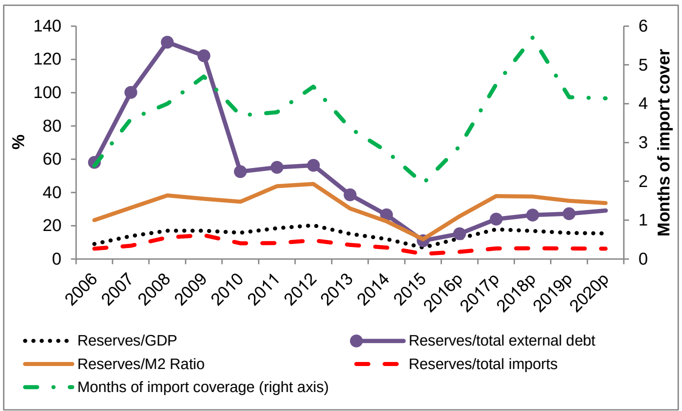
Sources: Bureau of Statistics, and IDB.

Suriname adopted a flexible exchange rate system. The weakened reserve position and the need to stabilise

[1] World Economic Outlook (WEO), April 2016.
[2] On average, the extractive sector accounts for 30% of GDP, 90% of total exports, and 47% of government revenues.
[3] The bauxite industry contributed to about 5% of GDP and government revenues between 2010 and 2015.
[4] WEO, April 2016.

the currency market resulted in the CBvS gradually abandoning the pegged exchange rate to adopting an auction-based foreign exchange system in March 2016[5] followed by a freely floating system in May. The flexible exchange system is expected to smooth out large fluctuations. The SRD dollar depreciated by as much as 43% since the shift in the exchange rate system.

Figure 2. International Reserve Indicators



Sources: IMF, Central Bank of Suriname, and IDB.

The fiscal situation is expected to improve in the medium term after deteriorating in 2015. The fall in international oil prices has resulted in a 67% loss of oil and mining revenues in 2015 compared to a similar period in 2012 when commodity prices were at their peak. At the end of 2015, government expenditure was 29.7% of GDP compared to 32.1% of GDP in 2014, while total revenue declined by 3.3% of GDP to 21% of GDP in 2015. The overall fiscal balance in 2015 deteriorated to −8.8% of GDP. Suriname's total debt stock to GDP increased by 14.2 percentage points to 43.3% at the end of 2015 compared to the previous year. At the end of February 2016, debt was equal to 45.3% of GDP (Suriname Debt Management Office). The external debt-to-GDP ratio increased from 16% in 2011 to 24%, given higher investment in capital projects. The available debt space for external and domestic debt remains at about 11% and 4% of GDP, respectively. The IMF projects that total debt stock would remain on average at 41% of GDP in the medium term. Sustained low international oil and gold prices would change the debt outlook unfavourably for Suriname.

The IMF programme aims at fiscal consolidation and rebuilding international reserves to levels more appropriate for a small and vulnerable economy. The programme targets a reduction in the primary fiscal deficit from 7.4% of GDP in 2015 to a surplus of 0.3% of GDP by 2018, while protecting social spending. The programme is expected to restore usable reserves to more than 4 months of imports by 2018 (US$900 million). The programme projections are based on strong technical and financial support (total financing US$470 million) from other international financial institutions (IFIs), which include the Caribbean Development Bank, the IDB, the Islamic Development Bank, and the World Bank. Most of the financing for the programme would be front-loaded for immediate balance of payment and budgetary support (about 48% in 2016, 33% in 2017, and 19% in 2018). Other parts of the programme involve strengthening the resilience of the monetary and exchange rate policy framework to further external shocks through institutional and operation reforms supported by technical assistance. Structural reforms will target an improvement in the private sector environment and competitiveness.[6]

Suriname has been downgraded to "highly speculative" grade by two credit rating agencies. Fitch Ratings and Standard and Poor's downgraded Suriname this year one notch from 'non-investment' or 'speculative' grade (BB-) to 'highly speculative' grade (B+). The outlook was revised from stable to negative. The decisions were based on a weakened external position (high current account deficit (−15.6% of GDP) and low reserves), driven by a shock to commodity export prices.

High Frequency Macroeconomic Indicators				
	Lastest data	Period	Prior data	Period
Real GDP growth (y/y)	0.1	2015	1.5	2014
Inflation (end of period)	36.6	Mar. 16	25.0	Dec. 15
Net international reserves (US$M)	276.4	Mar. 16	308.7	Jan. 16
Exchange rate (to US$)	5.6	May. 16	4.0	Dec. 15
Unemploment rate (%)	8.7*	2016	8.7	2015

Sources: Central Bank van Suriname; General Bureau of Statistics; World Economic Outlook (April 2016).
* data is estimated

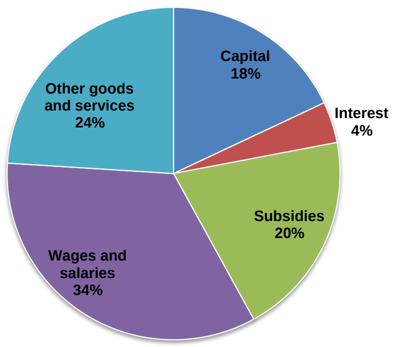
[5] https://www.cbvs.sr/images/content/pdf/2016/Valutaveiling/A_brief_outline_of_the_monetary_and_exchange_rate_policy_of_the_Central_Bank_of_Suriname-4April2016.pdf

[6] https://www.imf.org/external/np/sec/pr/2016/pr16170.htm

Introduction

Suriname's fiscal situation is exposed to movements in commodity prices. The oil sector accounts for 29% of government revenues, while gold accounts for another 13% (IMF 2013). This results in extreme exposure to changes in prices of mining and energy commodities. Government revenues are most affected when there are huge swings in the prices of oil, gold, and bauxite, with a strongly positive correlation (0.9). Commodity-related revenues averaged 34% of total revenue during the 2010-2014 period.[7] Most of the mining-related revenue within this period was derived from the oil sector (averaging about 65%) and the gold sector (30%), with the oil industry's contribution increasing over time (from 58% in 2010 to 76% in 2014). A heavy reliance on the extractive industries makes government revenue vulnerable to international shocks in commodity prices.

Figure 3: Distribution of Total Government Expenditure (2011-2015)



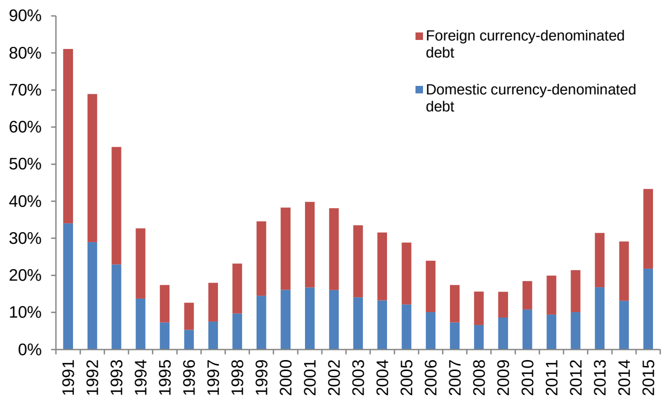
Sources: CBvS and IDB.

Government expenditure comprises mainly wages and salaries. Suriname's public sector accounts for about 60% of formal employment. The impact of government spending on aggregate demand is relatively larger. In the past five years, government outlays averaged 30% of GDP. Wages and salaries accounted for 34% of total public expenditure, which is relatively high compared to other Caribbean countries. Growth in expenditure, despite adverse trends in revenue, can pose a challenge for financing. Moreover, the decline in government revenues in view of sustained low commodity prices resulted in the fiscal balance moving from a surplus in 2008 (1.6% of GDP) to a deficit of 8.7% of GDP in 2015. Suriname's debt stock as a percentage of GDP increased by 23.2 percentage points between 2011 and 2015, however, it still remains among the lowest in the region (43.3% of GDP).

Debt in Suriname

Suriname's debt-to-GDP ratio is governed by the 2002 Debt Act.[8] In the early 2000s, Suriname reformed its debt management practices. The Debt Act limits the total stock of public debt to 60% of GDP.[9] About 51% of total public debt is denominated in foreign currency (Figure 4).[10] The two largest foreign creditors of the country are the IDB and China (averaging 36% and 39% of total external debt in the past five years, respectively). External debt service averaged about 1.7% of exports of goods and services between 2011 and 2015. Interest payments are projected at 1% of GDP and 5% of fiscal revenues. These ratios are within the lower range when compared to other countries in the Latin America and Caribbean (LAC) region.

Figure 4: Suriname's Debt Evolution (1991-2015)



Sources: World Economic Outlook (April 2016), and IDB.

Drivers of Debt in Suriname

Inflation and the primary balance influence debt most in Suriname. A decomposition of debt by its main components (primary balance, interest rate, real GDP growth, inflation, exchange rate depreciation, and other debt-creating transactions, also known as the residual), shows that the primary balance is the main contributor to higher debt. Inflation, on the other hand, was most

[7] Suriname has traditionally relied heavily on Dutch Treaty Funds, which at their peak reached 7.7% of GDP and 25.7% of total revenues and grants. The last disbursement of these funds was in 2012.

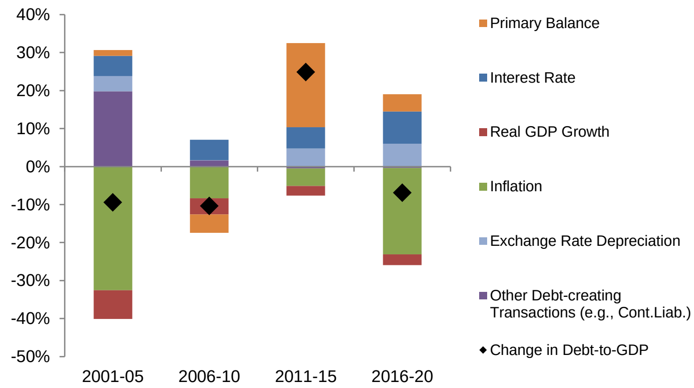
[8] Suriname's total debt stock now follows international definition but is still limited by a debt threshold of 60% of GDP. On 4 April 2016, the National Assembly voted in favour of amending the National Debt Act to adopt the international definition of debt. The change in definition allows for 6% of GDP in additional debt space.

[9] As mandated by law, total debt may not exceed 60% of GDP. Specific limits of 25 and 35% of GDP are also set for domestic and external debt, respectively.

[10] Over the past five years, bilateral creditors accounted for 55% of gross foreign debt, while 45% was provided by multilateral creditors.

accountable for decreasing the debt-to-GDP ratios (see Figure 5). Though interest payments and exchange rate depreciation have been less significant historically, the influence of both indicators on debt is expected to increase in the medium term (2016–2020).

Figure 5. Decomposition of General Government Debt (5-year averages)



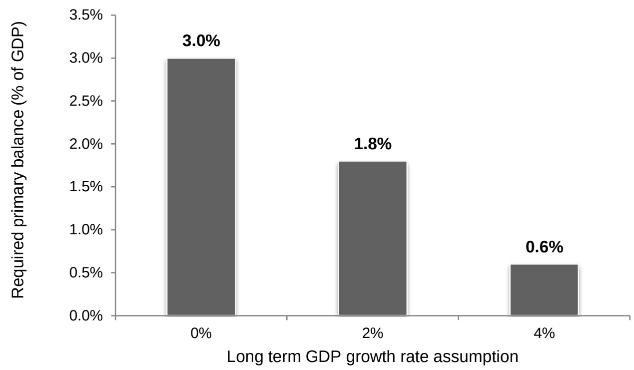
Sources: World Economic Outlook (April 2016), and IDB.

Debt Sustainability by Decreasing the Primary Balance

Mineral taxes have the most influence on the outturn of the primary balance. The fall in revenues of 4.9% of GDP in 2015 over 2013 was mainly a result of lower mineral taxes. Mineral taxes averaged around 36% of total revenue between 2010 and 2013. However, this share fell to 29% in 2014 and 15% in 2015. Though the primary expenditure to GDP ratio decreased from 32.2% in 2013 to 28.3% in 2015, the primary surplus worsened on account of revenue shortfall (Suriname: Selected Indicators Table).

The primary surplus would be sufficient to stabilise the debt-to-GDP ratio with the support of the IMF's SBA programme. The standard approach suggested a required primary balance of 0.3% of GDP (an adjustment of 7.7% of GDP to the primary balance) to stabilise debt at the 2015 level. According to recent IMF projections under the SBA, Suriname's primary surplus is expected to improve more in line with this debt-stabilising level over the medium term. The government's fiscal consolidation measures include the increase in both electricity tariffs and government take on fuels. Additional reform and policy measures are expected to be implemented under the economic adjustment programme that will make the public sector more efficient and reduce the fiscal gap. The country's enacted debt limit of 60% of GDP is not expected to be reached in the medium term. However, if this threshold is met, Suriname will require primary surpluses of between 0.6% and 3%, depending on the long-term growth rates, to stabilise the debt (Figure 6).

Figure 6. Scenarios for Required Fiscal Adjustment if Debt-to-GDP Ratio Threshold of 60% is Met

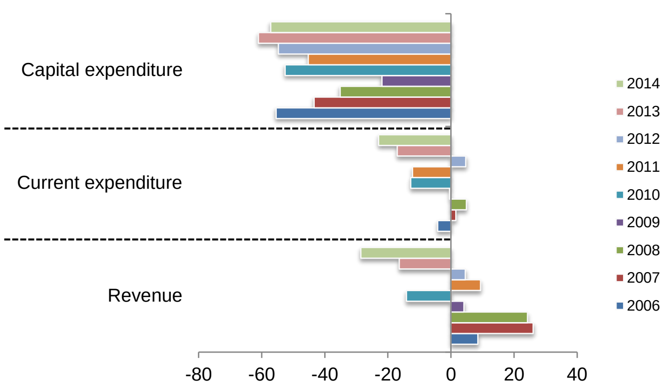


Source: IDB Staff calculations.

Budget Credibility

The budget process is an important element in planning and managing financial resources of a country. The budget in Suriname covers government operations for 17 line ministries and the transfers or subsidies to all autonomous government agencies and public enterprises. However, public funds that are raised by autonomous government agencies, which include service charges, fees, and tariffs, are not included in the budget. The credibility of the budget is affected by high variances between aggregate expenditures in the budget and actual aggregate expenditure; in particular, capital outlays tend to be overestimated during the budget process (Figure 7).

Figure 7. Variance in Budgeted and Actual Fiscal Outcomes (in%)



Sources: Ministry of Finance, and IDB.

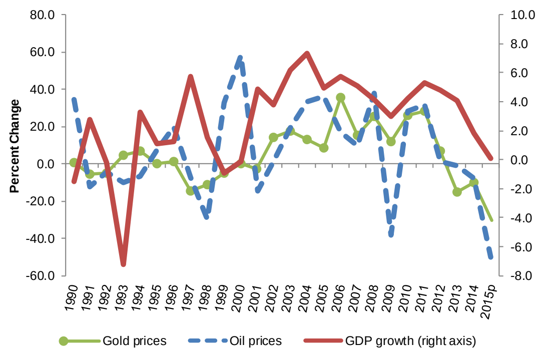
Conclusion

The end of the international commodity boom resulted in unsustainable fiscal balances. The lack of macroeconomic buffers reduces Suriname’s ability to implement countercyclical policies, especially during recessionary periods. The policy framework and fiscal space in the country will be determined over the next two years by mainly two factors: the macroeconomic stabilisation programme, under the auspices of the IMF, and a recovery in the extractive industry (international prices and investments). To sustain debt levels, Suriname will require key decisions and policies on fiscal consolidation. Institutional underpinnings for fiscal policy, budgeting, and spending will be important to promote growth and fiscal stability. Of equal importance will be the collection of more reliable statistics. Suriname’s fiscal situation can be put onto a sustainable path with fiscal rules and support from the IMF programme. The projected reduction in the primary balance would have to be supported by expenditure-reducing measures in the context of low commodity prices.

Suriname's Macroeconomic Snapshot

Low commodity prices restricted economic growth...

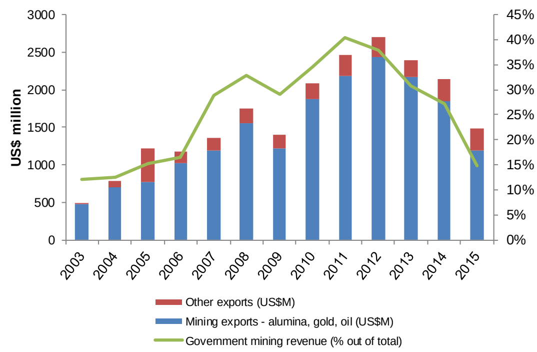
Figure A. Real GDP, and Commodity Prices



Sources: Central Bank of Suriname, and World Economic Outlook (April 2016).

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

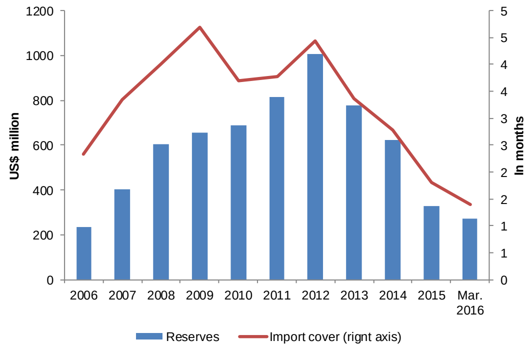
Figure B. Mining Dependence



Source: World Economic Outlook (April 2016).

As a result, the international reserve position weakened…

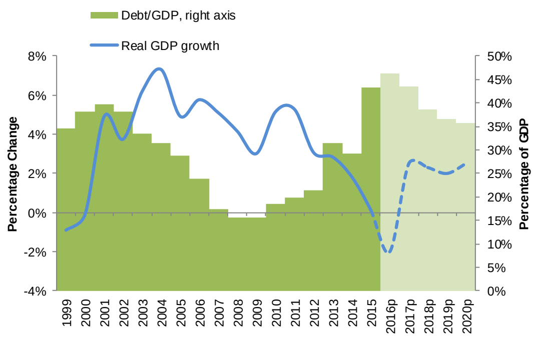
Figure C. International Reserves



Source: Central Bank of Suriname.

… and the stock of debt increased.

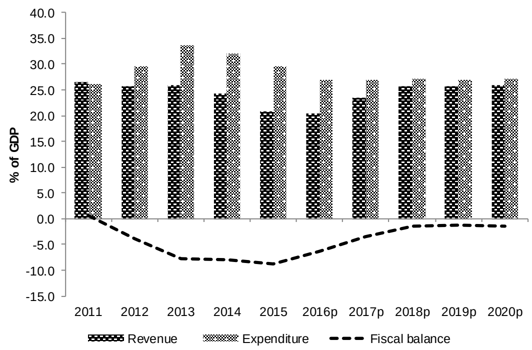
Figure D. Debt Evolution



Sources: Central Bank of Suriname, and World Economic Outlook (April 2016).

Investments in the mineral sectors should stabilize economic growth and return fiscal balances to pre-2012 levels …

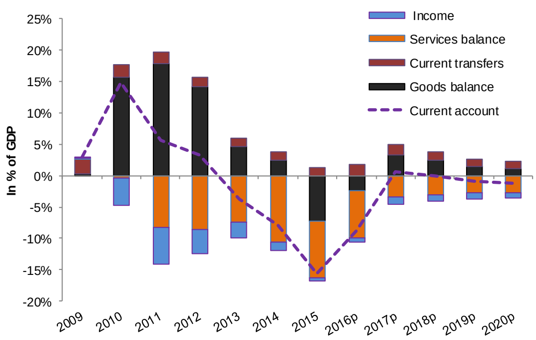
Figure E. Fiscal Performance



Source: Central Bank of Suriname, and World Economic Outlook (April 2016).

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

Figure F. Current Account Balance



Source: Central Bank of Suriname, and World Economic Outlook (April 2016).

Suriname: Selected Indicators

	2011	2012	2013	2014	2015 (p)	2016(e)
(Annual percentage changes, unless otherwise indicated)						
Real sector						
Real GDP	5.3	3.1	2.8	1.8	0.1	-2.0
Nominal GDP	20.5	13.7	3.0	1.5	2.3	29.6
Inflation (end of period)	17.0	4.4	0.6	3.9	25.0	26.0
Unemployment	7.5	8.1	6.6	6.9	8.7	8.7
Exchange rates (end of period)	3.3	3.3	3.3	3.3	3.4	5.6*
(In percent of GDP, unless otherwise indicated, on a calendar year basis)						
External sector						
Exports of goods and services	60.3	57.7	50.6	45.2	35.8	40.7
Imports of goods and services	50.7	52.0	53.1	53.2	52.0	50.4
Current account	5.7	3.3	-3.8	-8.0	-15.6	-8.0
Gross international reserves (US$ millions)	816.9	1008.4	775.4	621.8	330.2	276.4**
Central government						
Revenue and grants	26.7	25.7	25.9	24.2	21.0	20.6
Commodity-related revenues	10.8	10.1	9.0	7.0	3.1	2.0
Total expenditure	26.1	29.6	33.6	32.1	29.7	27.0
Primary balance	1.5	-2.9	-6.4	-7.0	-7.4	-4.4
Overall balance	0.5	-3.9	-7.7	-7.9	-8.8	-6.4
Debt indicators* **						
Total government debt	19.9	21.4	31.4	29.2	43.3	45.4
Government debt over revenues	74.8	83.1	121.4	120.3	206.7	215.0
External debt	10.5	11.3	14.7	16.0	21.5	30.2
Domestic debt	9.4	10.1	16.8	13.1	21.8	15.2
External debt as percent of exports of goods and services	17.4	19.6	29.0	35.4	60.1	74.2

Sources: Central Bank of Suriname; General Bureau of Statistics; World Economic Outlook, IMF (April 2016); IDB.

Notes: (p) denotes provisional figures. (e) denotes estimated figures.

* Data as at May 4, 2016. On March 22, 2016, Suriname adopted a flexible exchange rate regime.

** Data as at the end of March 2016.

Quarterly Bulletin June 2016

TRINIDAD AND TOBAGO

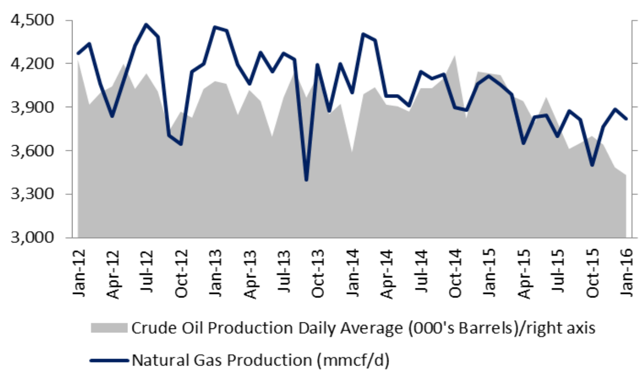
UNCERTAINTIES ON THE HORIZON

Contributor: Juan Jose Pradelli

Trinidad and Tobago's credit ratings are weakening along with economic prospects. On 15 April 2016, Moody's downgraded Trinidad and Tobago's government bond rating to Baa3 from Baa2, and revised the outlook to negative from stable. According to Moody's, low oil and gas prices will undermine the economic and fiscal fundamentals at least throughout 2018. Lacking macroeconomic data and a robust capacity for policy execution, the authorities' response—centred on the consolidation of public finances—may not be as effective and timely as required. In addition, there is the risk that the government financial support to Petrotrin, e.g., guarantees on loans, will be scaled up if the global energy prices and corporate profits remain depressed in the medium term.

Overall economic activity stagnated in 2015 following the contraction in the energy sector experienced since the collapse of global energy prices. Real GDP grew a mere 0.2% in 2015, disappointing early expectations for 1.5% growth. Along with falling oil and gas prices in the world markets and with plant shutdowns for maintenance and infrastructure upgrading, energy output contracted by 3.4% and dragged economic activity and incomes down (Figure 1). Non-energy output expanded by 2.3% in 2015, a timid recovery after its own stagnation during 2014. A strong growth upswing in the finance and agriculture sectors contrasted with weak performance in manufacturing and construction and an outright contraction in distribution. The outlook for 2016 remains grim in view of low energy prices, weak global and regional growth prospects, and the fiscal policy tightening envisaged by the country's authorities.

Figure 1. Energy Sector Output



Source: Central Bank of Trinidad and Tobago.

Economic stagnation may take a toll on employment and labour market conditions in the near future.

> ***Highlights***
>
> *Credit ratings are weakening and the outlook turns sour.*
>
> *Real GDP stagnated in 2015, with a large contraction in the energy sector.*
>
> *Fiscal austerity shapes revisions to the FY 2015/16 Budget, introducing spending cuts and additional revenue measures.*
>
> *Currency stability achieved by selling US$2 billion reserves since early 2015.*
>
> *Price hikes follow the reforms to the VAT regime effective since February 2016.*

According to the Central Statistical Office, the unemployment rate remained stable at around 3.3-3.5% in 2015. However, emerging signals point to job losses in the energy-related and construction sectors. The Ministry of Labour and Small Enterprise Development reports that 756 retrenchment notices were filed between October 2015 and February 2016, up from the 490 notices filed in the corresponding period one year earlier.

In April 2016, the Government introduced revisions to the FY 2015/16 Budget geared towards fiscal austerity. Facing revenue shortfalls and persistently low energy prices, the Government has formulated compensatory measures on both expenditure and revenue. Spending cuts amount to TT$4billion, or 6% of the expenses approved in the original budget. On top of the initiatives to boost non-energy revenues already envisaged in the original budget, new tax measures are proposed: a 15% increase in the gasoline price (complemented with the phasing out of subsidies on super); a new levy on online purchases of goods and services; and an increase in taxation on luxury vehicles and the consumption of alcohol and tobacco. Despite commendable efforts to consolidate public finances in order to cope with the adverse external environment, the budget deficit is now expected to be as large as 4% of GDP (against the 1.6% of GDP deficit envisaged in the original budget).

The public debt is on a rising path, despite a slight deleveraging since the beginning of FY2015/16. During the last quarter of 2015, net public sector debt (excluding instruments used for monetary regulation) declined by 1.7% and stood at TT$74.8 billion at end-December—or 42.5% of GDP. Most of the deleveraging is accounted for by redemption of Treasury Bills issued in

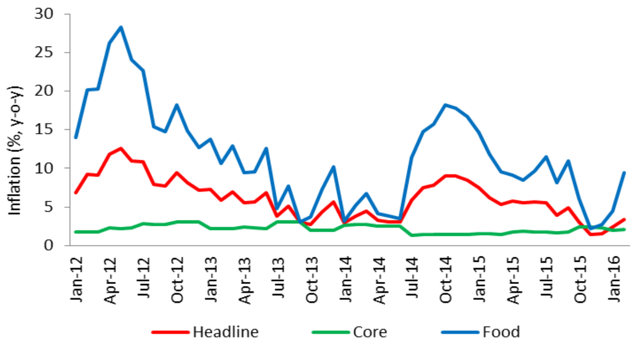
October 2014 to sterilise the proceeds of a state asset. However, the public debt is expected to increase in 2016 as the fiscal deficit widens and economic growth falters. According to the IMF's April 2016 World Economic Outlook (WEO), the gross general government debt will reach 62.8% of GDP by end-2016, increasing 10 percentage points relative to its level at end-2015.

Pressures on the foreign exchange market persist, and the Central Bank interventions preserve the currency stability. The supply of foreign exchange has declined in tandem with the energy export receipts, while capital outflows for speculative and precautionary motives are building up demand pressures. The Central Bank is intervening actively on the selling side to fill the shortage of foreign exchange and prevent any sharp currency depreciation. Its stock of net official reserves declined by nearly US$2 billion from end-December 2014 to end-March 2016, while the currency depreciated by just 3.3% against the U.S. dollar. Reserves currently stand at around US$9 billion, covering 11 months of imports of goods and non-factor services. Further depletion of reserves is to be expected insomuch as the supply of foreign exchange by energy companies is unlikely to increase in the short term.

Foreign trade and external balances largely deteriorate in an adverse global environment. Depressed global energy prices and lower export volumes are narrowing the merchandise trade surplus, which averaged US$119 million per month in the first three quarters of 2015, compared to a US$336 million monthly average in 2011–14. As corporate profits decline in the energy sector, the investment-income account deficit narrows as well, amounting to US$66 million per month in 2015 against a historical average of US$233 million. Overall, however, Trinidad and Tobago's external surplus is waning: the current account nearly balanced in 2015 after reaching a monthly average surplus of US$59 million in 2011–14. Thus, the country's external buffers and capacity to cope with new shocks may be compromised going forward.

Headline inflation accelerated in response to the reforms to VAT regime effective since February 2016 (Figure 2). Prices sharply increased for those goods and services—particularly food staples—which are now subjected to a 12.5% VAT statutory rate but were VAT-exempted in the past. Thus, monthly headline inflation spiked at 0.9% in February 2016, driven by a 4.9% jump in food prices. Monthly core inflation, in contrast, remained stable at around 0.1%. Going forward, it is uncertain whether the higher food-price level resulting from a wider VAT base would affect other prices in the domestic economy, e.g., through second-round effects on producers' cost structure and households' budget.

Figure 2. Inflation rate (percent)



Source: Central Bank of Trinidad and Tobago.

Monetary policy follows a cautious approach. In January and March 2016, the Central Bank's Monetary Policy Committee left the repo rate—its main policy tool—unchanged at 4.75%, thus pausing the monetary tightening observed during 2015. To justify its decision, it cited the challenges currently facing the domestic economy—most notably, the slow global growth and the adverse developments in the energy sector. Such a cautious approach is in line with decisions made by the central banks in advanced economies.

Liquidity of banks is abundant. Excess reserves held by commercial banks at the Central Bank have increased from TT$3.4 billion in December 2015 to TT$4 billion in March 2016. A TT$1.5 billion commercial bank fixed deposit was rolled over in March 2016, in contrast to the fixed deposits amounting to TT$3.5 billion which were not re-issued at maturity in the last quarter of 2015. These developments suggest the domestic banking system is not short of liquidity in local currency.

Credit to the private sector continues expanding despite a flat level of deposits. Credit extended by commercial banks and non-bank financial institutions to the private sector increased by 6.6% in 2015, reaching nearly TT$57 billion at end-December 2015. Meanwhile, the stock of deposits in these institutions hovered in the range of TT$103-105 billion and virtually stagnated. Interestingly, business lending by commercial banks grew more in sectors such as manufacturing, construction, and distribution, whose output growth was dismal and thus presumably reduced the margins for self-financing. In the

finance sector, on the other hand, the loan balance declined while output expanded rapidly.

Bank lending for real estate mortgages slows down and thus hits construction activity and housing prices. Mortgage loans grew at 8.9% in 2015 against an average of 12.1% in 2013–14. The Mortgage Market Reference Rate—a benchmark for pricing and re-pricing loans—is now absorbing the increase in policy rates during 2015: as of March 2016, the Rate was set at 3%, compared to 2.24% one year earlier. Declining incomes and relatively more expensive mortgages are expected to further weaken demand; in fact, loan applications and approved operations have already fallen over the last three quarters of 2015.

Domestic stock market continues its lacklustre performance. Equity prices fell abruptly in March 2016, echoing concerns about the economic outlook. The Composite Price Index dipped by 2.5% in March to 1,133.2 and reached its lowest value since late 2013. The market sell-off was widespread and significantly accelerated the trading volume to 14 million shares, doubling the monthly average volume observed since July 2015.

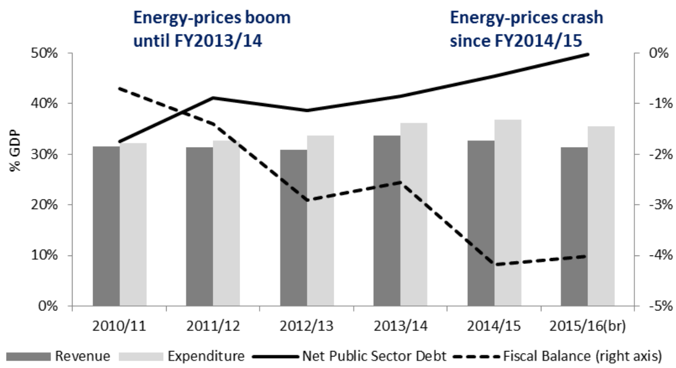
High-Frequency Macroeconomic Indicators				
	Last data	Period	Prior data	Period
Annual GDP growth (%)	-3.0	Q4 2015	-2.0	Q3 2015
Exports (12-month growth, %)	-23.4	Q3 2015	-20.1	Q2 2015
Imports (12-month growth, %)	-17.4	Q3 2015	-19.6	Q2 2015
Private sector credit (12-month growth, %)	6.8	Q4 2015	5.7	Q3 2015
Inflation (headline, % yoy change)	3.4	Feb.2016	2.4	Jan.2016
Exchange rate TT$/US$ (end of period)	6.64	Apr.2016	6.59	Mar.2016
Unemployment rate (%)	3.4	Q3 2015	3.2	Q2 2015

Source: Central Bank of Trinidad and Tobago.

Public Finances in Trinidad and Tobago: "I don't think we're in Kansas anymore."

Riding on the wave of booming energy prices, Trinidad and Tobago managed to run moderate fiscal deficits and preserve prudent levels of public debt (Figure 3). In the heydays of high oil and gas prices and buoyant energy revenues, a pro-cyclical fiscal policy boosted expenditure and domestic demand on non-energy sectors. Until FY2013/14, deficits were nonetheless contained and never exceeded 3% of GDP, while the public debt remained within safe margins and reached 41.5% of GDP. Admittedly, these public-finance outcomes compared favourably against the Caribbean standards, as well as the EU Maastricht benchmark.[1]

Figure 3. Public Finances



Source: Central Bank of Trinidad and Tobago.
Note: Revenue, expenditure, and fiscal balance of the Central Government. Official revenue data include asset sales and other one-off transactions, which the GFS conventions treat as below-the-line financing items. Net public sector debt includes Central Government debt and contingent liabilities, and excludes instruments used for monetary regulation. FY2015/16 (br) data correspond to the mid-year Budget Review.

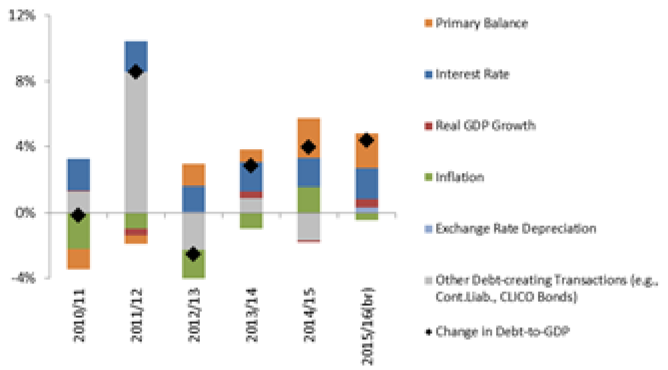
Public finances weakened since late-2014 when energy prices collapsed and the domestic economy stagnated. Energy revenues averaged TT$27.2 billion during the booming years, but dropped by one-third in FY2014/15 and are expected to fall further to TT$9 billion in the current FY. Ad hoc asset sales and revenue measures introduced in the last two Budgets aimed at offsetting the income losses by boosting non-energy revenues, which in the current FY are budgeted at TT$44 billion against TT$30.3 billion raised in FY2013/14.[2] Government expenditures held the line and were barely rationalised in FY2014/15—incidentally, in an election year where it was still uncertain whether the commodity

[1] Yet, Trinidad and Tobago run large budget surpluses before the global crisis, averaging nearly 5% of GDP in 2004–08.
[2] In the FY2015/16 Budget, revenue measures included an increase in fuel prices (with attendant savings in the fuel-subsidy bill); new asset sales; higher business levies; reforms to the VAT regime reducing the statutory rate from 15% to 12.5% while widening the base and removing exempted items; a reintroduction of the property tax on land and buildings; new legislation on transfer pricing and taxation of the gaming industry; reforms to the tax-administration agencies, creating the Revenue Authority; and the split of the Heritage and Stabilisation Fund into a savings fund and a stabilisation fund. In the recent mid-year Budget Review, additional tax measures envisaged new upward adjustments in fuel prices; a levy on online purchases; and an increase in taxation on luxury vehicles, alcohol, and tobacco.

prices would recover quickly or not.[3] A recognition that such a recovery will not happen anytime soon led the new Government to envisage substantial cuts in the current FY, with budgeted expenses amounting to TT$59 billion against TT$62.8 billion spent in FY2013/14.

Debt and asset buffers have smoothly accommodated the emerging, sizable fiscal imbalances. As a consequence of the adverse trends and policy responses to cope with them, the fiscal deficit rose to TT$7 billion—or 4.2% of GDP—in FY2014/15, and a deficit of a similar magnitude is budgeted for the current FY. Mounting budget imbalances are being financed using the borrowing space Trinidad and Tobago built during the booming years and the resources saved in the Heritage and Stabilisation Fund (HSF). Thus, the public debt is projected to reach nearly 50% of GDP by the end of the current FY, a level last seen in the early 2000s, but arguably sustainable and manageable.[4] As far as the HSF is concerned, the current Budget already envisages a US$1 billion drawdown in FY2015/16 and another US$0.5 billion in FY2016/17, thus providing significant financing resources.

Figure 4. Debt Dynamics Decomposition



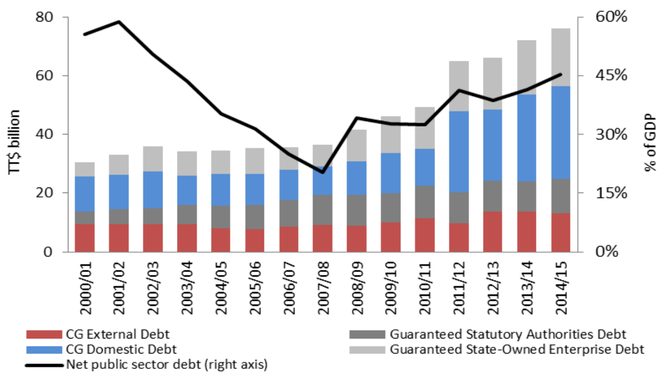
Source: Staff estimates using data from Central Bank of Trinidad and Tobago.

Anatomy of a Judicious Debt Build-up

Budget deficits, guarantees, and the CLICO affair go a long way in explaining the public indebtedness in the post-crisis years (Figure 4). Net public sector debt increased from 32.8% of GDP to 45.4% between FY2009/10 and FY2014/15. A major recurrent debt-increasing factor was the interest burden, which added 9 p.p. of GDP to the debt ratio on a cumulative basis. As primary deficits emerged only since FY2012/13, the contribution from primary balances was a mild 2.8 p.p. Non-recurrent transactions—most notably the guarantees granted to statutory authorities and state enterprises and the bonds issued in the aftermath of the CLICO affair since 2011—also fuelled the debt build-up and added 6.7 p.p.[5] On the other hand, inflation and economic growth acted as debt-reducing factors, subtracting 4.9 p.p. and 0.9 p.p. from the debt ratio, respectively.

Placing debt in domestic markets has been the preferred strategy to meet government financing needs (Figure 5). As funds were raised to finance fiscal deficits and bailouts, and guarantees extended to facilitate statutory authorities' and state enterprises' own borrowings, the stock of net public debt increased by TT$ 30 billion in the post-crisis years (FY2010/11 to FY2014/15). Domestic markets—benefiting from abundant liquidity more often than not—absorbed 60% of the additional debt, mainly through central government securities. Another 24% of the new debt originated in domestic guarantees granted to state enterprises. Notably, the central government has refrained from tapping global financial markets and thus preserved a low level of external debt—around 7–8% of GDP.

Figure 5. Debt Structure



Source: Central Bank of Trinidad and Tobago.

[3] A multi-year public-sector wage agreement led to a large increase in the wage bill, which authorities only partly offset through appropriations reducing expenses in other goods and services.
[4] Own estimate of public debt as of end-FY2015/16 differs from WEO's inasmuch it reflects more recent fiscal and GDP data, including the mid-year Budget Review measures.

[5] Guarantees (TT$31.2 billion) and CLICO bonds (TT$18.3 billion) represented two-thirds of the net public sector debt at end-FY2014/15.

Is fiscal consolidation the way forward? If so, consolidation for what, and how?

Fiscal consolidation should achieve budget savings and rein in deficits. Against the backdrop of large—and presumably protracted—losses of energy revenue, the fiscal policy must put the house in order, reducing the looming budget imbalances and avoiding over-borrowing in the next few years. The central government target of achieving a balanced budget by FY2017/18 provides a broad guidance on the consolidation front, but lacks details. Perfecting the strategy already adopted in the current budget cycle, structural measures—as opposed to ad hoc ones—are now necessary to increase recurrent non-energy revenues and rationalise expenditures in a credible and sustainable manner.

But fiscal consolidation must also be stabilisation- and diversification-friendly. Beyond generating budget savings, a fiscal-policy strategy cannot neglect its capacity (and political responsibility) to help stabilise the domestic economic activity—currently under severe contractive pressures—and to facilitate the economic diversification towards competitive non-energy sectors and away from hydrocarbons—which is arguably the overarching development challenge in today's Trinidad and Tobago. The macro-stabilisation objective requires carefully assessing the short-term effect of revenue-raising and expenditure-cutting measures on aggregate demand, employment, and output, and selecting a policy mix with an adequate profile. Impacts on income sources for vulnerable social groups should not be overlooked either. For its part, the diversification objective—realistically achievable in the medium- to long-term—poses an imperative to formulate and implement reforms to taxes and spending programmes that strongly encourage investment and employment in non-energy sectors exhibiting high potential for productivity growth and foreign-market penetration.

Existing buffers can buy some time to consolidate public finances gradually over the medium term, avoiding a front-loaded fiscal-tightening program. Trinidad and Tobago is undergoing an increasing fiscal distress that requires a budget retrenchment in the next few years. It has a reasonable margin of manoeuvre in the short term thanks to two important buffers: a relatively moderate level of public debt—equivalent to nearly 50% of GDP—with low foreign indebtedness and long maturity, albeit with weakening credit risk ratings; and the financial resources saved in the Heritage and Stabilisation Fund (HSF) during the booming years—estimated to be around US$5.7 billion, of which one-third is the stabilisation component. These buffers can buy some time and enable the government to consolidate gradually and credibly in the next few years, giving due consideration to the objectives of macroeconomic stabilisation and structural diversification. Yet strong political commitment is necessary to resist short-sighted temptations to use (and eventually erode) the buffers to avoid a fiscal adjustment altogether and preserve business-as-usual policies.

Existing buffers can provide fiscal resources immediately but cannot postpone the consolidation for too long. Based on the macroeconomic forecasts elaborated in the latest IMF World Economic Outlook (April 2016), a debt-dynamics simulation suggests that a fiscal policy running annual budget deficits of 3% of GDP from FY2016/17 to FY2019/20 is necessary to stabilise the net public sector debt-to-GDP ratio at 50%—a safe debt level, indeed. In nominal terms, these deficits translate into an annual average net borrowing of TT$5.9 billion in the next four fiscal years.[6] Achieving deficits of 3% of GDP will be challenging because the large capital revenues and HSF resources that helped fund budgets in FY2014/15 and FY2015/16 cannot be tapped forever.

A comprehensive fiscal reform is the appropriate context for a gradual budget consolidation. As long as there is space for the fiscal consolidation to proceed gradually, it is recommended to formulate structural reforms that put the public-finance system in sync with both the expected environment facing the energy sector in the medium-term, and the vision of a diversified economy in the long-term. On the revenue side, excessive tax incentives granted to petroleum companies should be removed, thus finding a more equitable distribution of sectorial rents between private investors and the State. A streamlining of corporate income taxes and VAT, including revision of numerous and dubiously-justified exemptions and zero-rated items, is long overdue. Any tax reform should encourage bringing vast underground activities—estimated to be as large as a quarter of measured GDP—back to formality. And to reap the gains of an enlarged formal economy, tax-administration efforts should target compliance rates. On the expenditure side, having outgrown the budget since the early 2000s and currently absorbing half of it, transfers and subsidies are natural candidates to seek for

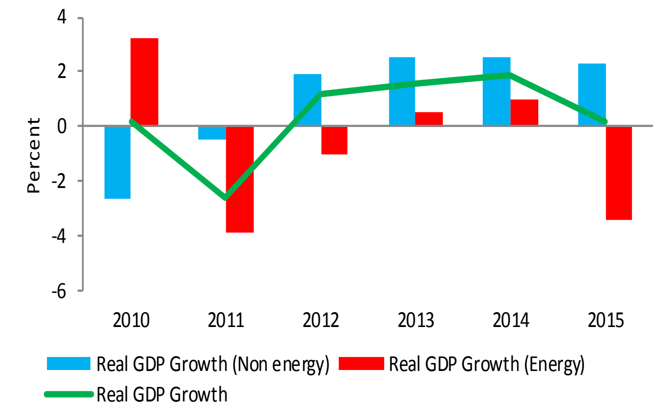
[6] The simulation is predicated upon the IMF WEO's forecast of nominal GDP growth rates, which average 6.2% in 2017–20. If the average growth rate halves, budget deficits of 1.5% of GDP will be required to stabilise the net public sector debt-to-GDP ratio at 50%. In turn, the corresponding annual average net borrowing is TT$2.7 billion in the next four fiscal years.

budgetary savings.[7] Rationalisation of these expenses can also free up resources necessary to upgrade infrastructure, education, and connectivity, key requirements emerging from the diversification strategy. Administrative procedures underpinning expenditure policy—particularly PFM and procurement—also badly need reforms.

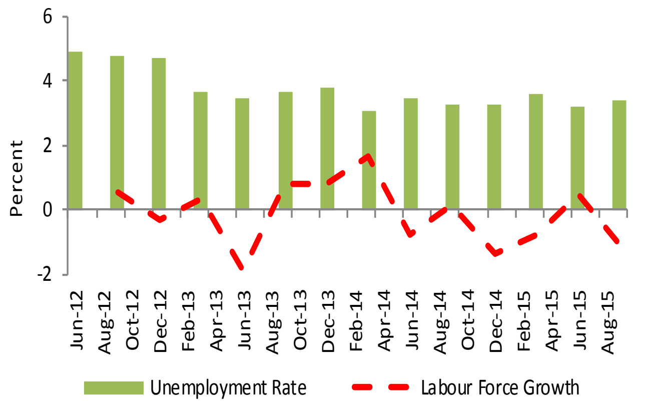
Fiscal policy alone cannot handle the external shock hitting Trinidad and Tobago; instead, it must be part and parcel of a policy mix. It could be very costly in terms of output and employment losses to rely solely on expenditure-reducing policies, such as fiscal consolidation and monetary tightening, to address the large external imbalances and attendant pressures on foreign exchange markets caused by the collapse in energy prices. Given the required external adjustment, a rather large budget retrenchment—whose political viability is questionable—would be necessary to contract economic activity, incomes, and eventually imports. Monetary policy has been tightened already and its contractive effects on credit and output are expected to be felt in the near term. Expenditure-switching policies should be considered as well to curb the demand for imported goods and services, including using the exchange rate policy to help correct an ostensibly overvalued currency in real terms. Arguably, a too-strong currency has boosted imports (both essential and non-essential) to record levels by making them relatively cheaper; concomitantly, it eroded the competitiveness of non-energy exporting sectors and limited the potential profits from import-substitution by raising the foreign currency-value of domestic costs. Thus, it would be wise for a policy mix formulated to cope with the external shock not to leave exchange rate policy off the table.

[7] Using these spending programs to channel rents from the energy sector to the country's citizenry may be a legitimate public policy; however, it is also legitimate to revise them if and when those rents decline drastically and remain depressed for a long while, and even more so when—as it happens—there is an unequal distribution of spending benefits among the citizens.

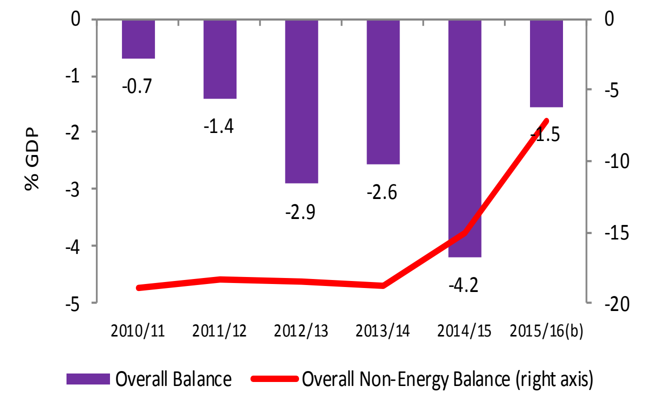
Overall economic activity stagnated in 2015 ...



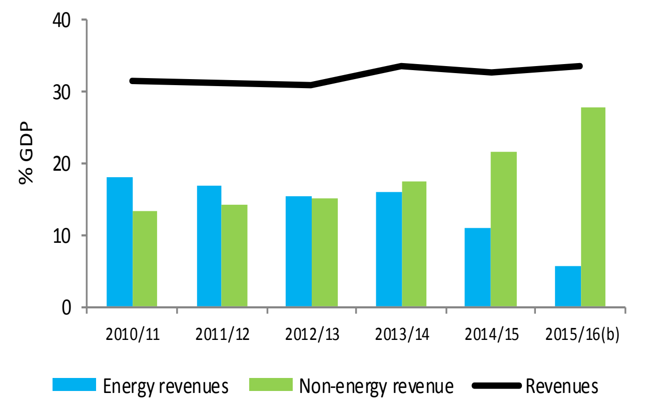
... but the labor market has not weakened yet.



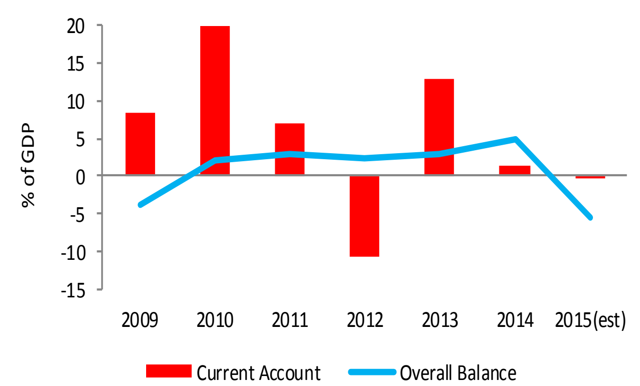
Central Government's fiscal policy gears towards consolidation ...



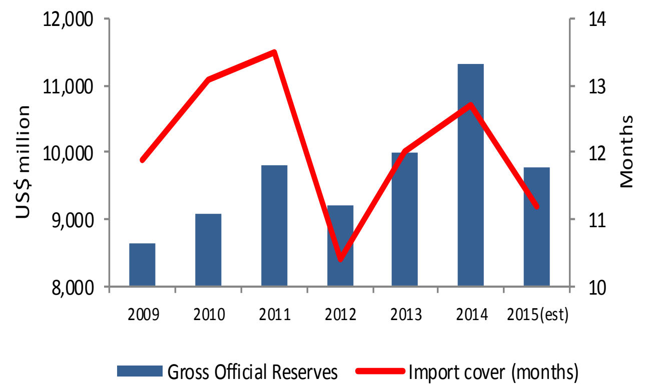
...with measures aimed at boosting non-energy revenue.



Adverse global conditions create external vulnerabilities ...



... and further tighten the foreign exchange market.



Source: Central Bank of Trinidad and Tobago.

TRINIDAD AND TOBAGO

SELECTED INDICATORS

	2010	2011	2012	2013	2014	2015 (P)
	(Annual percentage changes, unless otherwise indicated)					
Real Sector						
Real GDP	3.3	-0.3	1.3	2.3	-1.0	0.2
Real GDP - Energy	2.4	-3.9	-2.8	1.3	-2.4	-3.4
Real GDP - Non-energy	3.2	3.2	2.3	2.6	0.1	2.3
Headline Inflation	10.5	5.1	9.3	5.2	5.7	4.7
	(In percentage of GDP, unless otherwise indicated)					
External Sector						
Exports of goods and services	53.4	61.2	52.5	68.8	50.4	39.5
of which: oil and natural gas	44.8	51.6	39.8	55.7	41.9	30.8
Imports of goods and services	30.9	38.9	47.4	46.3	39.1	34.4
Current account	19.8	7.0	-10.6	12.9	1.4	-0.2
Central Government (on a fiscal year basis)						
Revenue and grants	34.0	31.5	31.3	30.8	33.6	32.7
of which: energy revenues	17.6	18.1	16.9	15.5	16.2	10.9
Current expenditure	28.9	27.6	28.2	28.8	31.3	31.9
Capital expenditure and net lending	5.0	4.6	4.4	4.9	4.9	5.0
Primary balance	2.3	1.2	0.5	-1.3	-0.8	-2.4
Overall balance	0.1	-0.7	-1.4	-2.9	-2.6	-4.2
Debt Indicators						
Net public sector debt	32.6	33.5	39.4	40.2	44.2	52.5
CG external debt	7.5	6.7	6.2	7.4	7.7	7.4
CG external debt service	1.0	1.1	1.2	0.8	1.0	n.d.

Source: Central Bank of Trinidad and Tobago

Contributors: Camilo Gomez Osorio and Shamar Blenman

Recent Developments in 2015[1]

Growth is gradually recovering across the OECS. In 2015, the union grew by an average 1.9%[2]. A more dynamic tourism sector, along with construction and agriculture, supported higher growth. The lower international oil and commodity prices were growth positive, as most inputs for production, fuel, and food are imported. Tropical Storm Erika led the output contraction of -3.9% in Dominica in 2015, while Antigua's economy grew by 2.2%, Grenada by 4.6%, St. Kitts by 5%, St. Lucia by 1.6%, and St. Vincent by 1.6%.

Tourists are returning to the OECS. Growth in long-stay and cruise arrivals had a positive impact on both tradable and non-tradable segments. Total arrivals grew by 9.9% in 2015, mostly from the cruise ship segment, which rose by 13.7% although long-stay arrivals also saw a 2.1% increase (see Table 1). Long-stay tourists from the USA and UK, which account for 60% of the sector, increased by 4.5% and 2.3% respectively. As a result, total spending per visitor increased by 2% to US$1,136.62 million, which is reflective of the more modest economic contribution from cruise ship passengers. Antigua is reaping the rewards of its new international airport and, with heavy marketing and hotel upgrades, managed a 13.5% increase in arrivals for the first three months of 2016.

Table 1: Tourist Statistics (% change), 2014-15

Country	Total Visitors	Long-Stay Visitors by Air	Cruise Ship Passengers	Total Visitor Expenditure
Antigua	13.8	0.5	22.4	-2.2
Dominica	-5.3	-2.9	-7.6	0.3
Grenada	2.8	4.4	3.6	5.9
St. Kitts	26.8	4.4	30.9	7.4
St. Lucia	3.8	2.0	5.6	1.7
St. Vincent	0.8	6.6	-3.6	3.6
OECS	**9.9**	**2.1**	**13.7**	**2.0**

Source: Eastern Caribbean Central Bank

The external position of the OECS had mixed results in 2015. Lower international oil prices facilitated a 2% decrease in imported goods in the union. However, Grenada and St. Kitts saw an increase in imports driven by manufactured goods. At the same time, exports of goods increased by 3.1%, particularly in Antigua and St. Lucia. However, the IMF in its April 2016 World Economic Outlook estimated that the current account improved in Antigua and St. Vincent in 2015, while it worsened in all other countries (See Selected Indicators).

Highlights

More dynamic tourism and construction sectors had a positive impact on growth.

Fiscal consolidation efforts are paying off and most islands achieved primary surpluses.

Reducing debt to 60% of GDP by 2030, the target of the ECCB, would be feasible.

Antigua reported a 13.5% increase in tourist arrivals for the first three months of 2016.

Non-performing loans in the OECS are high. At the end of September 2015, the non-performing loans-to-total loans ratio stood at 18.1% across the OECS—the highest in the Caribbean. As a result, credit conditions remain tight as commercial banks continue to be conservative when lending. Credit to the private sector declined by 6.3% year-on-year at the end of January 2016. Another area of concern for the OECS is the low capital adequacy ratio. While the Eastern Caribbean Central Bank targets a ratio of 10%, the average ratio across the union stood at 14.8% by end-December.

Dominica continues its recovery from Tropical Storm Erika. While tourism has largely been restored, work is still ongoing at the Douglas-Charles airport, although it remains open for business. Current works include: repairs to the three taxi ways, drainage rehabilitation, runway repairs, repairs to the river wall, and construction of an extension to the sea wall. The repairs are estimated to cost US$11.1 million and are expected to be completed by June 2016. The agriculture and manufacturing sectors are, however, still grappling with losses as a result of the storm. Replanting of crops and soil treatment are required to restore agriculture, while the manufacturing sector was hard hit by the closure of the main industrial plant.

St. Lucia will be the home porting destination for the Britannia over the 2016/2017 winter tourism season. The Britannia, a P&O Cruises cruise ship, arrives in St. Lucia on 12 November 2016, and will embark on a total of 28 voyages from St. Lucia. The last voyage will be 4 March 2017.

[1] This bulletin focuses 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.

[2] IMF, World Economic Outlook Database, Antigua and Barbuda, April 2016; Article IV 2015-2016 reports for other countries.

Outlook

The growth outlook for the OECS is positive. More dynamic tourism and construction sectors, especially tourism-related investments, would support output in the union at around 2.2% for 2016 (see Table 1). Growth in St. Kitts (3.5%) and Grenada (3%) would remain dynamic even with a slowdown in construction activity and a decline in CBI inflows. St. Vincent's economy would reach 2.2% with new tourism-related investment in line with the opening of the new airport and an improvement in arrivals. Strong tourist arrivals will support growth of 2% in Antigua and 1.4% in St. Lucia. In Dominica, output would be modest at 1.3% in 2016 subject to the impact from reconstruction efforts and donor grants.

Table 2: Real GDP Growth in the OECS (2015-2016)

	2015 (E)	2016 (P)
Antigua and Barbuda	2.2	2.0
Dominica	-3.9	1.3
Grenada	4.6	3.0
St. Kitts and Nevis	5.0	3.5
St. Lucia	1.6	1.4
St. Vincent and the Grenadines	1.6	2.2

Source: IMF, World Economic Outlook Database, April 2016; 2015-2016 Article IVs

Inflation would remain contained in 2016. With international oil and commodity prices low, the pressure across the OECS would ease over the medium term. However, new tax revenue measures may have an impact on prices in St Vincent.

Fiscal Consolidation Efforts are Showing Results

The average primary balance in the union improved from -0.5 to 2.1% of GDP between 2013 and 2015, while the overall balance narrowed from -3.3 to -0.5% of GDP. Three countries achieved primary surpluses this year: Antigua at 3% of GDP, Grenada at 2.2% and St Lucia at 1.4%. St Kitts maintained its trend of fiscal surpluses at 6.3%, although reporting half of that achieved a year earlier; St. Vincent reached a narrower position at -0.6%, and Dominica maintained its balance unchanged even under spending pressures from the reconstruction efforts (Table 3).

Table 3: Fiscal Balances in the OECS (2010–2015)

		2010	2011	2012	2013	2014	2015
Antigua	**Primary Balance**	1.0	-2.7	1.1	-2.4	-0.2	3.0
	Overall Balance	-1.4	-5.3	-1.3	-4.5	-2.9	0.1
Dominica	**Primary Balance**	-4.6	-6.6	-7.7	-7.4	0.4	0.4
	Overall Balance	-6.1	-8.4	-9.2	-9.5	-1.3	-1.2
Grenada	**Primary Balance**	-0.4	-0.7	-2.1	-3.4	-1.2	2.2
	Overall Balance	-2.4	-3.2	-5.5	-6.5	-4.7	-1.2
St. Kitts	**Primary Balance**	2.8	8.9	17.2	17.1	13.7	6.3
	Overall Balance	-4.3	2.5	11.3	13.3	10.3	4.5
St. Lucia	**Primary Balance**	2.2	-1.8	-3.0	-3.0	0.2	1.4
	Overall Balance	-0.6	-4.7	-6.5	-6.7	-3.6	-2.4
St. Vincent	**Primary Balance**	0.0	-0.2	0.3	-3.7	-1.8	-0.6
	Overall Balance	-2.9	-2.7	-2.1	-6.2	-4.1	-2.8

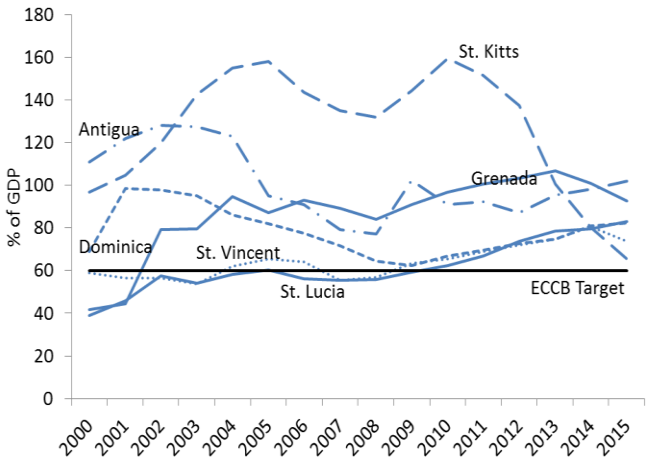
Source: Eastern Caribbean Central Bank.

Citizenship by Investment Programmes (CIPs) contributed to improved fiscal positions. Today, with the exception of St. Vincent, all OECS members have a current citizenship programme. Average inflows rose from less than 1% of GDP in 2008 to an estimated 13% of GDP in St. Kitts and 3.4% in Dominica (2013), respectively. These flows reversed primary deficits into surpluses. While data are limited, non-tax revenues increased from 1.3 to 4.6% of GDP in Antigua between 2013 and 2015, and from 1 to 1.6% of GDP in Grenada over 2014-15 reflecting the performance of CIPs.

CIP revenue inflows are subject to sudden stops. Third-country governance and transparency concerns could risk bringing flows to a halt with the imposition of visa restrictions to OECS nationals. In May 2014, St. Kitts was subject to visa requirements for travel to Canada. As such, these resources could be treated as temporary flows and may be more appropriate for financing investment flows, rather than current spending, which tends to be more rigid and could pose problems if funding comes to a halt.

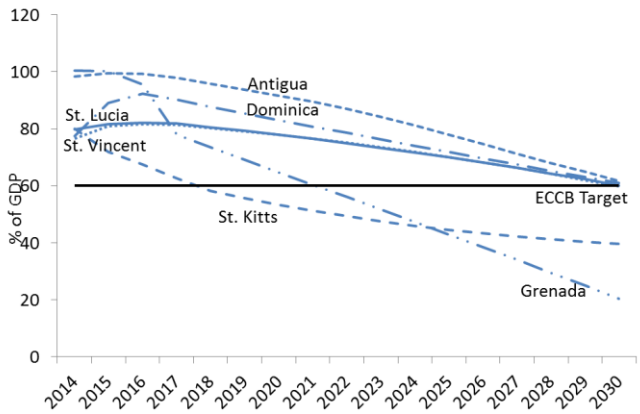
Debt levels across the union remain high at an average 83% of GDP in 2015. Indebtedness rose from 70% of GDP in 2000 from sustained primary deficits, higher interest rates and stagnant GDP growth; frequent natural disasters also contributed to rising trends because countries had limited fiscal space and budget contingencies and borrowed during reconstruction phases. The fact that union members have limited financial market access and do not benefit from concessional financing meant that portfolios carried higher interest rates and shorter maturities.

Figure 1: Debt-to-GDP Ratios in the OECS (2000–2015)



Source: World Economic Outlook, April 2016.

Figure 2: Projected Debt-to-GDP Ratios after Fiscal Consolidation



Source: Author's calculations from Eastern Caribbean Central Bank

Reducing debt to 60% of GDP by 2030, the target of the ECCB, would be feasible if members continue on their fiscal and growth paths.

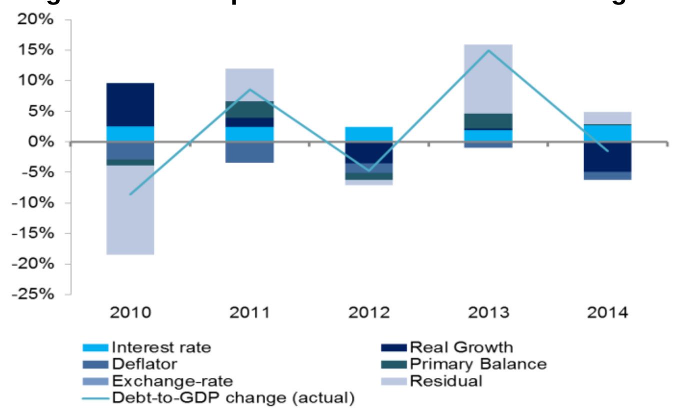
The results of a simulation to assess whether countries would reach this target set forth by the ECCB suggest that members are generally on track. The total additional primary adjustment required to meet it by 2030 would be: 4% of GDP in Dominica, with an average long-term growth rate of 2.2%; 3.25% of GDP in Antigua at an annual real growth of 1.94%; 2.75% of GDP in St. Lucia with 1.31% annual growth to 2030; and 2% of GDP in St. Vincent with real growth of 2.35% to 2030. In contrast, St. Kitts and Grenada are already on a path to achieve the target as a result of their respective IMF programmes.

Country-Specific Analysis

Antigua & Barbuda

Low tax revenue collection and high expenditure on transfers and subsidies drove primary deficits in Antigua. Antigua has the lowest tax collection in the OECS, averaging 18% of GDP over the period 2010-15. On the expenditure side, total expenditure averaged 23.2% of GDP, the bulk of which was current with capital investment averaging 1.4% of GDP over 2010-15. Transfers and subsidies were particularly high at 6.6% of GDP.

Figure 3: Decomposition of Public Debt in Antigua



Source: Author's estimates from Eastern Caribbean Central Bank.

Interest rates were the main contributor to debt. Debt grew at an average rate of 6.7% during 2010-14. Antigua's debt decomposition shows that domestic interest rates contributed most to debt, as 56% of liabilities are held domestically. In contrast, growth had a positive debt-reducing effect during years of dynamic output. With a fixed exchange rate, the effect was neutral. (Figure 3).

Table 4: Macroeconomic Indicators in Antigua

Country	Macroeconomic Variable	2016	2020	2025	2030
Antigua	Real GDP (% change)	1.94	1.94	1.94	1.94
	CPI (% change)	1.20	2.20	2.20	2.20
	Primary balance (% GDP)	-0.18	0.78	2.17	2.29
	Interest (% of GDP)	2.59	2.42	2.09	1.67

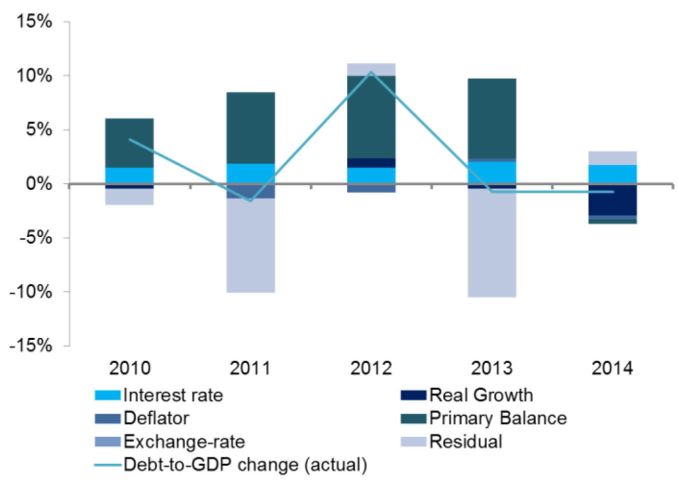
Source: Author's calculations from Eastern Caribbean Central Bank.

Dominica

Public spending widened Dominica's fiscal position. The island had the second highest revenue to GDP ratio in the union, at 29.5% of GDP, but it was insufficient to cover total expenditures at an average 35.5% of GDP over 2010-15. In 2015, tax revenues were significant at 23.1% of GDP. The largest budget items were wages and salaries, averaging 10.3% of GDP, and goods and services at 7.5% of GDP. Capital expenditures were particularly high at 10.7% of GDP, and were above the 6% of GDP average across the OECS.

The primary deficit led the debt-creating flows in Dominica. A closer look at the results of the debt decomposition suggests its fiscal position accounted for over two-thirds of the debt-creating flows. Growth contributed to lower debt in 2014 when the economy was dynamic. Prices did not make a significant contribution to debt reduction. Dominica's debt accumulated at a pace of 4.1% during 2010-14, at a time when primary balances averaged -5.2% of GDP.

Figure 4: Decomposition of Public Debt in Dominica



Source: Author's estimates from Eastern Caribbean Central Bank.

Table 5: Macroeconomic Indicators in Dominica

Country	Macroeconomic Variable	2016	2020	2025	2030
Dominica	Real GDP (% change)	4.00	2.00	2.00	2.00
	CPI (% change)	0.62	2.00	2.00	2.00
	Primary balance (% GDP)	-5.22	0.90	0.98	1.13
	Interest (% of GDP)	1.93	1.86	1.62	1.38

Source: Author's calculations from Eastern Caribbean Central Bank.

Table 6: Macroeconomic Indicators in Grenada

Country	Macroeconomic Variable	2016	2020	2025	2030
Grenada	Real GDP (% change)	2.43	2.40	2.40	2.40
	CPI (% change)	2.05	2.40	2.40	2.40
	Primary balance (% GDP)	3.57	3.99	4.14	4.45
	Interest (% of GDP)	3.36	2.70	1.89	1.08

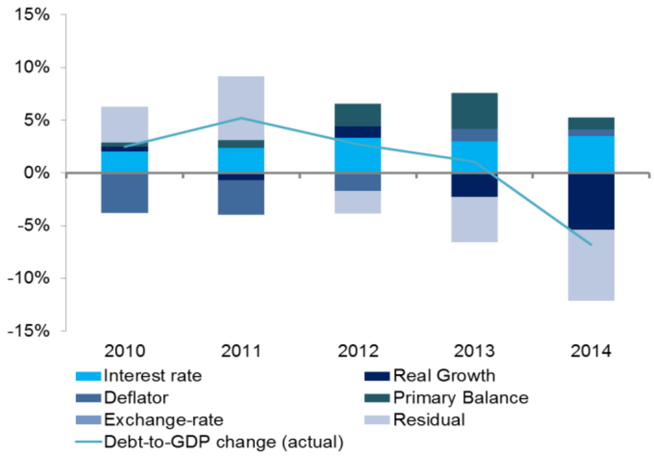
Source: Author's calculations from Eastern Caribbean Central Bank.

Grenada

Grenada is making good progress on fiscal consolidation supported by the IMF's Extended Credit Facility (ECF). The programme that began in 2014 is on track for 7.8% of GDP adjustment over three years. Low tax revenue and high wages and salaries pressure Grenada's fiscal position. Tax revenue collection averaged 19.1% of GDP over 2010-15, but rose to 20.1% in 2015. Expenditure at 26.6% of GDP was low for an upper-middle income country, and by regional standards. Its current spending was amongst the lowest in the OECS, at 19.8% of GDP in 2015. Wages and salaries have shown a downward trajectory since 2013 but remained high at 9.9% of GDP in 2015.

Interest rates, followed by primary deficits, were the leading factors contributing to higher debt in Grenada. Over two-thirds of the debt-creating flows were related to higher external interest rates, as domestic debt accounts for a third of the liabilities. With the country's previous default, external financing became more costly. Sustained primary deficits, averaging -1.6% of GDP over the period, also drove debt accumulation. On the other hand, robust growth during 2013-14 contributed to reduction of debt flows. (Figure 5).

Figure 5: Decomposition of Public Debt in Grenada



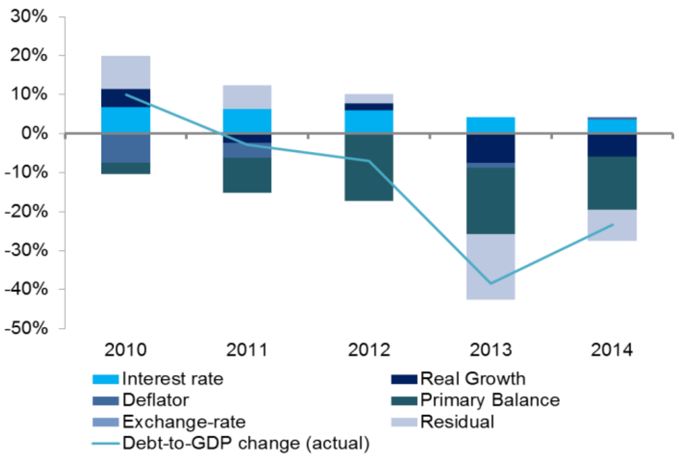
Source: Author's estimates from Eastern Caribbean Central Bank.

St. Kitts and Nevis

Large inflows from the CIP benefitted St. Kitts. The inflows have boosted public investment and driven the expansion in construction and growth. The island managed to repay early a significant share of its obligations to the IMF. Non-tax revenues doubled from 8.8 to 15% of GDP during 2010-15. On the other hand, tax revenue was stable at 20% of GDP. With expenditures averaging 33.3% of GDP, a sudden stop of these inflows would have an adverse impact on its fiscal position. Wages and salaries at around 11.4% of GDP are amongst the highest in the union.

Public debt declined since 2010. The decomposition analysis shows that, unlike peers, the factors contributing to this decrease were the primary surpluses and higher growth; in 2013 and 2014, when the economy was dynamic at 5.8% and 6.5%, respectively, it was evident. The GDP deflator also reduced debt flows in years of higher inflation. In contrast, interest rates were a debt-creating factor. (Figure 6).

Figure 6: Decomposition of Public Debt in St. Kitts



Source: Author's estimates from Eastern Caribbean Central Bank.

Table 7: Macroeconomic Indicators in St. Kitts

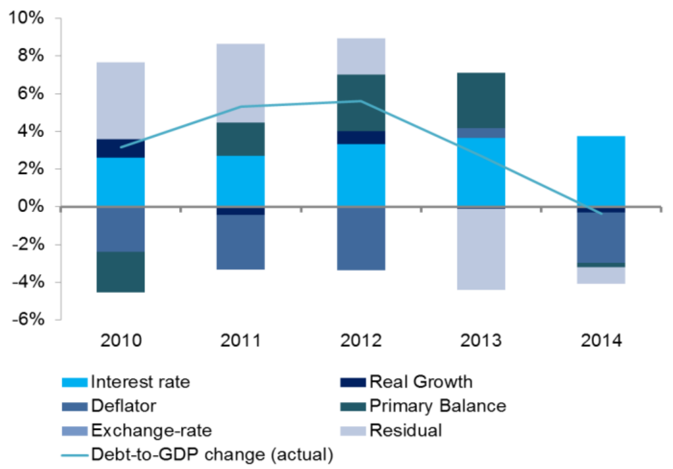
Country	Macroeconomic Variable	2016	2020	2025	2030
St. Kitts	Real GDP (% change)	3.50	2.50	2.50	2.50
	CPI (% change)	-0.25	2.75	2.75	2.75
	Primary balance (% GDP)	5.02	1.81	0.95	0.42
	Interest (% of GDP)	2.95	2.24	1.85	1.62

Source: Author's calculations from Eastern Caribbean Central Bank.

St. Lucia

A combination of higher current and capital spending pressured St Lucia's fiscal position. While total revenue collection averaged 24.9% of GDP, of which tax accounted for 22.2% of GDP, expenditures were much higher. Over the period 2010-15, wages and salaries averaged 10% of GDP, and capital expenditure 6.3% of GDP. in January 2016, the island launched its CIP that would likely yield higher non-tax revenues over the coming years.

Figure 7: Decomposition of Public Debt in St. Lucia



Source: Author's estimates from Eastern Caribbean Central Bank.

Interest rates and primary deficits were the leading debt-creating factors. St. Lucia relied on its domestic market for financing, which came at higher interest rates. The results reflect the impact of sustained primary deficits averaging 2.6% of GDP during 2011-13. In contrast, prices had an opposite effect and contributed to reduce obligations. (Figure 7).

Table 8: Macroeconomic Indicators in St. Lucia

Country	Macroeconomic Variable	2016	2020	2025	2030
St. Lucia	Real GDP (% change)	1.31	1.31	1.31	1.31
	CPI (% change)	2.70	2.50	2.50	2.50
	Primary balance (% GDP)	0.10	2.08	2.38	2.69
	Interest (% of GDP)	3.73	3.63	3.28	2.85

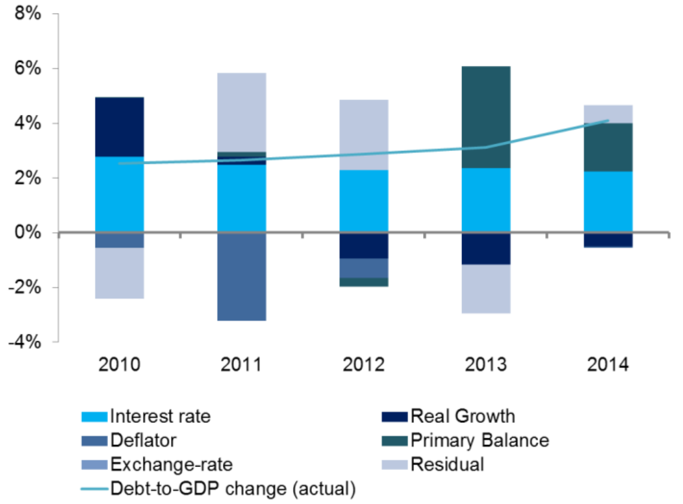
Source: Author's calculations from Eastern Caribbean Central Bank.

St. Vincent and the Grenadines

Wages and salaries pressure St. Vincent's fiscal balance. The island reports the largest public sector wage bill in the OECS averaging under 13% of GDP over the period 2010-15. Tax revenues were relatively high, averaging 23% of GDP. Currently, St. Vincent is the only island that does not receive CIP inflows.

Interest rates have contributed to rising debt flows. Debt grew at an annual rate of 6.2% during 2010-2014. The widening of the primary balance had a particular impact on debt creation in 2013-14. Conversely, when the island saw higher growth during 2012-13, output contributed to reduce debt. (Figure 8).

Figure 8: Decomposition of Public Debt in St. Vincent



Source: Author's estimates from Eastern Caribbean Central Bank.

Table 9: Macroeconomic Indicators in St. Vincent

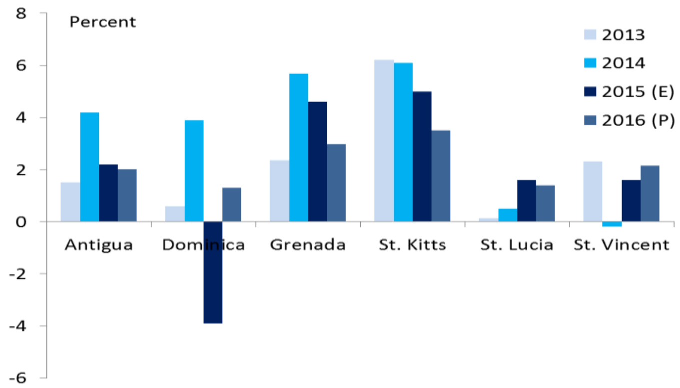
Country	Macroeconomic Variable	2016	2020	2025	2030
St. Vincent	Real GDP (% change)	2.35	2.35	2.35	2.35
	CPI (% change)	1.85	2.50	2.50	2.50
	Primary balance (% GDP)	-1.67	-0.13	0.53	1.17
	Interest (% of GDP)	2.36	2.29	2.08	1.80

Source: Author's calculations from Eastern Caribbean Central Bank.

The OECS Economies at a Glance

Growth is recovering in the OECS

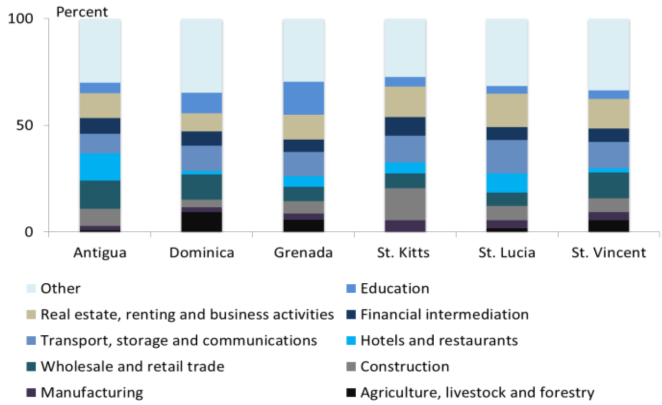
Figure 1: Real GDP Growth



Source: World Economic Outlook, April 2016

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

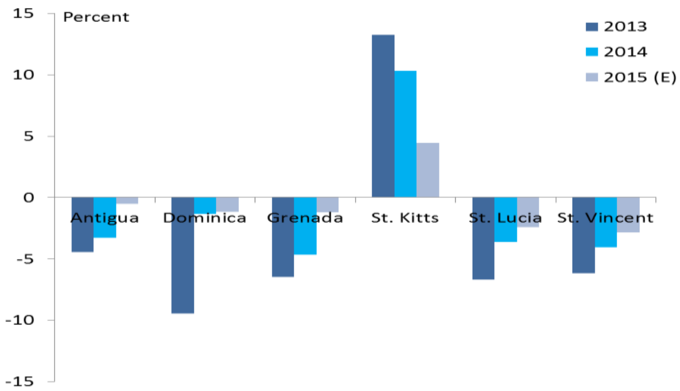
Figure 2: Contribution to GDP, 2015



Source: ECCB

Fiscal deficits are declining…

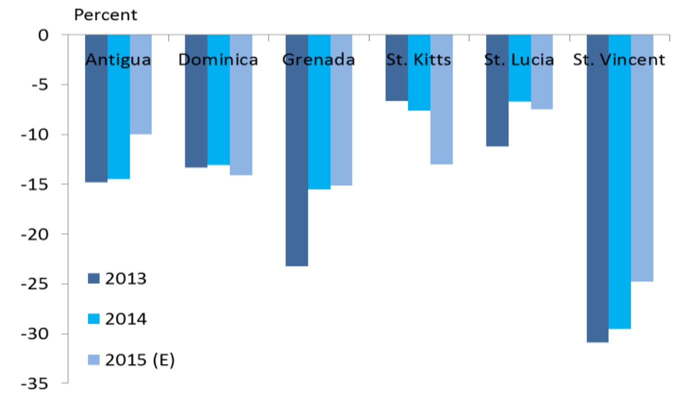
Figure 3: Fiscal Deficit (% of GDP)



Source: ECCB

... current account deficits remain high…

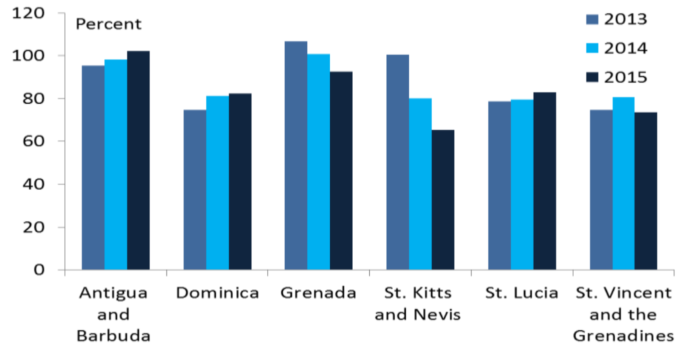
Figure 4: Current Account Balance (% of GDP)



Source: World Economic Outlook, April 2016

…and debt continues to accumulate…

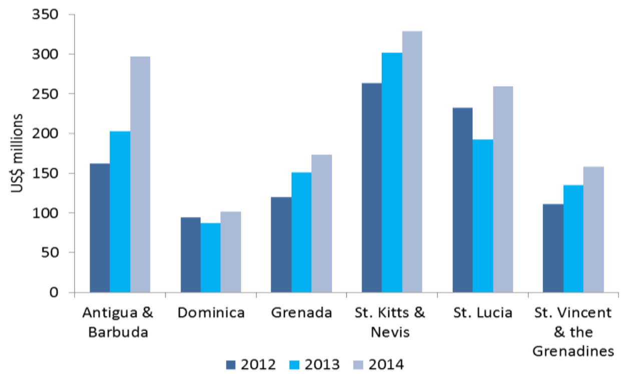
Figure 5: Central Government Debt (% of GDP)



Source: World Economic Outlook, April 2016

…but reserves have improved over time.

Figure 6: Gross International Reserves (US$ millions)



Source: ECCB

Selected Indicators

	Antigua and Barbuda				Dominica				Grenada			
	2012	**2013**	**2014**	**2015 (E)**	**2012**	**2013**	**2014**	**2015 (E)**	**2012**	**2013**	**2014**	**2015 (E)**
Real Sector												
Real GDP (% change)	3.6	1.5	4.2	2.2	(1.3)	0.6	3.9	(3.9)	(1.2)	2.4	5.7	4.6
Nominal GDP (% change)	6.6	(1.6)	5.3	3.1	(3.3)	4.4	3.4	(5.1)	2.8	5.3	8.2	4.6
Inflation (end of period)	1.8	1.1	1.3	0.9	1.2	(0.4)	0.5	(0.1)	1.8	(1.2)	(0.6)	(1.2)
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)	(14.8)	(14.5)	(10.0)	(18.8)	(13.3)	(13.1)	(14.1)	(21.1)	(23.2)	(15.5)	(15.1)
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	18.5	20.6	23.1	27.7	28.0	32.1	31.0	20.7	20.6	24.5	24.9
Current expenditure (% of GDP)	20.6	21.6	21.8	20.5	24.1	25.8	24.8	26.3	21.2	20.3	20.0	17.7
Capital expenditure (% of GDP)	0.6	1.3	1.7	1.5	12.9	11.7	8.6	5.9	5.0	6.8	9.2	8.5
Central government primary balance (% of GDP)	1.1	(2.4)	(0.2)	3.0	(7.6)	(7.4)	0.4	0.4	(2.1)	(3.4)	(1.2)	2.2
Central government overall balance (% of GDP)	(1.3)	(4.5)	(2.8)	0.1	(9.2)	(9.5)	(1.3)	(1.2)	(5.5)	(6.5)	(4.7)	(1.2)
Debt Indicators												
General government debt (% of GDP)	87.1	95.5	98.2	102.1	72.6	74.7	81.1	82.4	103.3	106.8	100.8	92.7

Notes:

(E) - denotes estimated figures

/1 - ECCB and IADB staff estimates for 2014

Source: Eastern Caribbean Central Bank; World Economic Outlook, April 2016

Selected Indicators (Cont'd)

	St. Kitts and Nevis				St. Lucia				St. Vincent and the Grenadines			
	2012	**2013**	**2014**	**2015 (E)**	**2012**	**2013**	**2014**	**2015 (E)**	**2012**	**2013**	**2014**	**2015 (E)**
Real Sector												
Real GDP (% change)	(0.9)	6.2	6.1	5.0	(1.1)	0.1	0.5	1.6	1.3	2.3	(0.2)	1.6
Nominal GDP (% change)	0.5	7.6	8.2	5.1	1.6	1.8	5.2	0.8	2.5	4.0	1.2	3.8
Inflation (end of period)	0.1	1.0	(0.6)	(2.9)	5.0	(0.7)	3.7	(2.1)	1.0	-	0.1	(1.7)
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)	(6.6)	(7.6)	(13.0)	(13.5)	(11.2)	(6.7)	(7.5)	(27.6)	(30.9)	(29.6)	(24.8)
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	46.3	42.5	37.9	23.7	24.5	25.3	26.1	27.0	26.9	28.1	27.3
Current expenditure (% of GDP)	27.7	26.4	26.6	26.6	23.3	23.5	23.3	22.9	26.1	25.2	25.8	25.2
Capital expenditure (% of GDP)	3.7	6.6	5.5	5.7	6.8	7.7	5.7	5.6	2.9	7.8	6.4	4.9
Central government primary balance (% of GDP)	17.2	17.1	13.7	6.3	(3.0)	(2.9)	0.2	1.4	0.3	(3.7)	(1.8)	(0.6)
Central government overall balance (% of GDP)	11.2	13.2	10.3	4.5	(6.5)	(6.7)	(3.6)	(2.4)	(2.1)	(6.2)	(4.1)	(2.8)
Debt Indicators												
General government debt (% of GDP)	137.4	100.4	80.2	65.5	73.7	78.6	79.7	83.0	72.0	74.7	80.6	73.6

Notes:

(E) - denotes estimated figures

/1 - ECCB and IADB staff estimates for 2014

Source: Eastern Caribbean Central Bank; World Economic Outlook, April 2016

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

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