Caribbean Region Quarterly Bulletin

2016:IV

Recent Developments and Prospects

Volume 5, Issue 4 | December 2016

IDB Country Department Caribbean

Contents

Challenges Continue

This edition of the Quarterly Buletin discusses recent economic developments in the Caribbean and gives an outlook for 2017 and beyond. In addition, given weak economic growth accompanied by fiscal challenges, the country contributions explore whether changes in fiscal policy could accelerate growth.

Selected Indicators	Real Growth Rate	Annual Inflation (% end of period)	General Government Primary Balance (% of GDP)	General Government Overall Balance	Current Account balance (% of GDP)	General Government Gross Debt (% of GDP)
Jamaica	1.7	4.8	7.0	-0.6	-2.8	123.9
Barbados	1.4	0.3	0.2	-7.8	-2.5	145.4
The Bahamas	0.3	1.0	0.4	-2.4	-11.4	74.1
Guyana	2.6	2.1	-4.5	-5.4	-3.0	52.3
Trinidad and Tobago	-2.3	4.0	-0.5	-5.0	n.a.	61.0
Suriname	-9.0	60.0	-2.6	-4.1	-4.2	70.0
CCB Average	-0.5	12.4	-0.2	-2.5	-3.0	85.0

Source: International Monetary Fund and country authorities.
Note: Year is 2016 or closest available date. Barbados debt figure includes holding of NIS.

Summary of Economic Update by Country

Economic activity in the **Bahamian** economy remains sluggish, with growth projected at 0.3 percent in 2016. In the first week of October 2016, Bahamas was struck by Hurricane Matthew with estimated damage of US$400 million. In spite of weak economic grwoth, the economy remains stable with gross international reserves forecasted to remain at stable levels and inflation projected to be lower than the previous year-end period. However, double-digit unemployment and the higher share of non-performing loans continue to constrain private credit.

A favorable external environment was growth positive for **Barbados** in 2015. Tourism arrivals rebounded and lower oil prices contributed to improve the external position. However, international reserves continue under pressure, and greater fiscal effort is needed to stabilize the increasing public debt.

Guyana's economy remains tethered to gold, which has supported real GDP growth and contributed to improvements in the external current account, along with low oil prices. Fiscal stimulus is heavy on transfer payments, while severe challenges remain in implementing the public sector investment program (PSIP). Guyana was removed from the FATF watchlist even though de-risking concerns remain.

The **Jamaican** economy remains stable with a positive outlook. Jamaica entered a new Stand-By Arrangement with the IMF, replacing the Extended Fund Facility that would have ended in March 2017. Economic growth forecasts for FY2016/17 have been increased after a strong performance in the third quarter or 2015.

Suriname's economy faces a deep recession amidst slow progress in the reform agenda. The economy is expected to contract significantly but improvements are likely for the current account and fiscal balances. The country makes its first appearance in the international bond markets and is taking additional time for the removal of subsidies to the electricity company through the implementation of higher tariffs.

The economic situation in **Trinidad and Tobago** was marked by lower oil and gas prices. Economic activity contracted in both 2015 and 2016 but is likely to rebound in 2017. Temporary disruptions in 2016 in the petroleum industries are expected to pass and production to normalize next year. Conversely, stagnant non-energy activity is likely to continue, and expenditure cuts are maintained in the FY2016/17 Budget, keeping fiscal policy remains austere.

The **Eastern Caribbean** is experiencing a tourism-led recovery, and fiscal consolidation efforts are paying off with countries achieving primary surpluses. Tropical Storm Matthew had an adverse impact on St. Lucia's agriculture sector, but Dominica made progress on its reconstruction and infrastructure rehabilitation efforts as a result of Tropical Storm Erika.

Special Regional Report: Prospects for the Caribbean

The regional supplement looks back on economic developments in 2016 and gives an outlook for 2017 and beyond.

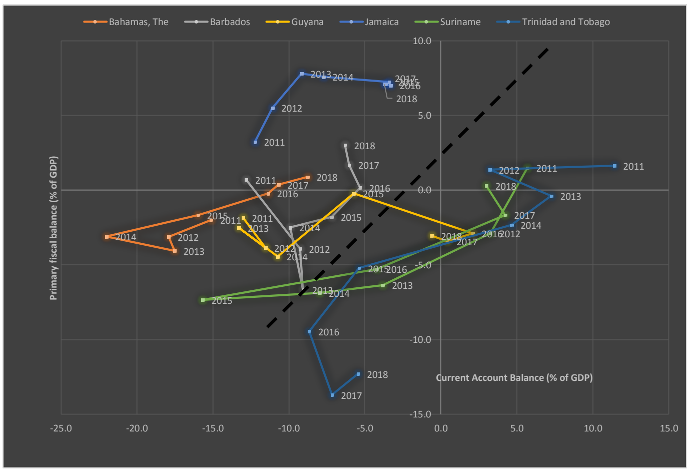
Contributor: Inder Jit Ruprah

Regional Overview: Recent Developments and Prospects

Caribbean's macroeconomic performance worsened in 2016 but is expected to improve in 2017.[1] Average economic growth fell from a low of 0.2 percent in 2015 to -0.4 percent in 2016. Simultaneously, debt to GDP increased from 71 to 73 percent, and the primary fiscal deficit increased from 1.5 to 1.8 percent of GDP. On the back of lower oil prices, the current account of the balance of payments improved from -8.9 to -5.1 percent of GDP. The unemployment rate remained at 19 percent and is expected to increase slightly in 2017. Economic growth is expected, according to the IMF World Economic Outlook in October 2016, to be 1.9 percent in 2017, the primary fiscal balance deficit to be reduced by half, and debt to GDP and current account of the balance payments to GDP to be of similar values as in 2016.

However, the overall macroeconomic performance and outlook of the Caribbean masks large divergences between tourism-dependent and commodity-dependent countries. The former's economic performance is characterised by improvements and the latter's performance as the opposite.

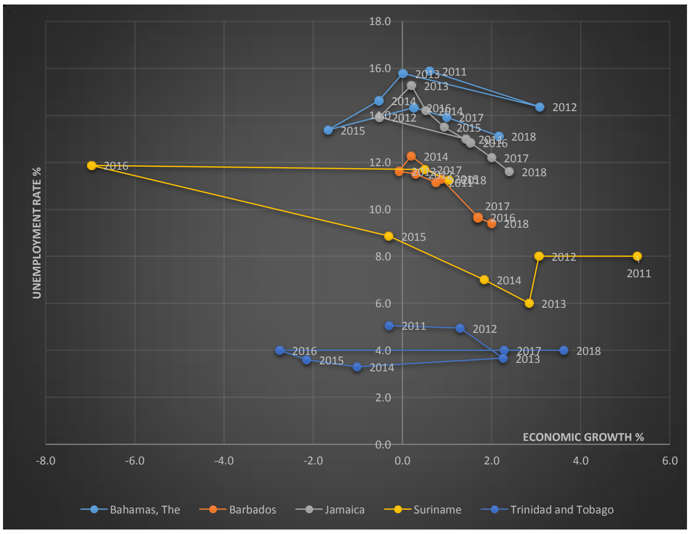
Figure 1. Fiscal Deficit and Current Account of the Balance of Payments (percent of GDP)



Source: IMF WEO October 2016. Figure is based on the identity: current account of balance of the balance of payments is equal to the fiscal deficit plus domestic private sector's financial balance.

The economic performance of the Caribbean tourism countries, Jamaica, Barbados, and The Bahamas, continued to improve. These countries are benefiting from windfall gains from a decline in the world price of commodities: a lower oil import bill, plus an ongoing boost from outbound travel in key tourism source countries plus higher remittances. These developments engineered an improvement in Jamaica, The Bahamas, and Barbados' external positions (-8.1 to -5.1 percent of GDP) at a time of improved economic growth (from 0.1 percent in 2015 to 1.2 percent in 2016) and fiscal consolidation (1.3 to 2.3 percent of GDP). Growth in Jamaica, The Bahamas, and Barbados is forecast to modestly improve but remain muted (an average of 1.6 percent) in 2017.

Figure 2. Economic Growth and Unemployment Rate (percentage points)



Source: IMF WEO October 2016. Note: Guyana does not produce unemployment data.

The economic performance of the Caribbean commodity-dependent countries, Guyana, Suriname, and Trinidad and Tobago, worsened. Caribbean commodity-dependent countries, in contrast, have been hit hard by the end of the world commodity cycle. In 2016, economic growth declined (from 0.3 percent in 2015 to -1.9 percent in 2016), primary fiscal balances increased (from -4.3 to -5.9 percent of GDP), and public debt rose (from 45.7 to 49.7 percent of GDP).

Trinidad and Tobago, with its fiscal buffer, the Heritage Fund, can make adjustments gradually, although the primary fiscal balance almost doubled to 9.5 percent of GDP and is expected to further deteriorate to 13.7 percent of GDP in 2017.

Suriname, without a buffer, does not have that luxury; hence, its fiscal balance decreased in 2016 to -5.7 percent of GDP in 2016 and is expected to decline further, to -1.7 percent of GDP in 2017. Not being able to buffer the adjustment, Suriname adopted a stabilisation

[1] The figures in this regional review, for comparison purposes, use exclusively data from the IMF's October World Economic Outlook; hence, they may differ from the data in individual country reports.

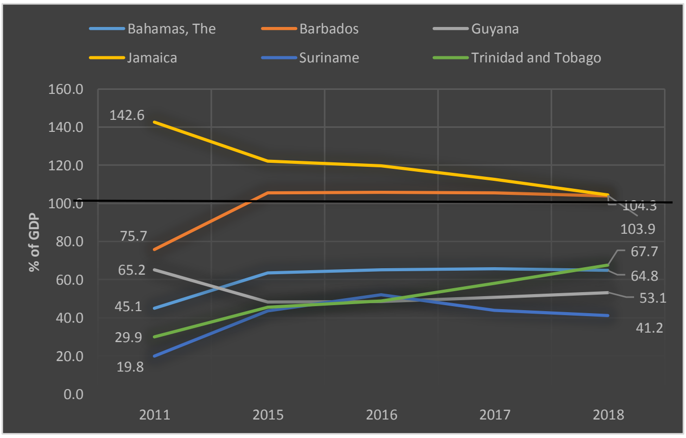
stance, including an IMF-approved program. Currently it is off-track with that program.[2]

Guyana also had space to manoeuvre, as the fiscal balance was -0.2 percent of GDP in 2015. The authorities, therefore, have adopted a countercyclical fiscal stance by increasing the primary balance to 2.9 percent of GDP.

Growth prospects for 2017 are an average of 2.3 percent for commodity-dependent Caribbean countries (ranging from 4 percent for Guyana, 0.5 percent for Suriname, to 2.3 percent for Trinidad and Tobago.

Overall, the Caribbean has become one of the most indebted regions in the world. The gross government debt-to-GDP ratio has risen to an average of 74.3 percent of GDP, which is above sustainable levels for small, open, and undiversified economies (about 60 percent of GDP). Commodity-dependent countries, absent fiscal adjustment, are beginning to join the tourism-dependent countries that already have debt above that threshold and have been unable to reverse their rising trajectory. Jamaica is the exception, as the country, through a policy of a 7.0 percent of GDP and above primary fiscal balance, has started on a debt-reduction trajectory.

Figure 3. Public Debt to GDP (percent)



Source: IMF WEO October 2016.

The region's economic woes are exacerbated by its geographical location plus international downside risks that, if realised, will worsen economic performance. The Caribbean is one of the most disaster-prone areas in the world, with tropical storms and floods estimated to cost the region approximately 2 percent of GDP per year. Storms are expected to increase in frequency. The subdued world economic growth of 3.1 percent forecasted for 2017 by the IMF carries warnings of downside risks. "These forces include new shocks, such as Brexit; ongoing realignments in China and among commodity exporters; slow-moving trends in demographics and productivity growth, as well as noneconomic factors, such as geopolitical uncertainties."[3]

Against this backdrop, sovereign credit ratings -that are beginning to formally include climate change effects into their analysis- do not paint an optimistic outlook: Credit rating agencies currently hold a negative outlook for Trinidad and Tobago, Suriname, The Bahamas, and Barbados. Guyana is not rated. Jamaica is again the exception, with a positive outlook.

[2] The trajectory of Suriname in this section assumes that the country follows the IMF program.

[3] See: http://www.imf.org/external/pubs/ft/weo/2016/02/

Contributor: Alllan Wright

Overview

The Bahamas faces a modest growth outlook. Growth has been stagnant, averaging 0.5 percent over the past 10 years. Estimates suggest that real GDP is projected to grow by 0.3 percent in 2016, compared with -1.7 percent a year earlier. Growth improved mainly because of increased tourist arrivals of 1.7 percent. The Government's strategy has been to promote growth through the provision of incentives, airlift subsidies, and tax concessions, to encourage large, private tourism-related capital projects, and to enable a faster recovery over the medium term. Specifically, two major infrastructure projects will support the recovery: the Baha Mar Casino and Hotel (US$3.5 billion) and the Freeport Container Port (US$300 million).

Post-Hurricane Matthew construction activities will be growth positive. Hurricane Matthew damaged sections of northern and central parts of The Bahamas. Grand Bahama, North Andros, New Providence, and Berry Islands were the most affected areas, with initial estimates of US$400 million in damages, or roughly 4 percent of GDP. Public financing of US$150 million will be sought to settle for recuperation and remaking costs.

Recent Developments

The Baha Mar mega resort project is now expected to open in early 2017. Total investment was approximately US$3.5 billion, the resort yielding over 2,200 direct jobs, and creating tax revenues of US$315million and US$2 billion in economic impact. The Government of The Bahamas (GoBH), announced the commencement period of the US$300 million expansion of the Freeport Container Port and the creation of an additional 600 jobs for the final quarter of 2016. Both capital ventures are expected to make outstanding contributions to gross domestic product, enhance factor efficiency, and improve competitiveness.

The Bahamas' fiscal position will be affected by Hurricane Matthew in 2017. The primary balance for 2016/17 is estimated to be 0.4 percent of GDP, an improvement from a deficit of -0.2 percent in the previous fiscal year. However, with the impact of Hurricane Matthew, the government is expected finance recuperation costs of essential public services and infrastructure.[1] As a result, the primary balance could worsen to about -0.7 percent of GDP in the current fiscal year and 0.4 percent in the next fiscal year relative to the pre-hurricane shock forecasts.

> ***Highlights***
>
> *Real GDP expected to grow by 0.3 percent despite the impact of Hurricane Matthew.*
>
> *Baha Mar Casino and Hotel project expected to be operational by the end of 2016/17 winter season.*
>
> *Expansion of Freeport Container Port expected to start in October.*
>
> *Restructured primary expenditure can be growth positive.*

Tourist arrivals are increasing and stabilising the real sector contribution, but risks persist. Air arrivals expanded steadily by 2.7 percent to June 2016. However, the largest category, sea landings, contributed 1.5 percent, resulting in growth of 1.7 percent in overall total arrivals. The Ministry of Tourism has amplified efforts in adding new connections and direct flights from continental Europe and western markets within the United States. On August 7, Southwest Airlines started a new daily nonstop service from Fort Lauderdale to Nassau, connecting the archipelago to the entire Southwest network.

There has been an improvement in the external position, due in large part to lower international oil prices. Coming from 22 percent of GDP in 2014, the current account deficit declined to approximately 11 percent. Lower global oil prices and the reduction in construction imports from the stalled Baha Mar project have improved the external position. Investment in energy reforms, within an environment of persistent low oil prices, will be credit positive for the economy, as the current deficit is financed by inflows from private and real estate investment, which could pose downside risks if there is any change in confidence.

The implementation of a value added tax, financial sector fees, and updates to the property tax system have enhanced revenue collection, with the overall primary balance projected at 0.4 percent (vs. negative 1.7 percent in 2013/14). The current medium-term fiscal program (MTFP) will aid consolidation, and with the widening of the recovery, there is hope that fiscal balances will gradually improve in the medium term, and assist in a gradual decline in the overall central government and publicly guaranteed debt, which currently stands at 74 percent of GDP.

[1] During the first week of October, a category four (4) hurricane struck parts of central and northern Bahamas (the most affected areas were **Grand Bahama, North Andros, New Providence and Berry Islands) with still preliminary estimates of** US$400 million in damages.

Debt remains high, and above the targeted level within the MTFP. Weak economic performance has impacted the fiscal outcome. The IMF 2016 report suggests that, despite notable progress at fiscal consolidation, more systematic implementation of other fiscal reforms will be required in the forthcoming periods, including to the National Insurance Board (NIB) pension fund.

Beyond the medium term, the national insurance system could pose a risk to fiscal sustainability and debt. The NIB pension, which remains unfunded, represents approximately 50 percent of GDP. With the BD$1.7 billion reserve fund being exhausted in 2029 (IMF, 2016), this could trigger a fiscal crisis and large increases in national debt, beyond the already high levels. The corrective actions recommended by the IMF include: raising the retirement age to 67, freezing benefits for a two-year period, and increasing contributions to 16.2 percent from 10.8 percent. The likelihood of this happening within the near term following Hurricane Matthew and already weak domestic consumption from troubling double-digit unemployment appears remote and therefore presents a downside risk to the economy.

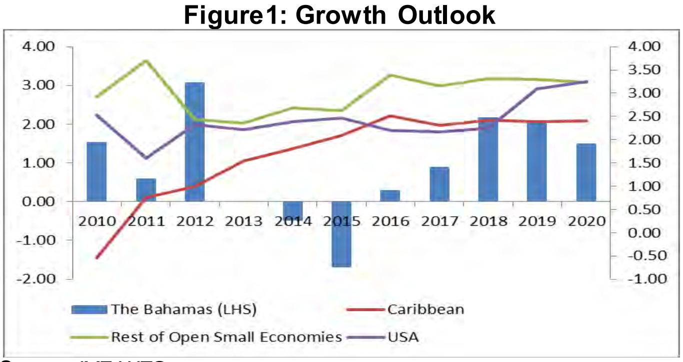
Moody's downgraded the sovereign ratings to Baa3 with a stable outlook in August 2016. A less than robust growth outlook and increasing debt were the reasons given for the downgrade. However, efforts to strengthen the economic performance and reduce the overall deficit have accounted for the stable outlook. For Standard and Poor's (S&P) weaker than expected growth prospects, the high level of non-performing loans, poor asset quality, reduced private sector credit, and alarming unemployment rates were the factors underlying the current credit rating at BBB-.

Low levels of private sector credit, growing non-performing loans and threats of de-risking pose downside risks to the financial sector. The level of private sector credit continues its steady decline in 2016, caused by the slowing economic outlook (concerning double-digit unemployment and the previous uncertainty with the Baha Mar project). Juxtaposed with the overhang from the financial crisis of 2008, the financial sector continues to experience high levels of non-performing loans (NPL) and weak credit. Credit risk levels have risen for the sector, particularly for mortgages, which now account for 54 percent of non-accrual loans, even within the context of a well-capitalized and liquid financial industry.

The Bahamas has been experiencing challenges within the financial sector from the terminations of correspondent banking relationships, through the severing of business relations with clients perceived as high risk, particularly with remittance services and cash-intensive transfers. At this time, there appears to be no material impact on the financial sector. However, if there were de-risking among several entities within the financial sector, this could signal the beginning of a systemic risk within the economy. Enhancement of the regulatory compliance framework is needed to help combat the ongoing threat of de-risking.

Outlook

Figure1: Growth Outlook

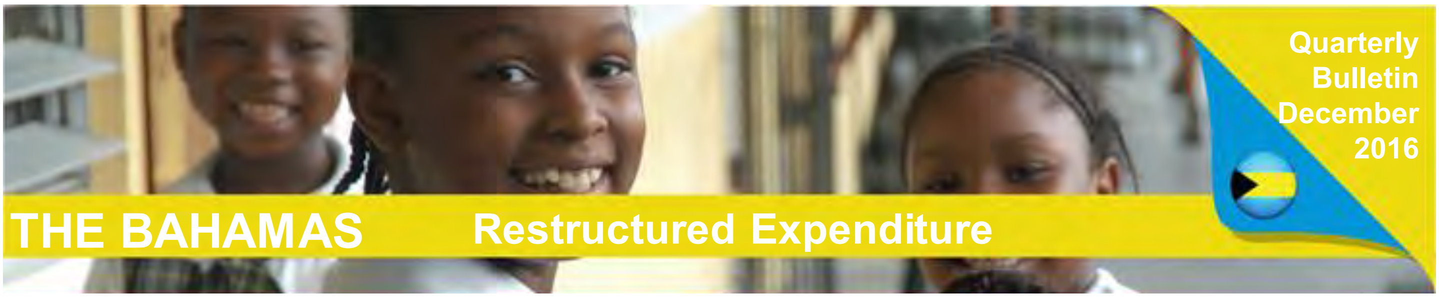


Source: IMF WEO.

After the past two periods of decline, growth for 2016 is expected at 0.3 percent, below comparable economies within the Caribbean and ROSE. The Baha Mar Casino and Hotel, which is expected to be operational by the end of the winter season 2017, and the Freeport Container Port expansion expected to start in October 2016 are both projected to be major contributors to long-term growth.

Conclusion

Growth is forecasted to be modest. The resumption of work on Baha Mar Casino and Hotel and the expansion of the Freeport Container Port capital projects will enhance total factor productivity and improve cost competitiveness within the economy. Improved air and sea landings will bring stability to the real sector, as the Government's fiscal consolidation program reduces the overall deficit. External conditions have contributed to the better external position, even as reserves remain stable.



Introduction

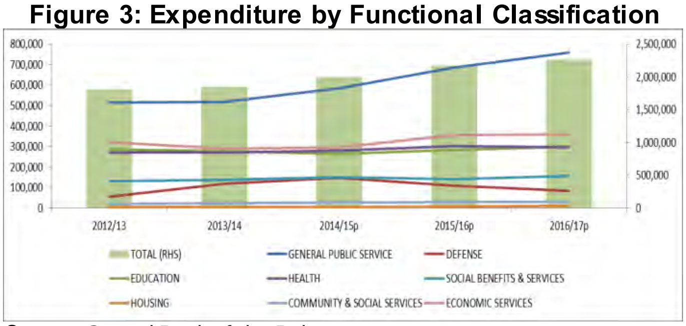
With fiscal consolidation being the goal for many Caribbean economies, can restructured primary expenditure be used to enhance growth? There is sufficient worldwide evidence after the global financial crisis (GFC) that stimulus packages, primarily including tax cuts and increased spending by governments, can be short-term growth positive and stabilize the economy. However, can a restructured primary expenditure be long-term growth positive within the context of keeping the overall fiscal position stable?

A decomposition of The Bahamas central government expenditure by economic and functional classifications shows that within the last six periods 2010/11 to 2015/16, total spending has increased by roughly 26 percent, current expenditure grew by 27 percent, while capital spending moved by 18 percent. Within the functional classification, the largest increases were observed with Housing and Defense (both doubling), Community and Social Services by 52 percent, while General Public Service, including general administration, by 32 percent. Education spending is projected to decline, while health care spending is estimated to increase by 5 percent.

Figure 2: Total, Current, and Capital Expenditures

Source: Central Bank of the Bahamas.

Figure 3: Expenditure by Functional Classification



Source: Central Bank of the Bahamas.

Using an integrated approach[2] based on a procedure of production maximization and expenditure factors, we determine the elasticities of real output/GDP with respect to labour, capital formation, human capital, and different types of government spending (capital, current, and functional areas). We applied the dynamic ordinary least squares (DOLS) procedure in uncovering the long- and short-run estimates for the determinants of GDP, as it performs better in small samples than other estimators and it reduces the problem of endogeneity. The analysis was performed on data obtained from the IMF WEO database and Central Bank of The Bahamas Quarterly Statistical Digest (August 2016 report).

The long-run estimates show that capital expenditure, foreign direct investment, secondary school enrollment, and the labour participation rate as proxies for capital formation, human capital, and labour are all significant and show the expected signs. The robustness checks show the model is well specified with no evidence of autocorrelation or non-normal residuals.

An enhancement of the original model to include expenditure from the functional areas shows the past four variables remain significant, and education, health, and economic services are also now contributors to long-term growth within the economy. For policy makers, these results show that a long-term sustainable growth path can be achieved with investment in education, health, services related to the economy, such as air and shipping transportation, tourism, and improved value chain linkages to agriculture and fisheries.

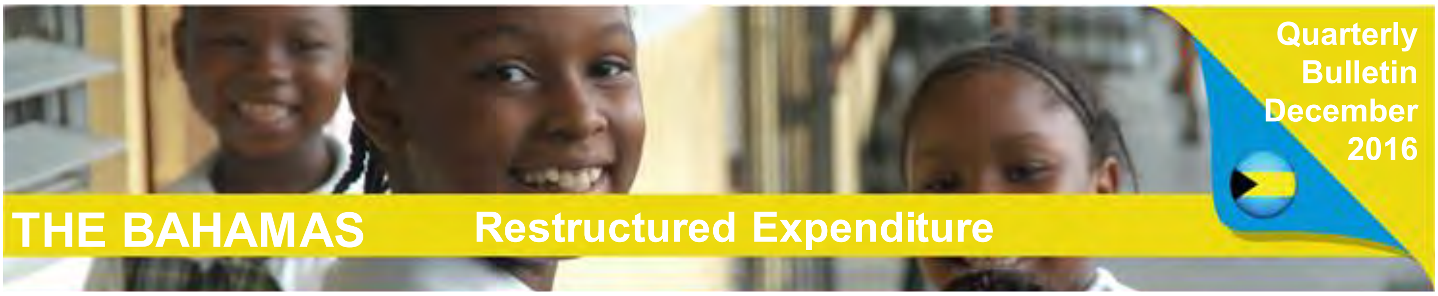
The key conclusion, therefore, is that a restructured primary expenditure towards capital expenditure, investments in education, health, and other economic services can be long-run growth positive, with no further increases in the overall fiscal position.

Long-run growth and development were not influenced by current expenditure, which primarily included consumption of goods and services, personal emoluments, transfers, and subsidies. However, this category was found to be a short-term stimulus for the economy and suited for providing a quick response to exogenous shocks to the economy (including natural disasters).

Vision 2040, the national development plan for The Bahamas, outlines several areas that—once addressed—could place the economy on a sustainable path for long-term growth. Investment in specific sectors

---

2 $\Delta(\phi)=\prod\phi_{t-1}+\sum_{i=1}^{k-1}\alpha\Delta\phi_{t-1}+\delta\gamma_t+e$



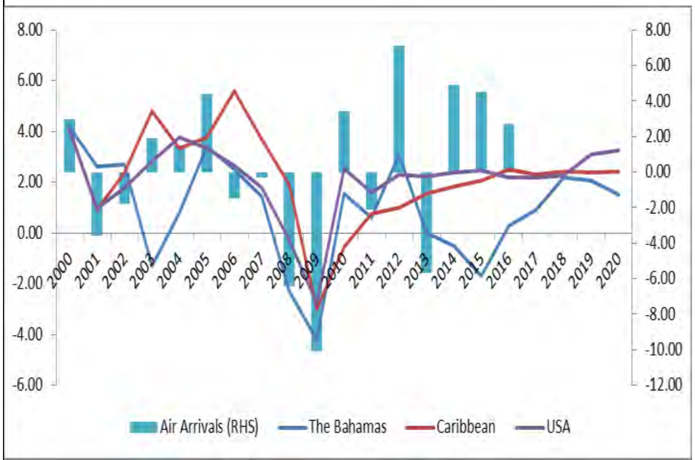
would develop an adequately trained workforce through targeted growth in educational services, improve efficiency and competitiveness of economic-related services such as air, sea, road transportation; energy generation, and distribution; create a sustainable tourism product; and effectively contribute to varied scale foreign infrastructure investment projects. Our analysis indicates that a restructuring of primary spending towards targeted sectors can be long-term growth positive while maintaining fiscal prudence and reversing the current trajectory of the national debt.

Restructuring of primary spending, targeting key sectors with expenditure of capital, education, health, and economic services will significantly contribute to varied scale investment projects and will be long-term growth positive. Creative ways must be found that will help to enhance total factor productivity, the key driver of potential growth, while maintaining a balanced fiscal position.

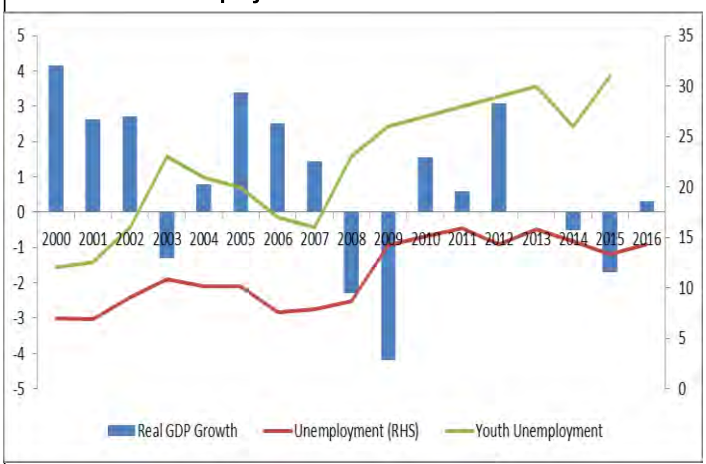
Table 1: Dynamic Ordinary Least Squares

Dynamic Ordinary Least Squares	Model A	Model B	Model C
Constant	0.02	1.54	0.78
FDI_GDP	1.49	1.08	0.92
Labour_Force	0.0021	0.086	1.24
School_Enrolement	2.703	1.46	1.05
Capital Exp_GDP	1.58	0.95	2.94
Education Exp		0.52	1.62
Health Exp		0.0039	0.0216
Economic Serv. Exp		2.81	1.83
Current Exp			1.81
Error Correction Term			0.181

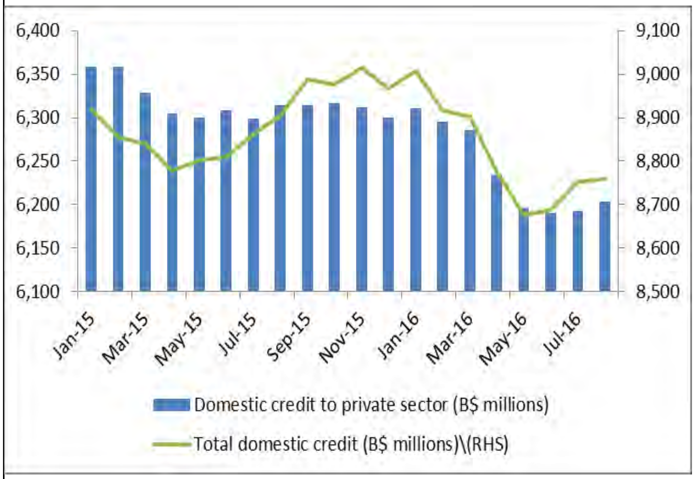
Real GDP Growth and Air arrivals



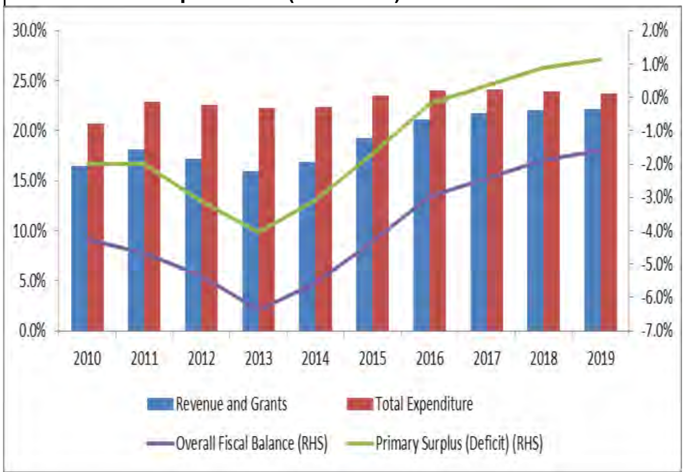
Real GDP and Unemployment



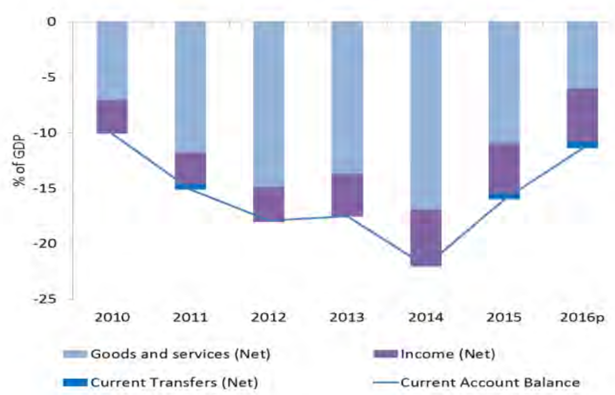
Private sector credit



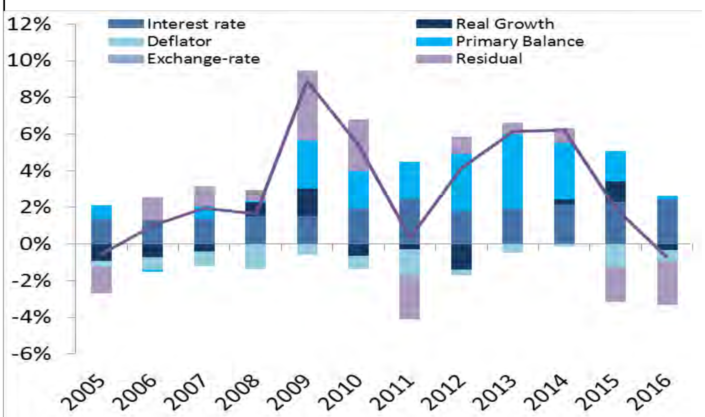
Revenue and Expenditure (% of GDP)



Current Account Balance



Debt Decomposition - Drivers of Debt Growth



Source: The Central Bank of The Bahamas, Ministry of Tourism, and International Monetary Fund's World Economic Outlook.

Table 2: Selected Indicators for The Bahamas, 2011-2016

Social and Demographic Indicators (most recent year)			
GDP (US$ millions), 2016	9,035	Adult literacy	95.6
Per capita GDP (2015,US$)	23,903	Poverty rate (percent), 2014	12.8
Life expectancy at birth in years (2015)	76.1	Population (thousands), 2015	364
Rank in UNDP Development Index (2014)	55	Unemployment (May 2016)	12.7

Economic Indicators

	2011	2012	2013	2014	2015	2016
(Annual percentage change, unless otherwise indicated)						
Real Sector						
Real GDP (% change)	0.6	3.1	0.0	-0.5	-1.7	0.3
Nominal GDP(% change)	-0.3	6.5	1.5	1.1	2.7	2.2
Inflation (end of period)	3.0	0.7	1.0	0.2	2.0	1.0
Unemployment	15.9	14.4	15.8	14.6	13.4	14.3
(In percent of GDP, unless otherwise stated)						
External Sector						
Exports of goods and services	43.6	44.4	43.8	42.5	38.6	40.4
Imports of goods and services	57.3	59.3	56.3	61.3	47.1	44.1
FDI	8.4	6.3	4.5	2.9	1.3	0.3
Current account balance	-15.1	-17.9	-17.5	-22.0	-16.0	-11.4
Gross International Reserves (US$M)	885	810	742	788	812	850
In months of next year's imports	2.1	2.0	1.7	2.3	2.4	2.5
Central Government Operations	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**2016/17**
Revenue and grants	17.2	15.9	16.8	19.2	21.1	21.7
Total Expenditure	22.6	22.3	22.4	23.5	24.0	24.2
Overall balance	-5.3	-6.4	-5.6	-4.3	-3.0	-2.4
Primary balance	-3.1	-4.1	-3.1	-1.7	-0.2	0.4
Memorandum items:						
National debt (in millions of $B)	4,362.8	4,995.7	5,590.1	6,284.5	6,653.4	6,695.4
In percent of GDP (including contingent liabilities)	55.3	60.7	65.6	72.9	75.2	74.1
Nominal GDP (in millions of B$)	7,890.0	8,399.0	8,522.0	8,618.0	8,854.0	9,035.0

Source: IMF WEO and Article IV, The Central Bank of The Bahamas, and the Department of Statistics.

Contributors: Camilo Gomez Osorio and Kimberly Waithe

Overview

Tourism and construction activity continue to lead economic activity in Barbados. A favorable external environment was growth positive. Dynamic tourism demand and low international oil prices improved Barbados's external position, narrowing the current account deficit by the end of September 2016. Lower food import prices and weak domestic demand contributed to deflation. International reserves continue under pressure and greater fiscal effort is needed to stabilize the increasing public debt.

Recent Developments

Barbados' economy grew by 1.3 percent at the end of September 2016. This outturn is positive compared with the 0.4 percent growth recorded the same month a year earlier and reflects the gradual increase in tourist arrivals. Tourism value added grew by 2.6 percent, as long stay arrivals rose by 5.7 percent to reach 457,200 visitors. The growth in arrivals came from the United States (10.7 percent) and CARICOM (13.0 percent), which is a continuing trend that was evident before the Brexit vote. Barbados has yet to see a negative impact on UK arrivals as a result and the depreciation of the pound sterling. Growth in arrivals from the United Kingdom (2.6 percent) and Canada (1 percent) was modest. Cruise passengers grew by 3.8 percent at the end of June 2016. The non-tradable sectors grew by 1.5 percent. The construction sector led the way (4.6 percent growth y-on-y), with the start of major tourism projects, followed closely by business and other services (2.8 percent). (Table 1)

Table 1: Tourist Arrivals by Source Market

	Jan-Sep 2015	Jan-Sep 2016	% change
United Kingdom	150.7	154.7	2.6
Canada	55.6	56.1	1.0
USA	111.8	123.8	10.7
Germany & Other Europe	28.0	27.4	-2.1
CARICOM	66.8	75.5	13.0
Rest of the World	19.8	19.7	-0.5
Total long stay arrivals	432.7	457.2	5.7
Cruise Passengers*	327.6	340.0	3.8

Source: Central Bank of Barbados and Caribbean Tourism Organization. *Cruise Passenger data from January to June.

Barbados is advocating for Caribbean countries to invest in Leeward Islands Air Transport (LIAT). The Antigua-based airline, which is particularly important for connectivity across the OECS countries, is aiming to reduce operating costs but continues to report losses. Its largest shareholder is Barbados with 49.5 per cent, followed by Antigua and Barbuda 13 percent, St. Vincent 12 per cent, and Dominica less than 10 percent. In 2016, the airline is projected to lose EC$9 million (US$3.3 million), which is lower than the EC$56 million reported in 2015 (US$20.7 million). LIAT currently has 10 aircraft and connects 18 countries with some 700 flights per week.

Highlights

Real GDP grew by 1.3 percent at the end of September 2016.

Fiscal deficit widened US$45.2 million to reach US$121 million by second quarter of FY2016/17.

Reserves declined and stood at 2.7 months of imports or US$450.2 million.

S&P downgraded Barbados from B to B- with a negative outlook.

A favorable external environment in 2017 would continue to support growth recovery

On 23 September, S&P downgraded Barbados from B to B- with a negative outlook. The rating was justified on account of "persistently high fiscal deficits, reflecting both budget slippage and unbudgeted spending." In their report, S&P highlights that the Central Bank continues to be the main financier of the government deficit, which the rating agency considers at odds with its goal to defend the currency peg with the U.S. dollar. Moreover, the government deficits, coupled with current account deficits not fully financed by foreign direct investment, have increased the country's external vulnerabilities. S&P does expect economic growth to pick up during the next two to three years, but private-sector confidence, continued delays in several tourism projects, and potential spillover from Brexit should keep growth moderate.

Barbados' fiscal deficit widened. The fiscal balance increased to reach US$121 million (5.4 percent of GDP) from April to September 2016, compared to 3.4 percent of GDP by the same period a year earlier. Revenues fell by US$13.3 million (2.1 percent) with a decline in personal income taxes (5.6 percent). Total expenditure grew marginally by 4.5 percent to reach 33.3 percent of GDP driven by higher domestic interest payments and goods and services. Fiscal adjustment has not stabilized an increasing trend in public debt, which reached an estimated 145.4 percent of GDP (central government gross debt inclusive of National Insurance Scheme -NIS) by September 2016, up from 138 percent a year earlier. IDB estimates suggest that stabilising public debt would require a primary surplus of around 3–3.5 percent of GDP if the long-term annual growth rate would average 1.8 percent.

The Financial Statement and Budgetary Proposals for FY2016/17 was presented to the House of Assembly on 16 August, 2016. The Government aims for a deficit at 5.8 percent of GDP for FY2016/17 (on a cash basis). Measures focused on the revenue side with new taxes and a tax amnesty for arrears. Some of the main revenue-raising initiatives announced included: 1.

National Social Responsibility Levy: A new 2 percent duty on all imports, effective 1 September, 2016, and estimated to collect 0.9 percent of GDP this fiscal year and 1.6 percent next year; 2. *Bank asset tax rate increase from* 0.2 percent to 0.35 percent, which is estimated to collect additional revenue of 0.2 percent of GDP in FY2016/17; and 3. *Tax amnesty* for arrears across the tax categories of VAT, income tax, and land tax starting 15 September, 2016 through to 15 February, 2017. It is estimated to collect around 0.2 percent of GDP or US$7.5 million in overdue payments.

On the expenditure side, the Budget Speech announced a target of US$12.5 million across-the-board spending cuts and an additional US$12.5 million savings during the mid-term review across all ministries. In addition, the Government announced a new reduction target of US$100 million over the next four years and 0.5 percent of GDP or US$25 million during FY2016/17 for transfers and subsidies to state-owned enterprises (SOEs).

Barbados continues to experience deflation. The CPI declined by 0.8 percent by end-June 2016, compared with a 1.0 percent rise a year earlier. Lower commodity prices and weak domestic demand kept inflation in check. This declining trend in prices suggests weak domestic demand. At the same time, average unemployment decreased to 10.2 percent by June 2016, compared with 12 percent recorded a year earlier.

The external position improved and the current account deficit narrowed to 2.5 percent of GDP at end-September 2016. This was a positive development when compared with the 6.1 percent of GDP in 2015, driven mainly by higher travel receipts which grew by 14 percent. At the same time, fuel imports were down by 1.9 percentage points of GDP.

Reserves stood at US$450.2 or 2.7 months of imports as at end-September 2016. This represents a decline when compared with US$488.8 million recorded in the similar period a year earlier, due to debt service payments and lower tourism receipts when compared with the previous quarter. Lower commodity prices and weaker domestic consumption continue to restrain imports.

Barbados ranked lower in the Global Competitiveness Report 2016. Barbados commendably tops the Latin America and Caribbean region in infrastructure, labour market efficiency, health and primary education, and technological readiness. However, the country slipped 17 places to 72nd out of 138 countries since 2014.[1] Moreover, the economy stands at 129 out of a possible 138 countries with respect to macroeconomic indicators, specifically, ranking 122nd in terms of government budget balance (percent of GDP) and 127th with respect to government debt (percent of GDP).

Outlook for 2017

Barbados's medium-term growth outlook is positive but modest. The Central Bank of Barbados projects 1.4 percent by the end of 2016. The IMF suggests 2.1 percent this year and 2.3 percent for 2017. Over the medium term, IDB forecasts suggest output will grow by an average of 1.8 percent annually.

A favourable external environment during 2017 would continue to support recovery. International oil prices would remain low at around US$55 per barrel (World Bank), which is beneficial for a net importer like Barbados. The tourism sector would be dynamic. An estimated 11 percent increase in airlift capacity from the main tourism markets is expected over the upcoming winter season. A downside risk for the economy remains, the adverse impact on UK tourist arrivals and FDI as a result of the depreciation of the pound sterling and Brexit. If projects like the new Sandals Hotel and the rehabilitation of Sam Lord's Castle continue on schedule, private investment would contribute to dynamism in construction and other non-tradable sectors, as well as improve the current account balance, at -2.5 percent of GDP at end-September 2016.[2]

Fiscal adjustment would continue over the medium term. Through the implementation of new tax measures, and divestment, the announced sale of the Barbados National Oil Terminal Ltd, a fiscal deficit of 5.8 percent of GDP (cash basis) was announced for FY2016/17. This target is subject to containing current spending pressures, particularly transfers and subsides to SOEs.

Inflation would remain low in the medium term. Low oil and commodity prices would continue to contain inflation at below 2 percent 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 (%)	1.3	Sep-16	1.3	Jun-16
Tourism arrivals (annual % change)	5.7	Sep-16	5.3	Jun-16
Nonperforming loans (%)	9.6	2016 Q2	11.0	2015 Q2
Private sector credit growth(%)	0.1	Jun-16	-0.6	May-16
Foreign Exchange Reserves cover,weeks	14.0	Sep-16	13.5	Jun-16
Inflation(%)	-0.8	Jun-16	-1.0	May-16
Unemployment rate (%)	10.2	2016 Q2	9.3	2016 Q1

Source: Central Bank of Barbados.

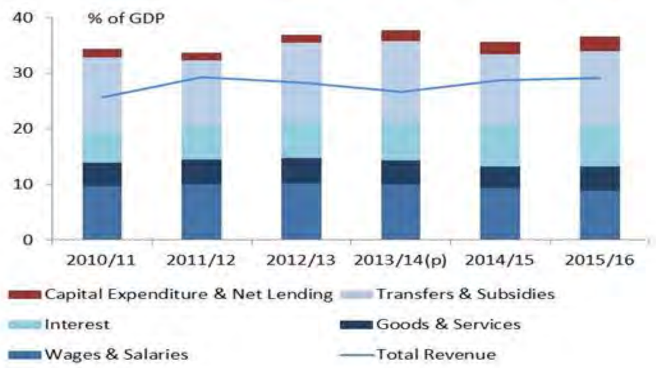
[1] The country was not ranked in 2015 due to insufficient information received by the World Economic Forum (WEF).

[2] Private investment in hotels and tourism estimated at over US$600 million over the next four years.

Improving Barbados' fiscal position is the greatest challenge. The deficit contributes to rising public debt and greater fiscal effort is required to stabilize it. Since the 2009 global downturn, the country has pursued expansionary fiscal policy. Understanding the channel by which its stance affects growth is the focus of this special section.

Expansionary fiscal policy came with macro implications. The deficit financing is absorbing resources for current expenditures that could be channeled towards boosting private consumption and investment. During FY2014/15, the deficit declined from 11 to 6.9 percent of GDP, but widened to 7.4 percent of GDP last year (FY2015/16).[3] This trend is likely to sustain over the next few years with the Budget for FY2016/17 aiming for a deficit target of 5.8 percent of GDP (cash basis). The central government gross debt stood at 108.4 percent of GDP for September 2016 and around 145.4 percent of GDP when including National Insurance Scheme holdings. (Figure 3). The contribution of public spending to GDP remains significant at 36.6 percent in 2015, although it gradually declined from the 37.7 evident in 2013.

Figure 2: Barbados Public Finances



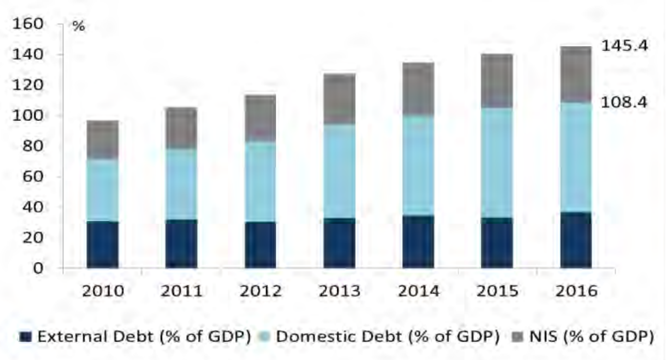
Source: Ministry of Finance and Central Bank of Barbados.

Total expenditures outpaced revenue growth and stood at 36.6 percent of GDP in 2015/16. Primary expenditures, exclusive of interest payments, declined from 30.7 percent of GDP in 2013 to 29 percent by 2015. Over the last five years, current spending crowded out public investment that averaged 1.9 percent of GDP. Expenditures are particularly rigid with interest payments at 7.5 percent of GDP and the public sector wage bill at 8.9 percent of GDP accounting for 45 percent of total public spending in 2015/16. The largest items are transfers and subsidies at 13.2 percent of GDP and wages and salaries at 8.9 percent. (Figure 2) These transfers are projected to decline in the approved budget estimates but then to increase through supplementary budget approvals during the mid-year estimates review.

Revenue collection in Barbados is challenged by weak domestic demand, erosion of the revenue base over time, and tax administration. Revenues fell by US$13.3 million (2.1 percent) at the end of the first six months of FY2016/17 on account of: lower fuel import excises, a decline in personal income tax rates in 2015, and lower VAT collections. Since 2009, revenues have been hit by the contraction of GDP amid weaker tourism demand. Tax incentives in the form of concessions, waivers, and reduced rates narrowed the revenue base overtime. To compensate for this decline, new tax measures and higher rates were introduced each year since 2014.[4] The budget continues with this trend and focuses heavily on the revenue side to reduce the financing gap.

Debt service increased in line with higher debt. Interest payments and amortizations represented almost 18 percent of GDP in FY2015/16. Interest payments alone are amongst the largest budget items, at 7.5 percent of GDP, 26 percent of revenue collection, and 21 percent of total spending. The next major external repayment is due in 2021 estimated at US$150 million. (Figure 3)

Figure 3. Barbados Public Debt (% of GDP)



Source: Central Bank of Barbados.

Fiscal consolidation reduced the financing gap, but greater fiscal effort is required to stabilize public debt. Launched in August 2013, the home-grown program aims to improve public finances with new taxes and austerity through public sector retrenchment and lower transfers and subsidies. During 2014, around 3,000 public sector jobs were rationalized (about 10 percent of

[3] Preliminary figures from the Financial Statement and Budgetary Proposals 2016/17.

[4] During FY2011/12-2013/14, total revenue collection declined from 29.3 to 26.7 % of GDP due to lower corporate and personal income tax receipts, declining VAT and excise tax collections.

the civil service), which contributed to an overall adjustment of primary expenditure at around 1.7 percent of GDP 2013/14–2015/16. In 2015/16 and 2016/17 the measures focus on closing the financing gap from the revenue side, rather than greater austerity on the expenditure side.

Barbados pursued procyclical fiscal policy since 2011. In an environment of limited fiscal space and with stagnant growth in the tourism sector during 2007–2013, the country pursued fiscal consolidation in years of economic contraction. Through a structural vector autoregressive (SVAR) estimation on time series data, one can explore if fiscal policy and the composition of public spending were conducive to growth. This is the focus of the following section.[5]

Results

A Structural Vector Autoregressive (SVAR) estimation was calculated to better understand the impact of fiscal policy on growth in Barbados. Using time series data from 1970–2015, public expenditure was disaggregated into capital and current expenditure. Further disaggregation of current expenditures, namely wages and salaries, transfers and subsidies, and goods and services, was available from 1980 to 2015. As control variables, tourism arrivals, since Barbados is a tourism driven economy, and inflation were included in the model. Unit root tests we used in this analysis, the Augmented Dickey–Fuller (ADF) test (1979), Phillips–Perron (PP) test (1989), the Kwiatkowski-Phillips-Schmidt-Shin (KPSS) test (1992), and showed that all variables had a unit root. Using first difference the series became stationary. Thereafter, the optimal lag length for each variable in the VAR models was determined by the various lag length selection tests and model diagnostics: the sequential modified likelihood ratio test statistic, the final prediction error, the Akaike information criterion, the Schwarz information criterion, and the Hannan-Quinn information criterion. Two lags were chosen for the underlying VAR for both models.

The results of the aggregate model suggest that current expenditure, arrivals, and inflation had a significant positive impact on GDP. The results indicated that a 1 percent change in current expenditure would result in a 0.2 percent change in GDP. Current expenditures are particularly important in a small-island economy like Barbados, where they represent a significant share of household disposable income. The effect does not sustain over time, and only one period lag was statistically significant. The impact is modest because the country is heavily dependent on imports of food, oil, and inputs. Hence, an important share of this spending leaves the island without having a larger impact on output. On the other hand, the impact of capital expenditure and inflation on growth was found to be statistically insignificant. In the case of tourist arrivals, the impact of a 1 percent change in arrivals led to a 0.3 percent change in GDP, highlighting the importance of the tourism sector to economic output.

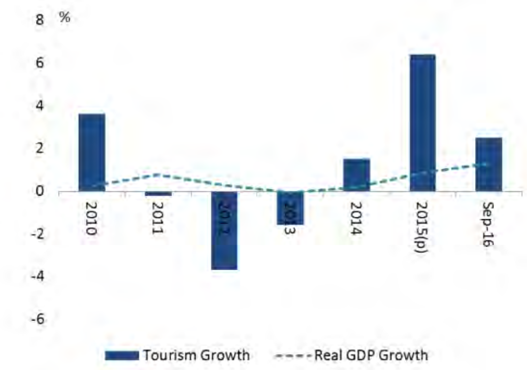
A second model further disaggregated the components of current expenditure. Results suggest that spending on *goods and services* and *transfers and subsidies* had a positive and statistically significant impact on output. Capital expenditure, wages, and salaries were statistically insignificant. Once again, the control variable of tourist arrivals was statistically significant, while the effect of inflation was insignificant. The results indicated that a 1 percent change in goods and services would result in a 0.1 percent change in GDP. Goods and services expenditure includes the contribution of goods and services to the operation and maintenance of infrastructure, services rendered to government, and includes the government's contribution to development projects, which have a higher locally sourced component. In addition, the SVAR results indicated that a 1 percent change in transfers would result in a 0.13 percent change in GDP. This is not surprising, as spending on transfers includes grants to individuals that are subsidies that have a direct impact on disposable household income and greater local content. The positive effect does not persist over time, as only one period lag was statistically significant. The impact from tourism arrivals is, of course, the dominant effect in magnitude at 0.4 percent and in statistical significance. Given that the breakdown of public finances and GDP are available only on a yearly basis, the time span of the time series and restrictions on observations are a caveat to these estimates.

[5] This estimation is based on yearly data from the Central Bank of Barbados from 1970-2016

Barbados's Economy at a Glance

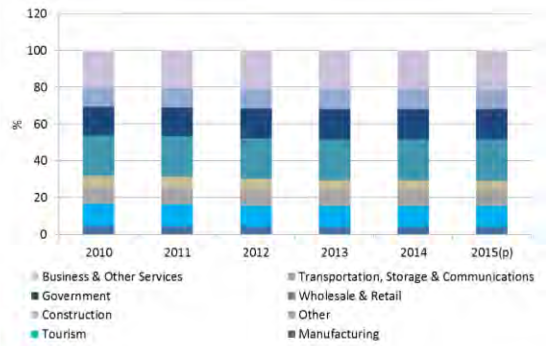
Gradual tourism recovery with weak domestic demand

Figure A. Real growth and Tourism growth



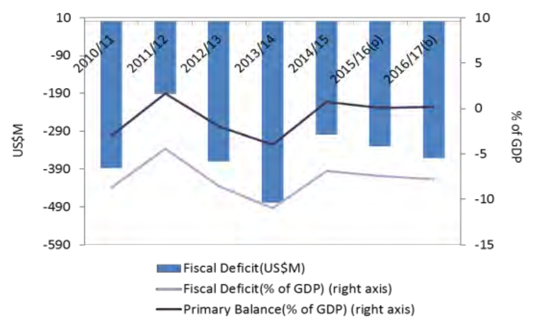
… which are the driver of growth.

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



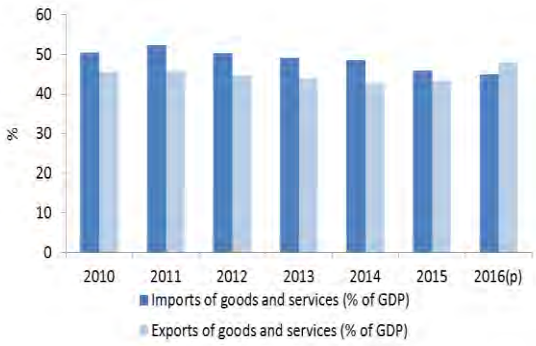
Fiscal consolidation reduce the deficit

Figure C. Revenues and Expenditures (% of GDP)



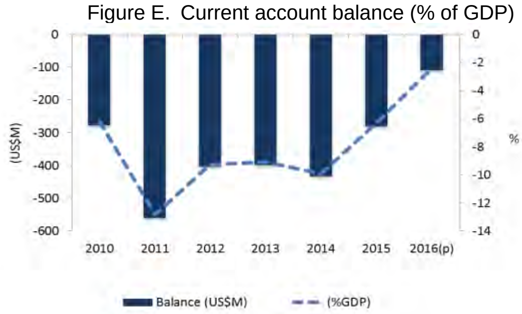
…lower oil and commodity prices contained imports

Figure D. Exports and Imports (% of GDP)



…improved the current account balance

Figure E. Current account balance (% of GDP)



…and stabilized reserves.

Figure F. Gross reserves (US$ millions)

Sources: Central Bank of Barbados; World Economic Outlook, IMF (April 2016); Ministry of Finance.
Note: (p) projected figures for 2016.

Barbados: Selected Indicators

	2011	2012	2013	2014	2015	2016(p)
(Annual percentage changes, unless otherwise indicated)						
Real sector						
Real GDP	0.8	0.3	-0.1	0.2	0.9	1.4
Nominal GDP	-2.0	-0.6	0.9	-0.4	1.6	1.7
Inflation (end of period)	9.4	4.5	1.8	1.9	-1.1	0.3
Unemployment	11.2	11.5	11.6	12.3	11.3	9.7
External sector						
Exports of goods and services (% change)	0.4	-5.3	0.2	-3.2	3.6	9.9
Imports of goods and services (% change)	1.9	-4.8	-1.2	-1.5	-3.9	-0.7
Current account (percent of GDP)	-12.8	-9.3	-9.1	-9.9	-6.3	-2.5*
International reserves (US$millions)	707.4	728.9	572.1	526.1	463.4	450.2*
International reserves cover (months)	3.7	4.0	3.2	3.0	2.7	2.7*
(In percentage of GDP, unless otherwise indicated, on a fiscal year basis)						
Public sector						
Total revenue	29.3	28.4	26.7	28.8	25.7	28.5[+]
Total expenditure	33.7	36.9	37.7	35.7	33.6	36.4[+]
Central government primary balance	1.6	-2.0	-4.0	0.7	-0.2	0.2[+]
Central government overall balance	-4.4	-8.5	-11.0	-6.9	-7.4**	-7.8[+]
Debt indicators						
General government debt	78.0	83.5	94.4	100.1	104.9	108.4*
General government debt (inclusive of NIS holdings)	105.3	113.6	127.3	134.5	140.4	145.4*
Central government debt over revenues	266.7	294.5	353.4	347.8	382.8	368.5*
External debt service as percentage of exports of goods and services	6.9	7.3	6.9	7.6	11.9	9.1

Sources: Central Bank of Barbados; World Economic Outlook, IMF (April 2016); Ministry of Finance (MOF).
Note: (p) projected figures for 2016.
n.a. not available
* Data as end of September 2016.
***Source*: Central Bank of Barbados (September 2016 economic review). The MOF reports a lower deficit that is not comparable on a cash basis.
[+] Budgeted figures for FY2016/17.

GUYANA EXTRACTIVE SECTORS SHOULDER GROWTH

Contributors: Mark Wenner and Dillon Clarke

Overview

Guyana's economy continues to grow on the back of strong performances in the extractive sectors. However, lower commodity prices for rice, sugar, and forestry products dampened end-of-year growth figures, resulting in an end-of-year 2.6 percent lower than the expected 4.4 per cent announced at the start of the year. The low price environment and in particular the continued low prices for oil help to maintain inflation low and improve the current account. Fiscal stimulus remains heavy on transfer payments while severe challenges remain in implementing the government investment program. The financial sector remains sound despite mounting nonperforming loans.

> ***Highlights***
>
> - *ExxonMobil makes another significant oil discovery at third offshore well.*
> - *Economic growth was buoyed by strong performances by gold and bauxite sectors, while first half drought and low agricultural commodity prices compound challenges in agriculture sector.*
> - *Guyana removed from FATF watchlist, but de-risking concerns remain.*
> - *2017 National Budget was presented early on 29 November.*

Recent Developments

Mining activities continue to compensate for sluggish performances in agriculture sectors due to prolonged droughts. Guyana realized real growth of 2.0 percent in the first half of the year. In August 2016, authorities indicate that both gold and bauxite production continue to surpass previous estimates, growing at an annualized rate of 87.9 percent and 16.6 percent, respectively. The outturn is due to higher prices and increased production efficiency for both mineral sectors, notably gold, which have seen strong performances since the commissioning of two large-scale mines. In stark contrast, sugar and rice continue to struggle from a plethora of structural and market issues and drought, which have exposed poor cost competitiveness. Rice production for the first eight months was 25.3 percent lower than the previous comparable period due to late sowing and adverse weather conditions. Similarly, sugar recorded a slump in production of 65.9 percent. Authorities are expected to revise growth forecasts downwards due to the depth of the value chains associated with agriculture.

Low price environment continues. Price levels rose a tepid 0.76 percent in August 2016 on an annualized basis. Low inflation continues to reflect low oil prices and 20 percent electricity tariff reductions. However, price level rises were reported for food and clothing. Current yearly indices are applicable to the Greater Georgetown metro area and do not capture the sharp urban-rural differences in the cost of living. Inflation statistics are published quarterly. Authorities project a price level rise of 2.1 percent in 2016.

Strong mineral export earnings and low oil prices offset weak agriculture export performance. Following a first half surplus of US$40.9 million, the current account is expected to record a US$72.9 million surplus for 2016 (approximately 2.2 percent of GDP from a deficit of -3.2 percent of GDP in 2015). In August 2016, export earnings were 27.5 percent higher than in August 2015 and reflected strong earnings for gold, bauxite, and diamond exports. However, sugar and rice export growth remained depressed while timber exports also contracted. Meanwhile, low oil prices and lower capital goods imports continues to offset surges in food and intermediate imports during the month of August 2016.

Stimulus outlay continues. The primary fiscal balance was in surplus at the start of the year but eroded by 46 percent to G$9 billion (approx. 2 percent of GDP) at end-June 2016. The deterioration of the primary fiscal balance is expected to accelerate as the Government continues to implement its stimulus plan. At the end of August 2016, current expenditures grew by 27.9 percent due to a 5 percent public sector wage increase, the addition of new government agencies and constitutional bodies, increases in statutory pensions and gratuity, and increased provision of government goods and services. Capital expenditure rose by 130.7 percent, reaching $20.9 billion at the end of August, 2016, compared to $9.0 billion expended during January to August 2015. Despite this large increase, capital spending remains below its budgeted target due to the slow pace of implementation of the Public Sector Investment Programme (PSIP).

Central Government current revenues totaled G$107.7 billion by end August 2016, an increase of 10.1 percent or G$9.9 billion compared to revenue collections during January to August, 2015. This growth was driven by increases in both nontax and tax revenues.

GUYANA EXTRACTIVE SECTORS SHOULDER GROWTH

While rate of expansion has slowed, monetary policy remains accommodative. Broad money grew by 3.2 percent in the runup to August 2016, while currency in circulation expanded by 10 percent, yielding a constant money liquidity ratio of 39 percent relatively unchanged. In August 2016, the exchange rate closed at 206.5, unchanged from June 2016. Monetary authorities attempt to manage inflationary expectations by anchoring the exchange rate through frequent sterilization exercises.

Domestic private sector lending, excluding real estate mortgages, contracted in August, falling by 1.2 percent from G$135.5 billion in July to G$133.9 billion in August. Compared with August 2015, credit grew by 1.3 percent. This represents a relatively tepid annual rate of credit growth, especially in contrast to the strong year-on-year growth rate of 4.6 percent seen in July. Symptomatically, due to weak performances in agriculture and small mines, nonperforming loans rose to 11.7 percent in March 2016 from 11.5 percent in December 2015. However, commercial banks remain well capitalized with an industry average capital adequacy ratio of 25.3 percent, well above prudential benchmark of 8 percent. The capital adequacy ratio (CAR) measures a bank's ability to absorb losses without winding up and defaulting on depositors. Authorities indicate measures to increase provisioning and implement the new Basel III core principles.

ExxonMobil discovers third oil well off Guyana's shores. The new well dubbed 'LIZA-3' is 12,100 feet below the sea bed at a location 2.7 miles from the Liza 1 discovery within the Stabroek block. The well was reported to have a favorable gas-to-oil ratio. Exxon indicated the find comprises recoverable resources of between 800 million and 1.4 billion barrels of oil-equivalent (boe).

Guyana was removed FATF watch list. Guyana was officially removed from the FATF watch list for standards of Anti-money Laundering and Combating the Financing of Terrorism earlier this month at FATF's plenary in Spain. The successful exit from the FATF/ICRG (International Country Risk Guide) process now paves the way for it to be removed from the Caribbean Financial Action Task

Force (CFATF) monitoring process come November. CFTAF is the regional monitoring body of FATF. Authorities noted that Guyana's removal from the watch lisoffers assurance that doing business in Guyana does not pose threats.

Guyana's 2017 National Budget was presented on November 29, 2016. The early presentation is expected to allow for more time for spending of public funds on a range of projects and projects. The new budget at G$250 billion (US$1.21 billion) is the largest ever in Guyanese history; features a number of tax administration measures—a higher income threshold; a reduction in VAT from 16 to 14 percent but the inclusion of VAT on electricity and potable water services; the introduction of a dual tax rate for companies engaged in both non-commercial and and commercial activities; and fines for not keeping accounting records. Current spending will again surpass projected revenue, resulting in a projected deficit of 5.2 percent as a share of GDP in 2017. Constitutionally, the National Assembly must debate and approve Guyana's budget for assent by the President by 30 April of each year.

Guyana and the United States create pact for reporting holdings of U.S. citizens in an effort to stem tax evasion. The implementation of the Foreign Account Tax Compliance Act (FATCA) introduces reporting requirements with respect to certain accounts held by U.S. persons and certain foreign entities in which U.S. persons hold substantial ownership interest. FATCA follows the reciprocal model A1 Inter-Governmental Agreement (IGA) with the U.S. Internal Revenue Service (IRS) that allows financial institutions in Guyana to identify and disclose details regarding the holders of dollar accounts. Congress enacted FACTA to target noncompliance by U.S. taxpayers using foreign accounts.

2017 Outlook

According to the October World Economic Outlook 2016, prospects in in 2017 are expected to be positive--4 percent growth, inflation is expected to be 2 percent, but exports will be two percent less than 2015. The current account deficit is expected to improve due to continued low oil prices.

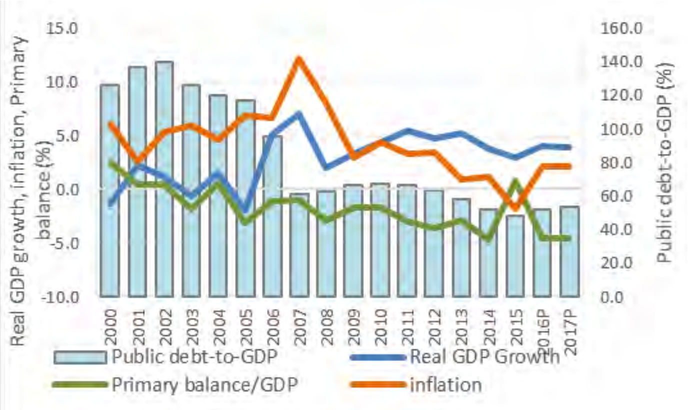
High-Frequency Macroeconomic Indicators				
	Last	Period	Prior	Period
Annual GDP growth (%)	3	2015	3	2014
Exports (12-month growth)	0.2	2015	-15.1	2014
Imports (12-month growth)	-17.7	2015	-5.1	2014
Private sector credit growth	6.2	2015	9.1	2014
Inflation	-1.8	2015	1.2	2014

Source: Central Bank of Guyana, IMF

Expansionary fiscal policy used to compensate for weaknesses in the key productive sectors

Real GDP growth decelerated to 3.0 percent in 2015 from 3.8 percent in 2014, as most key sectors were buffeted by depressed commodity prices and adverse weather. Despite rebounds in the gold and bauxite industries, underlying challenges remain for all productive sectors in the economy. Meanwhile, low oil prices and one-off fiscal spending slump in 2015 due to elections significantly improved Guyana's fiscal balance to –0.1 percent of GDP (from -5.7 percent of GDP in 2014), while the debt-to-GDP ratio fell to 48.6 percent (see Figure 1). The improved fiscal space has seen authorities implement a five-year stimulus plan in 2016 that will run a fiscal deficit of approximately 5 percent of GDP through 2020. A sustained expansionary fiscal policy will lead to an increase in public debt from currently 48.6 percent of GDP to 57.9 percent of GDP by 2020.

Figure 1. Real GDP Growth, Inflation, Primary Balance and Public Debt



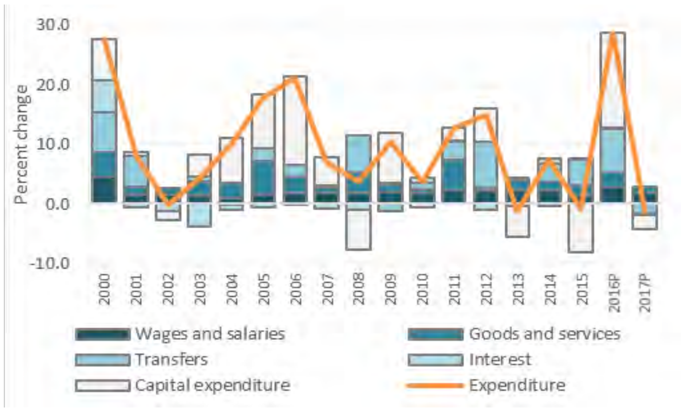
Sources: Bank of Guyana, Ministry of Finance, and staff.

Drivers of fiscal expenditure growth

Public expenditure affects output and income distribution patterns. Public expenditure as a share of GDP has been sustained between 28 and 30 percent over the last five years. Guyana's fiscal stimulus is aimed at addressing social and infrastructural deficits that will hopefully alter the medium- and long-term dynamics if effective in achieving goals. Authorities project in 2016 a 28.6 percent increase in public spending to G$237.7 billion (approx. 34.3 percent of GDP). Growth is expected in all factor-paid categories of expenditure, with: wages and salaries increasing by 11.6 percent, good and services (by 10.4 percent), transfers (25.1 percent), interest payments (4.6 percent), and capital expenditures (79.5 percent).

Over the last five years, transfer payments and capital investment accounted for the largest broad-based changes in public expenditure (see Figure 2). Transfer payments have largely been used to bridge operational shortfalls in two state-owned sugar corporations (GUYSUCO) and the Guyana Power & Light (GPL). The rapid decline in oil prices that started in June 2014 eventually led to a gradual reduction of energy subsidies to the power company as its oil imports contracted. However, severe structural challenges and industrial action in the sugar sector resulted in an 18.2 percent increase in transfers during 2015 to G$53.3 billion (equivalent to 8.2 percent of GDP). Transfer payments are projected to increase by 25.1 percent to G$66.7 billion (9.6 percent of GDP) in 2016. Authorities posit continued financial support for GUYSUCO, voucher programs for low income families, and creation more statutory institutions.

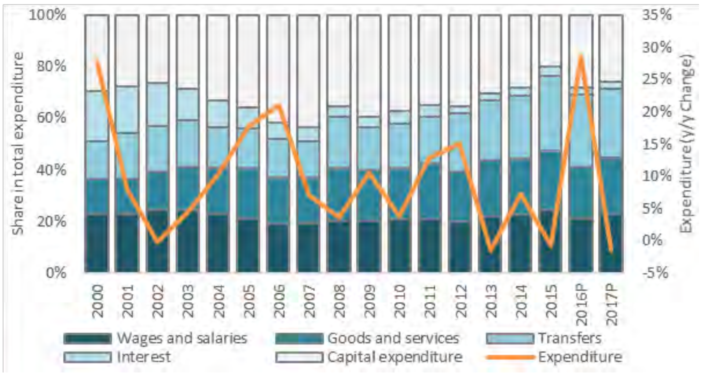
Figure 2. Drivers of Fiscal Expenditure Growth



Sources: Bank of Guyana, Ministry of Finance, and staff.

Historically capital expenditures have been one of the principal drivers of expenditure growth and are expected to be so in the future. As can be seen in Figure 2, decomposition of expenditure growth, capital expenditures are more often above the line than below. Between 2010 and 2014, capital expenditures averaged G$54.5 billion but fell in 2015 due to one-off political factors (suspension of Parliament and no passed budget). In the medium term (2016–2020), capital expenditure, is forecasted to average G$66.66 billion per year, an increase of 24 percent over the 2010–2014 average. In relative terms, whereas capital expenditures as a share of GDP averaged 6.6 percent in the 2010–2014 in the projected medium term, the average share rises to 8.7 percent.

Figure 3. Changing Composition of Fiscal Expenditure



Sources: Bank of Guyana, Ministry of Finance, and staff.

The composition of public expenditures has started to change. In the period 2007–2013 (post debt relief), capital expenditures were a prominent share of total expenditures, whereas expenditures on goods and services and wages and salaries remained fairly stable. Since 2013, however, transfers as a share of total expenditures are increasing while potentially productivity enhancing capital expenditures are falling (Figure 3).

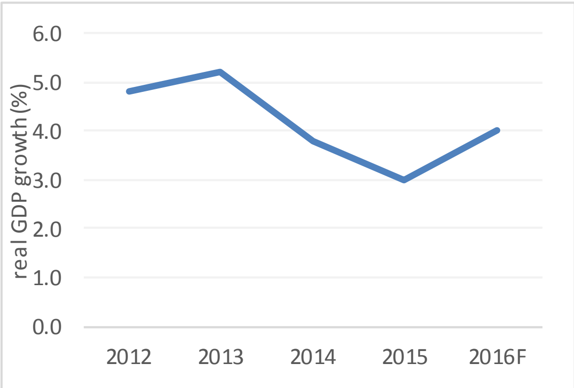
Low expenditure efficiency dampens the impact of fiscal spending on growth. A dynamic OLS model, to accommodate a limited number of time series observations, was used to assess the responsiveness of real GDP to changes in fiscal expenditure. Estimates for the period 1982–2015 suggest that significant long-run relationships exist between economic growth and fiscal expenditure related to goods and services, wages and salaries, and capital expenditure. Specifically, capital expenditure has an instantaneous but negative impact on growth. This points to lower growth dividends than would normally expected with a productivity-enhancing infrastructure expenditure. The likely explanation for the negative relationship is the poor implementation of capital project (delays in project mobilization and execution. Public spending on goods and services exerts an instantaneous negative impact on growth but a positive effect after one year has lapsed. However, wages and salaries had the reverse effect; a positive instantaneous effect but negative effect after one year. As such, the conclusion is that public sector authorities should make it a priority to improve the efficacy of the public investment program and strive to conduct better cost-benefit studies, improve designs, manage costs better, reduce delays in execution, insist on better built quality and properly maintained completed works so as to prolong the useful life of infrastructure investments and obtain higher growth dividends.

Table 1: Dynamic Ordinary Least Squares (DOLS)

	Model 1		Model 2	
	Coefficient	P-value	Coefficient	P-value
CONSTANT	-2.0919	0.0002	-2.3369	0.0000
Terms of trade	0.1329	0.0000	0.1306	0.0000
Terms of trade (-1)	-0.0302	0.0900		0.0000
D(INFLATION)	0.0968	0.0001	0.0912	0.0000
D(INFLATION(-1))	0.0431	0.0725		0.0000
CAPITAL_EXP	-0.0296	0.0000	-0.0215	0.0000
CAPITAL_EXP(-1)	0.0078	0.0894		0.0000
GOODS_SERVICES	-0.0463	0.0000	-0.0383	0.0000
GOODS_SERVICES(-1)	0.0411	0.0000	0.0394	0.0000
WAGES_SALARIES	0.0977	0.0000	0.0667	0.0000
WAGES_SALARIES(-1)	-0.0344	0.0114	-0.0312	0.0000
INTEREST	-0.0145	0.0382		0.0000
INTEREST(-1)	-0.0087	0.1206		0.0000
BREAK (1992 =0)	4.7337	0.0000	5.1981	0.0000
ERROR CORRECTION TERM	1.0295	0.0000	1.0000	0.0000

Guyana's economy continues to grow on the back of strong performances in the extractive sectors

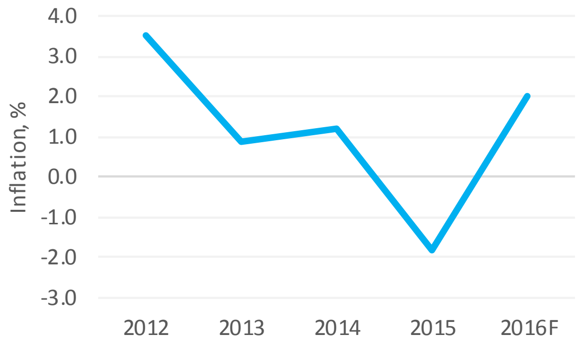
Figure A. Real GDP growth



Source: Ministry of Finance, staff

Price level expect to increase at end of 2016 due to higher food prices

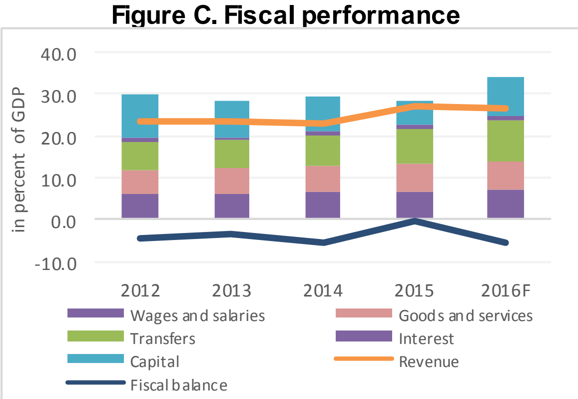
Figure B. Price level changes



Source: Bank of Guyana and the Ministry of Finance

Fiscal stimulus remains heavy on transfer payments while severe challenges remain in implementing the public sector investment

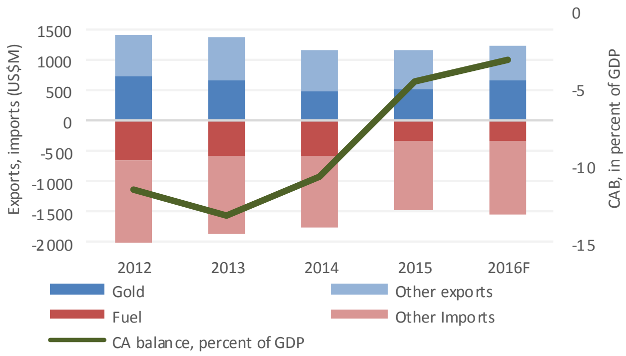
Figure C. Fiscal performance



Source: IMF, Ministry of Finance, staff

Significant improvement in the current account reflect lower fuel costs and strong mining exports.

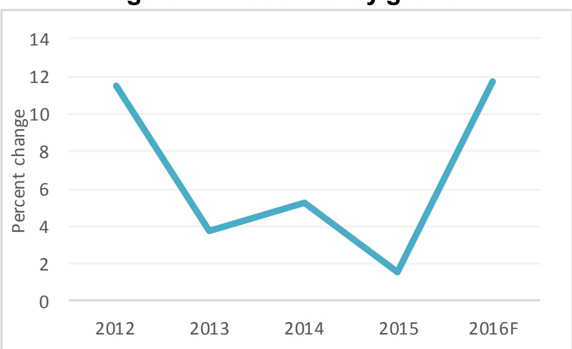
Figure D. External performance



Source: IMF, Ministry of Finance, staff

Meanwhile, monetary policy remains accommodative…

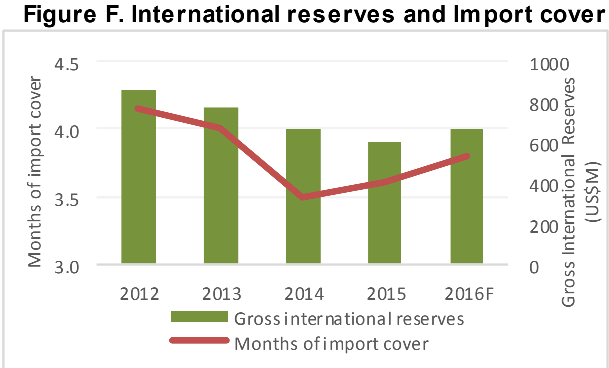
Figure E. Broad money growth



Source: IMF, Ministry of Finance, staff

…and international reserves are adequate

Figure F. International reserves and Import cover



Source: IMF, Ministry of Finance, staff

Guyana: Selected Indicators

	2012	2013	2014	2015	2016F
(Annual percentage changes, unless otherwise indicated)					
Real sector					
Real GDP	4.8	5.2	3.8	3.0	2.6
Nominal GDP (GYD millions)	582656	614100.0	635300.0	653300.0	N/A
Inflation (end of period)	3.5	0.9	1.2	-1.8	2.1
External sector					
Exports of goods	25.4	-2.8	-15.2	-1.4	19.2
Imports of goods	12.8	-7.5	-3.0	-16.7	4.4
Current account (percentage of GDP)	-11.6	-13.3	-12.5	-5.7	-3.0
Remittances (percentage of GDP)	16.0	12.7	14.9	13.2	8.1
FDI (percentage of GDP)	10.3	7.2	8.5	4.0	4.2
(In percentage of GDP, unless otherwise indicated, on a fiscal year basis)					
Central government					
Revenue and grants	23.6	23.4	23.0	24.9	24.7
Current expenditure	19.5	19.7	21.1	22.6	24.5
Capital expenditure and net lending	10.7	8.6	8.2	4.7	6.7
Primary balance	-3.6	-2.9	-4.7	0.8	-4.5
Overall balance	-4.6	-3.7	-5.6	-1.4	-5.4
Debt indicators					
Central government debt	63.7	57.9	51.9	48.6	52.3
External public debt (end of period)	47.7	41.8	39.5	36.1	36.0

Source: Central Bank of Guyana, World Economic Outlook, IMF (October, 2016).
Notes: (P) denotes projected figures. FDI= foreign direct investment.

JAMAICA — GROWING, FINALLY

Contributor: Juan Pedro Schmid

Overview

Jamaica's economy remains stable with a positive outlook. Jamaica entered a new Stand-By Arrangement with the IMF, replacing the Extended Fund Facility that would have ended in March 2017. Economic growth forecasts for FY2016/17 have been increased after a strong performance in the third quarter or 2015.

Recent Developments

The IMF Board approved a three-year precautionary Stand-By Arrangement with the Fund. If needed, Jamaica will be able to access up to SDR1.2 billion (equivalent to around US$1.64 billion) under the precautionary three-year program. Of this amount, US$412 million was made available at signing on 15 November 2016. The program foresees semi-annual review missions. While quantitative performance targets remain focused on fiscal consolidation, the structural benchmarks focus on public sector modernization.

The SBA continues the reforms of the Extended Fund Facility. Key areas include public sector efficiency, rebalancing from direct to indirect taxes, strengthening the social safety net, and reallocating public resources to infrastructure spending. While these efforts should facilitate economic growth, job creation, and social protection, the primary surplus is projected to remain at 7 percent of GDP for the medium term. In addition, the program foresees further strengthening monetary operations to facilitate a move to inflation targeting, including a commitment to maintaining exchange rate flexibility, and continuing to build precautionary reserves through market-based purchases of foreign exchange. Finally, financial sector stability should be increased by strengthening financial supervision, improving the crisis resolution framework, and further reducing vulnerabilities from securities dealers.

Economic Performance and Outlook

The macroeconomic environment remains conducive. As of September 2016, inflation remained subdued at below 2 percent while net international reserves of US$2.46 billion were above prudential levels. Given the remaining funds from the EFF, gross international reserves at end-September amounted to US$3.1 billion, equivalent to 20.6 weeks of imports of goods and services. The approval of the SBA boosted potential reserves by another US$412 million.

Low Treasury bill and policy rates are not fully reflected in loan rates. The 180 day T-bill rate has been 6 percent or below since early 2016 compared to 6.6 percent average in 2015. In addition, the Bank of

Highlights

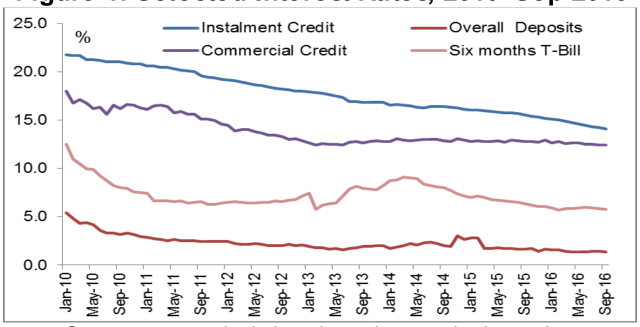
The IMF Board approved a three-year precautionary Stand-By Arrangement with the Fund in November 2016.

Jamaica experienced 2.2 percent growth in the July-September 2016 quarter, the highest year-over-year growth rate since 2002.

The macroeconomic environment remains positive.

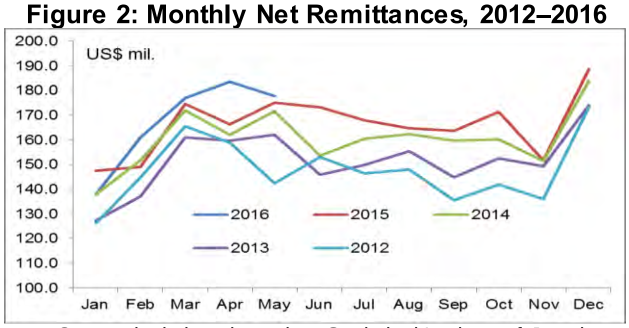
Jamaica's benchmark 30-day Certificate of Deposit rate has remained at 5.0 percent since May 2016, a cumulative reduction of 1.25 percent compared to January 2016. However, while bank deposit rates have declined to below 2 percent, loan rates remain high in international comparison and in terms of the spread between lending and deposit rates (Figure 1).

Figure 1: Selected Interest Rates, 2010–Sep-2016



Source: Own calculations based on Bank of Jamaica.

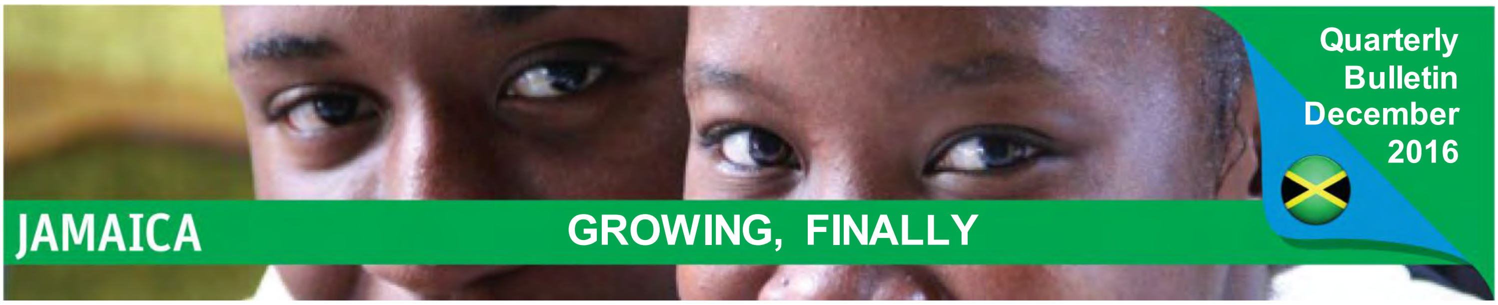
Figure 2: Monthly Net Remittances, 2012–2016



Source: Own calculations based on Statistical Institute of Jamaica.

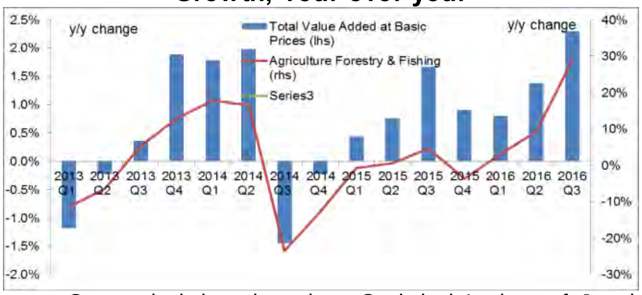
Remittances continued to increase. Remittances experienced a sharp fall during the world economic downturn but have increased every year since 2009 (Figure 2). Based on the current flows, they are again projected at around 15 percent of GDP, supporting the current account and acting as an important safety net for thousands of Jamaicans who receive them from abroad.

Growth is projected to accelerate. Growth for the current fiscal year FY2016/17 that will end in March 2017 could end up at the higher end of the 1–2 percent government forecast. The revision follows growth of 2.2



percent in the third quarter of 2016, the strongest quarterly growth in over a decade. The recovery was driven partly by an expansion of agriculture by 28 percent, but all other sectors except manufacturing also performed well (Figure 3).

Figure 3: Total and Agricultural Quarterly GDP Growth, Year-over-year



Source: Own calculations based on Statistical Institute of Jamaica. Notes: Based on unadjusted quarterly series at 2007 constant prices.

The strong performance of agriculture is partly explained by a recovery from two years of droughts. Jamaica experienced strong drought conditions in the summer months of both 2014 and 2015, which affected agricultural GDP. In addition, the drought in 2014 was related to the outbreak of Chikengunya, which had negative effects on economic activity. However, even taking into account these effects, agriculture has performed strongly and output for the first three quarters of 2016 has been 17 percent higher than for the same period in 2013 when there was no drought. Import substitution and the production of agro parks have helped the sector.

Table 1: Growth in Stay-Over Tourist Arrivals by Country, January-August

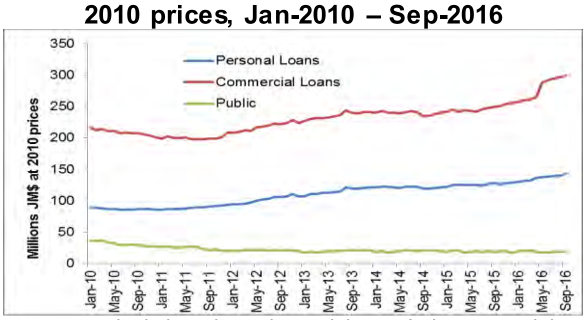
	2014	2015	2016
USA	0.4%	3.5%	4.9%
Canada	6.5%	-6.0%	-8.2%
Europe	9.0%	8.1%	4.9%
UK	13.0%	16.6%	2.2%
Others	2.3%	2.3%	2.0%
Total	**2.6%**	**2.1%**	**2.4%**
Number (thousand)	**1,467**	**1,497**	**1,532**

Source: Own calculations based on Jamaica Tourist Board.

Tourism continues to perform well. Performance in the current year up to August was strong even though it varied by sender country (Table 1). Canada experienced a second year of decrease, but the main market, the United States, continued to perform strong. At the same time, the growth of arrivals for the United Kingdom slowed down considerably, probably also related to the GBP depreciation and uncertainty over Brexit. However, Europe, including the United Kingdom, showed healthy growth in arrivals at 4.9 percent compared to the same period one year earlier.

Credit growth is accelerating. Credit growth has been performing strongly, including for commercial loans that have been boosted by a large loan for an acquisition in June 2016. Private sector credit in Jamaica remains low in international comparison at around 23 percent of GDP, but the acceleration is in line with improved business confidence and bodes well for the growth outlook.

Figure 4: Commercial Bank Credit at Constant Jan-2010 prices, Jan-2010 – Sep-2016



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

The SBA is expected to provide a sustainable framework for the next three years. Growth in 2017 and 2018 is projected to accelerate further e to 2.0 and 2.4 percent. With a stabilization in oil prices, inflation should increase from its record low levels to around 5 percent, still well below historical levels. Similarly, the current account deficit is projected to remain below 4 percent (see also snapshot below for forecasts under the SBA).

Conclusion

Jamaica's economic growth over the last three years has been disappointing. While macro stability starts to be engrained in Jamaica, achieving higher growth has proven elusive. However, signs are increasing that the Jamaican economy might finally reap the benefits from the macroeconomic stabilization. Credit growth is accelerating, the business climate is buoyant, and quarterly growth indicates an acceleration of different sectors. That being said, Jamaica continues to face macroeconomic vulnerabilities that require careful policies, which are the foundation for lasting economic growth.

High Frequency Macroeconomic Indicators	Last data	Period	Prior data	Period
Real GDP Growth (y/y)	2.2	2016 Q3	1.4	2016 Q2
Inflation (y/y)	1.9	Sep-16	2.2	Jul-16
Net international Reserves (US bil)	2.5	Sep-16	2.5	Aug-16
Exchange Rate (end of period)	129.0	Nov-16	127.6	Aug-16
Unemployment Rate (%)	12.9	Jul-16	13.7	Apr-16

Sources: Bank of Jamaica and Statistical Institute of Jamaica

ALL EXPENDITURES ARE EQUAL?

Introduction

Jamaica's long-term growth performance has been disappointing. At an average of 1.4 percent between 1980 and 2015, Jamaica's growth performance in real terms was the third lowest in Latin America and the Caribbean. Jamaica's recent performance has also been weak. Since the advent of the world economic downturn in 2008, growth was negative for four out of eight years. At the same time, Jamaica has embarked upon a strong fiscal consolidation since 2013, which will keep revenues high and government expenditures constrained. According to internal simulations, to reduce debt-to-GDP from currently around 120 percent to 60 percent as mandated by the Fiscal Rule, Jamaica will require primary surpluses of around 7 percent from 2016 to 2026.

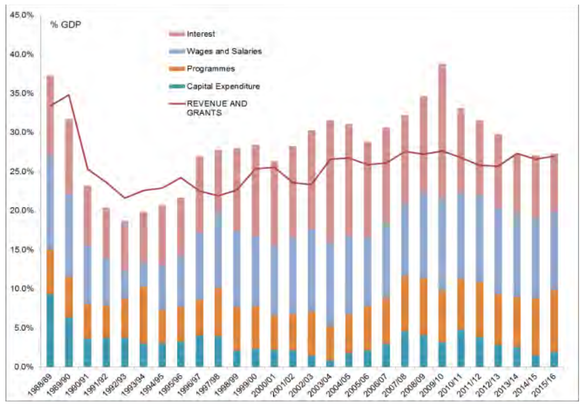
In spite of low historical economic growth, the potential for fiscal policy to stimulate economic growth is restricted, given the continued fiscal consolidation going forward. Given restrictions on overall government spending, the question arises whether the composition can be adjusted to increase growth. Intuitively, and confirmed by a vast academic literature, expenditure on capital expenditure should have more lasting effects on economic growth than expenditure on consumption, such as wages and salaries—though they might have short-term effects when public sector employees spend their incomes on the domestic economy. Similarly, expenditure for social services such as health and education should increase human capital in an economy, which would bring long-term economic gains. Conversely, expenditure on interest payments, especially to foreign debt holders, is a drain on the budget, and on the country's citizens through taxation, while probably not stimulating growth.

The exact relationship between government expenditure and growth varies by country. After exploring the composition of government expenditure in Jamaica, we will econometrically analyse the effects. The final part will draw conclusions and policy recommendations.

Expenditure Patterns in Jamaica

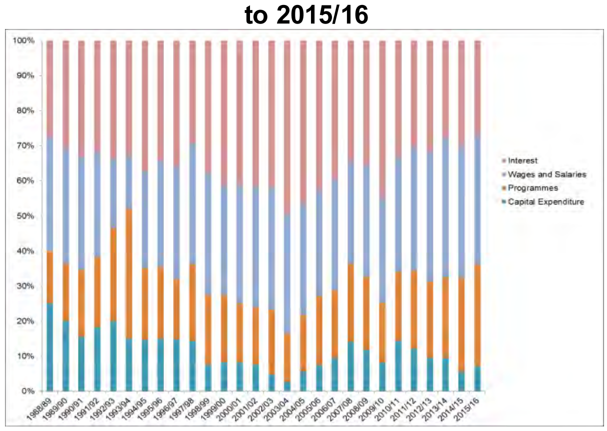
Fiscal deficits driven by recurrent expenditure are a characteristic of Jamaica's public finances. Starting in the late 1980s, capital expenditure fell below 5 percent of GDP and remained below that level thereafter. At the same time, Jamaica experienced deficits in every year after FY1995/96 (Figure 1). In terms of composition, interest payments have dominated Jamaica's budgets, reaching up to 50 percent of total government expenditures in some years. Wages and salaries are the second important expenditure category, fluctuating between 7 and 12 percent of GDP. The remainder, program and capital expenditure, are the most flexible and thus have varied the most, probably to avoid larger deficits (Figure 2).

Figure 1: Government Expenditures and Revenues, 1988/89 to 2015/16



Source: Own calculations based on Bank of Jamaica and MOFPS.

Figure 2: Government Expenditures Shares, 1988/89 to 2015/16



Source: Own calculations based on Bank of Jamaica and MOFPS.

Growth Effects of Different Expenditure Groups

A Structural Vector Auto Regressive (SVAR) model was used to explore the importance of expenditure composition in Jamaica. Using time series data from 1972 to 2016, the relationship between capital expenditure and overall expenditure was tested (Figures 3 and 4). In addition, public expenditure was disaggregated into capital expenditures, expenditure for wages and salaries, and program expenditure for 1986–2016 (Figures 5 and 6).

Increases in public expenditure do not stimulate economic growth in the short term. The results indicate a short positive impulse for recurrent expenditure one year after the increase in expenditure, though the effect is not statistically significant. In addition, the relationship turns negative in the second year before starting to fade as the effect approaches zero (Figure 3). For capital expenditure, the effect is negative throughout, but only statistically significant in the first year (Figure 4).

Figure 3: Real GDP Response to an Increase in Recurrent Expenditure

(In response to one standard deviation shock)

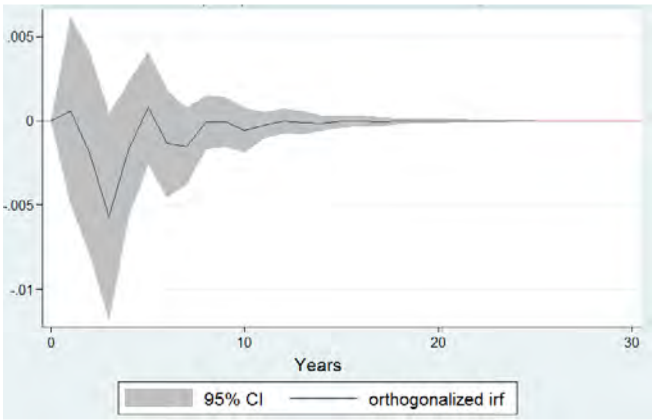
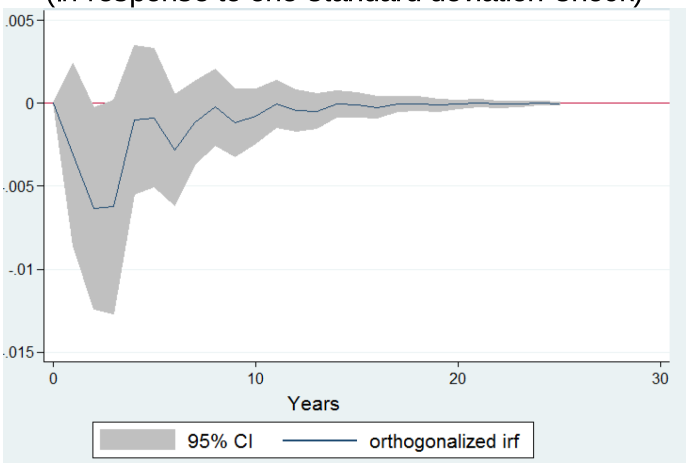


Figure 4: Real GDP Response to an Increase in Capital Expenditure

(In response to one standard deviation shock)



The negative effect of capital expenditure is surprising at first sight. Different factors besides data issues can be responsible for this result. When capital expenditure is financed through debt, it results in higher levels of debt-to-GDP and higher interest payments, both of which have been shown to be a constraint for economic growth. Also, fiscal multipliers have been shown to be small in small, import-dependent countries like Jamaica as an important part of capital has to be imported.

Figure 5: Real GDP Response to an Increase in Program Expenditure

(In response to one standard deviation shock)

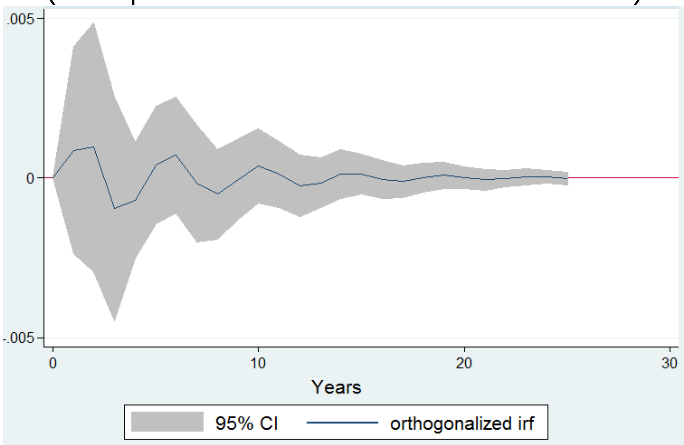
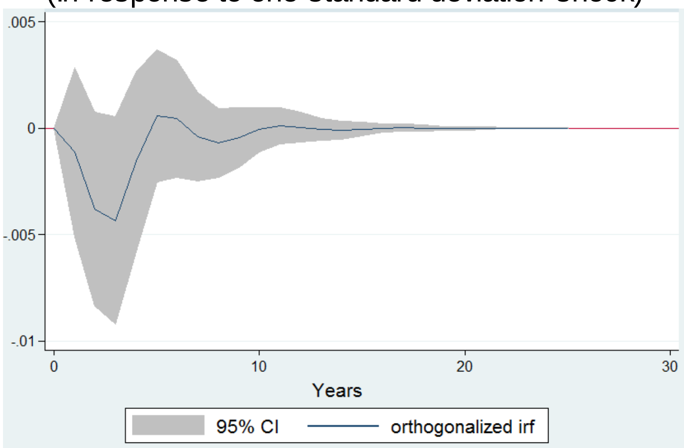


Figure 6: Real GDP Response to an Increase in Wages and Salaries Expenditure

(In response to one standard deviation shock)



The effects of government expenditure on economic growth are only weakly related to the type of expenditures. Program expenditure would have a positive effect in the first two years but is not statistically significant effect (Figure 5) while a change in expenditures for salary and wages would have a clear negative effect but is again not statistically significant (Figure 6).

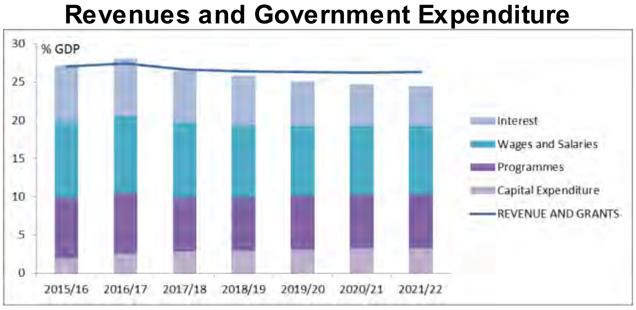
Conclusion and Policy Discussion

Wages and salaries, interest payments, and program and capital expenditures, each currently comprise around one third of government expenditures. Among these, wages and salaries as well as interest payments

are the most rigid, meaning that these obligations are difficult to change in the short term. The fiscal framework going forward tries to reduce these rigid expenditures in order to create space for program and capital expenditures or to allow for a decrease in taxes/revenues.

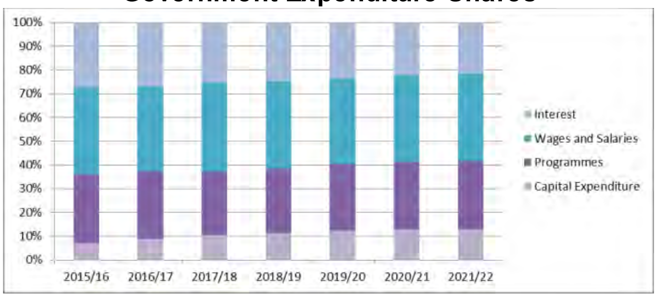
The results above suggest that the relationship between expenditure composition and economic growth is weak in Jamaica. Program expenditure does not affect economic growth in a statistically significant way, but capital expenditure and expenditure for salary and wages seem to have a negative effect. Given the data limitation (especially the short time series for detailed expenditure), the lack of statistically significant results has to be interpreted with caution, but the results indicate that the potential to increase economic growth through fiscal stimulus, or a re-orientation of expenditures within the overall level, is limited.

Figure 7: Fiscal Framework 2015/16–2021/22, Revenues and Government Expenditure



Source: Ow n calculations based on Bank of Jamaica.

Figure 8: Fiscal Framework 2015/16–2021/22, Government Expenditure Shares



Source: Ow n calculations based on Bank of Jamaica.

Jamaica's budget is highly rigid and does not seem to support economic growth. However, there are differences in terms of expected impact on economic growth and welfare of the population:

Interest payments are a drain on taxpayers while delivering little benefit to the country. The overall goal of the fiscal consolidation is thus to reduce them through a combination of a decrease in debt-to-GDP and appropriate debt management. Interest payments cannot be reduced directly but only through a reduction of debt through lower expenditures (or higher revenues), impacting all other expenditures. Even beneficial expenditures, for instance for social development or infrastructure, need to be discounted by the negative effect they have on debt-to-GDP and thus interest payments.

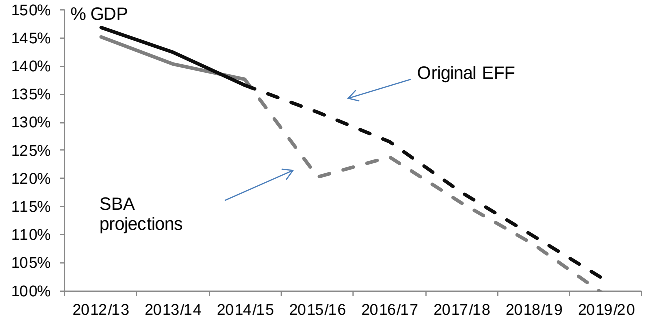
Wages and salaries are currently high in international comparison. The estimation suggests that reducing wages and salaries could also be beneficial for economic growth. However, reducing public sector wages is complicated as the public sector provides central services, including for health, education, and safety, which are even more relevant for lower income households. As such, public sector wages are projected to decrease as the public sector modernization advances, which will focus on efficiency and service delivery.

Program expenditures are essential to run the government. Within those there are areas that can be reduced and re-allocated in line with the overall public sector modernization. Also, there are expenditures that can be reduced without affecting the level of service delivery, for instance expenditure for electricity can be reduced through energy saving measures.

Capital expenditures have been acting as fiscal buffers in Jamaica. When actual revenues were lower than projected, or other expenditures higher, capital expenditures have been adjusted to compensate.[1] However, infrastructure is the backbone of an economy as it facilitates social services as well as private sector development. As such, the fiscal framework foresees an increase in capital expenditure. However, capital expenditure is also more flexible than other types of expenditure, which means it would continue to be adjusted if necessary. Finally, the results above indicate that the growth effect of capital expenditure has been limited, highlighting the need to carefully select investment projects in high impact areas for both economic growth and social services.

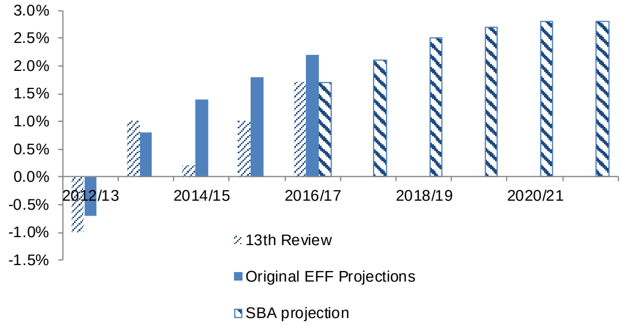
[1] See Schmid (2014) for details on budget variations over the fiscal year.

The SBA will still focus on debt reduction …
Figure A. Debt-to GDP 2011/12 - 2019/20



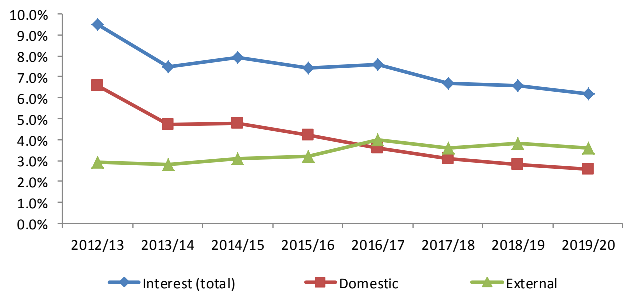
Source: International Monetary Fund

and continue to hope for grwoth acceleration
Figure B. Annual GDP growth rate



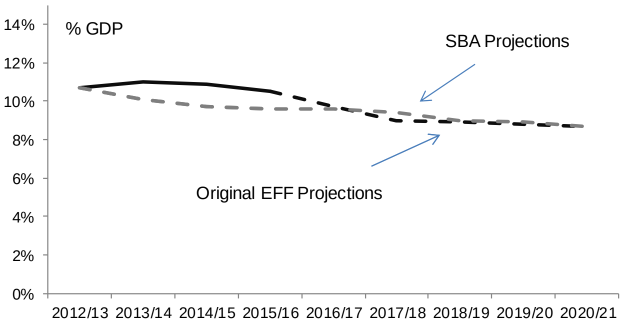
Source: Statistical Institute of Jamaica and IMF

Interest Payments are on a downward path…
Figure C. Interest payments on Government Debt (% of GDP)



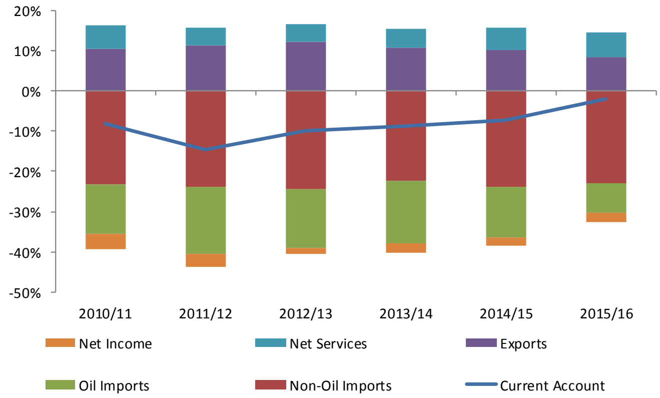
Source: International Monetary Fund.

while reduction of public sector salaries remains a target
Figure D: Public wages and salarias (% of GDP)



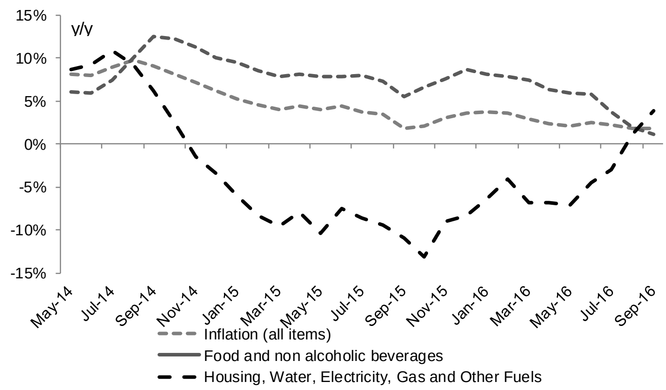
Source: International Monetary Fund.

The Current Account has benefitted from low oil prices
Figure E. Contributors to current account deficit (% of GDP)



Source: Bank of Jamaica

…which has helped to keep inflation under control
Figure F. Inflation and its Main Components (y/y % change)



Source: Bank of Jamaica

Jamaica: Selected Indicators

	2012/13	2013/14	2014/15	2015/16	2016/17 (P)
(Annual percentage changes, unless otherwise indicated)					
Real Sector					
Real GDP	-0.7	0.9	0.2	1.0	1.7
Nominal GDP	6.1	8.9	6.9	7.5	4.6
Inflation (end of period)	9.1	8.3	4.0	3.0	4.8
Exchange rate (end of period)	98.9	109.6	115.0	122.0	
External Sector					
Exports of goods and services (yoy, %)	3.5	3.5	-5.0	0.3	
Tourism receipts (yoy, %)	1.4	1.8	10.0	5.9	
Imports of goods and services (yoy, %)	0.4	0.4	-7.3	-9.7	
Current account (percentage of GDP)	-11.5	-8.4	-6.6	-1.8	-2.8
Percentage of GDP, unless otherwise indicated, on a calendar year					
Central Government					
Revenue and grants	25.8	27.2	26.3	27.0	27.4
Budgetary expenditure	29.9	27.1	26.8	27.2	28.0
Primary balance	5.4	7.7	7.5	7.1	7.0
Budget balance	-4.1	0.1	-0.5	-0.3	-0.6
Public sector balance	-4.2	0.1	0.4	1.6	-0.6
Treasury bill rate (percent, end of period)	5.8	8.0	7.0	5.8	
Debt Indicators					
Public sector debt	146.4	141.6	124.8	120.3	123.9
Public sector debt over revenues	n.a.	516.4	491.6	445.6	452.2
Foreign currency public debt (end of period)	76.0	76.4	49.9	70.0	
International Reserves					
Net international reserves (USD Mill)	884	1303	2294	2416	2536
Gross international reserves (weeks of good and services imports)	<12	14.4	19.4	23.3	24

Source: International Monetary Fund and country authorities.

Contributor: Chrystol Thomas

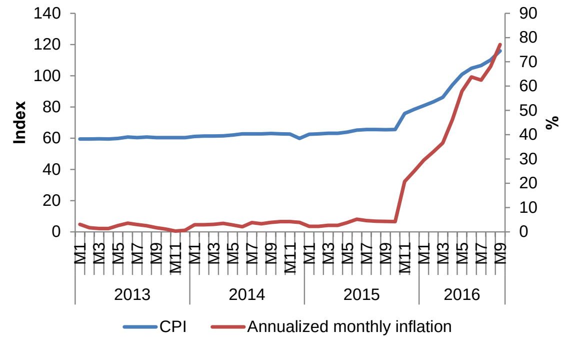
Overview

Suriname's economy faces a deep recession amidst slow progress in the reform agenda. The economy is expected to contract significantly, but improvements are likely for the current account and fiscal balances. The Government pursued new means of external finance and has requested additional time for the removal of subsidies to the electricity company through the implementation of higher tariffs under the IMF Stand-By Arrangement (SBA).

Economic Performance and Outlook

Suriname's economy is expected to contract further this year while inflation levels continue to rise. The International Monetary Fund (IMF) recently revised Suriname's growth prospects for 2016 downward from −2 percent in April 2016 to −9 percent. Suriname's growth performance for 2015 was also revised to −2.7 percent from no growth. The deep recession reflects the cessation of production activities in the bauxite industry in November 2015 and the contractionary fiscal adjustments.[1] Annualized monthly inflation remained in high double digits at 77.1 percent in September, with the price index increasing by 5.3 percent (Figure 1). Much of the inflation spikes are attributed to higher costs for utilities and the depreciation in the exchange rate. The IMF forecasts inflation for 2016 at 60 percent, following the removal of the peg of the Surinamese dollar, which led to a 54 percent devaluation against the dollar since November 2015. The devaluation was forced after a drop in the price of commodities.

Figure 1. Inflation



Sources: Bureau of Statistics, and CBvS.

current **The current account position improved for the first six months of the year, but significant risks remain**. According to central bank statistics, the account deficit for the first half of 2016 was lower by 8 percentage points of GDP over the similar period of 2015 (Figure 2), almost entirely because of lower imports. The IMF projects a current account deficit of below 4 percent of GDP in 2016, while a surplus of 2 percent of GDP is expected in 2017. The stock of foreign reserves at end-September stood at US$350 million (estimated 2.3 months of import cover). The reserve position has been below international benchmarks since mid-2015 and has since trended downwards except in June 2016 with the IMF program disbursements.[2] Government's efforts to stem the fall in the stock of foreign reserves were concentrated on tightened fiscal policy since August 2015, by means of expenditure cuts. However, dampened oil and gold prices could offset any improvement in the external position.

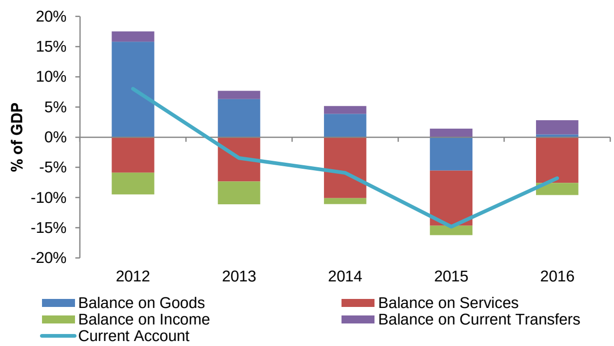
Highlights

Suriname's economy forecasted to contract further given closure of bauxite industry and slow reform progress.

Suriname makes its first appearance in the international bond markets.

Expansionary fiscal policy, through increasing primary expenditure, can generate some gains for economic growth in Suriname.

Figure 2. Current Account Balance (first half)



Sources: Central Bank of Suriname, and IDB.

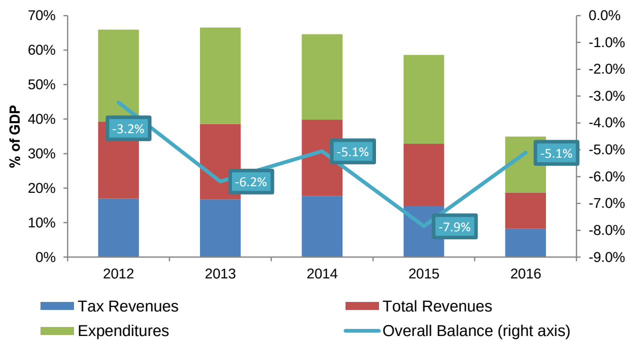
The overall fiscal balance improved for the first half of 2016 and is above the IMF SBA-targeted balance for 2016. The fiscal deficit for the January to June period is estimated at 5.1 percent of GDP (SRD$670 million), 2.8 percentage points lower than the previous year (Figure 3). The budget gap narrowed primarily on account

[1] IMF, 2016. Suriname: Concluding Statement of the 2016 Article IV Mission. November 17, 2016.
https://www.imf.org/en/News/Articles/2016/11/17/MS111816-Suriname-Concluding-Statement-of-the-2016-Article-IV-Mission

[2] International financial institutions disbursed US$201 million in support of the IMF Stand-By Arrangement. The IMF, IDB, and CDB disbursed US$81 million, US$70 million, and US$50 million, respectively.

of current expenditure falling by 8 percentage points of GDP, which offset the decline in total revenues that moved from 18 percent of GDP in 2015 to 10 percent of GDP in 2016. Total subsidies fell to 4 percent of GDP from 9 percent of GDP, reflecting mostly the reduced subsidies to the electricity company given increased electricity tariffs. To achieve fiscal consolidation, the IMF estimated a fiscal balance of −6.4 percent of GDP for 2016 in its SBA program. Government's financing needs for the first half of 2016 were met by using SDR$1062.4 million from external sources.

Figure 3. Fiscal Performance (first half)



Sources: Central Bank of Suriname, and IDB.

Suriname debuted in the international global bond markets, selling a US$550 million benchmark bond at 9.25 percent. The bond is equal to about 13 percent of the country's estimated GDP for 2016. The proceeds will be used for renegotiating and restructuring debt at state entities such as the state oil company (US$300 million), among other things.[3] Suriname does not have an investment-grade rating and was downgraded this year by three major credit rating firms to four levels below investment grade.[4] The rating of the bond loan (B+) is in line with the creditworthiness of the country.

External debt levels are rising. The IMF projects General Government's debt stock for 2016 at 70 percent of GDP, up from an earlier projection of 46.2 percent, with additional borrowing under the SBA, other investment projects from both bilateral and multilaterals,[5] and the international bond issuance. Suriname's available debt space for foreign and domestic debt is limited by its National Debt Act, which was amended earlier this year to reflect the international definition of debt.[6] In November, the government proposed an increase in the debt ceiling to 80 percent of GDP.

The IMF Stand-By Arrangement is on pause until further progress on the program has been made.[7] The IMF described performance under the SBA as mixed in its August Review mission. The IMF indicated a continuation of discussions with the authorities with further progress, in particular with the removal of subsidies on fuel and energy. The Government has hinted at a renegotiation of the program to assuage the financial burden on the population. The conclusion for the November Article IV mission indicated a challenging economic outlook and macroeconomic stability and growth that hinges on the agreed reform agenda.

Newmont Mining Corporation has completed construction of the Merian gold mine and has started commercial operations. On 1 October, Newmont declared commercial production. Annual profits in the first five years of production are expected to be between US$30 million and US$87.5 million. The start of the Merian operations is expected to bring financial and social gains for the country. Newmont's current workforce includes just over 1,100 employees.

The short- to medium-term outlook remains challenging. A deep recession is projected by the IMF for 2016, while a modest recovery for the economy is likely in the medium term with new production in the extractive sector. The overall macroeconomic framework should improve in 2017, with fiscal and current account deficits of 4.1 percent and 4.2 percent. Inflation is expected to decrease to below 10 percent in 2017.

Conclusion

Suriname continues to feel the pinch from low commodity prices as the severity of the recession worsens. Advancement of the Government's stabilization and recovery plan, with support from the IMF, will help amend the current trajectory in the overall macroeconomic framework.

High Frequency Macroeconomic Indicators				
	Lastest data	Period	Prior data	Period
Real GDP growth (y/y)	-9.0	2016	-2.7	2015
Inflation (end of period)	77.1	Sep. 16	63.8	Jun. 16
Net international reserves (US$M)	350.1	Sep. 16	404.3	Jun. 16
Exchange rate (to US$)	7.4	Nov. 16	7.1	Jul. 16
Unemployment rate (%)	11.9*	2016	8.7	2015

Sources: Central Bank van Suriname; General Bureau of Statistics; World Economic Outlook (October 2016); IMF Press Statement (November 17, 2016).
* data is estimated

[3] Other uses include: repayment of existing central government debt (US$88 million), payment of the 5 percent stake in Newmont Suriname (US$27 million), and the repayment of debt associated with the Petrocaribe oil deal with Venezuela (US$54 million). See http://www.starnieuws.com/index.php/welcome/index/nieuwsitem/38014

[4] Only Argentina, Ecuador, and Venezuela have lower ratings in South America.

[5] Suriname announced in September it will invest US$1.3 billion in infrastructure and energy projects between 2016 and 2018, which it will finance with a US$1.8 billion soft loan from the Islamic Development Bank.

[6] The external and domestic debt thresholds are 35 percent and 25 percent of GDP, respectively.

[7] In May 2016, the Executive Board of the IMF approved a two-year SBA for US$478 million to support the Government's economic reform program.

Introduction

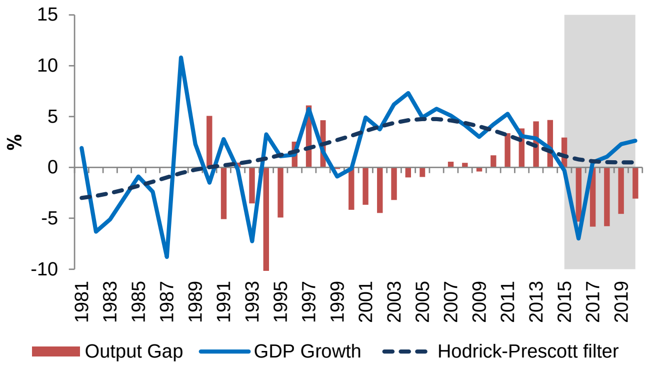
Fiscal policy is an important component of Suriname's macroeconomic policy as most investment and consumption activities are financed through public expenditure.[8] Public investment is an area that can have direct relevance for economic growth (Alshahrani and Alsadiq, 2014).[9] The impact of expansionary fiscal policy, in particular increasing government expenditure, on economic growth has been researched widely (Alshahrani and Alsadiq, 2014; Niloy, Emranul and Denise, 2003; Ram, 1986; Wu, Tang and Lin, 2010) with inconclusive empirical evidence. This note provides a preliminary assessment of the relationship between economic growth and expansionary fiscal policy through the primary public expenditure for Suriname. Despite some data limitations, we use the Vector Error Correction Model (VECM) techniques to estimate the effects of increasing primary expenditure on real national income and employ annual data over the period 1980–2015.

GDP Trends and their Composition

Prior to 2000, Suriname experienced strong economic growth rates accompanied by episodes of high volatility. Suriname's long-term growth rate trended upwards since the 1980s.[10] However, a combination of external and domestic shocks have affected economic activities, in particular the volatility in world market prices for the main export products (gold, oil, and bauxite). GDP growth was volatile during the 1980–2000 period, with a standard deviation of 4.55 percent and a mean growth rate of -0.3 percent. The period 2001–2014 was characterized by lower volatility, alongside economic growth rates that outperformed most countries in the region (averaging 4.5 percent with a standard deviation of 1.4 percent). However, with the end of the super commodity cycle, economic growth contracted significantly, resulting in a severe recession (average economic growth for 2015–20 is estimated at −0.1, with a standard deviation of 3.2) (Figure 4; see also Recent Macroeconomic Development section, above).

The structure of Suriname's economy is strongly biased towards the non-traded sector. Although a high portion of Suriname's exports (95 percent) are from the mining and quarrying sector, services are the largest economic sector, accounting for almost 60 percent of GDP. Within this, wholesale and retail trade dominates, at 23 percent of GDP. Manufacturing is also a significant contributor to the economy (22 percent), followed by the agriculture and fisheries sector (13 percent).[11] Construction, trade, transportation, and agriculture have been the fastest growing sectors of the economy in more recent years.

Figure 4: Real GDP Growth



Sources: CBvS, WEO (October 2016) and IDB.

The public sector is the largest employer, reflecting its extensive presence in the economy. The tradable sectors represent around 30 percent of GDP but only 20 percent of employment. (Direct employment in mining accounts for 3 percent—a low figure due to the capital intensive nature of these activities). The State has a dominant position in the economy, including state-owned enterprises (of which there are around 144, many of them providing pure private goods). It is estimated that the public sector employs 60 percent of the formal sector workforce. The central government's share of GDP is estimated around 25 percent.[12] There is also a large informal economy in Suriname, the size of which is thought to vary significantly depending on the country's political and economic performance. More recently, it is estimated at around 20 percent of GDP (IDB, 2013).

Structure of Suriname's Central Government Expenditure

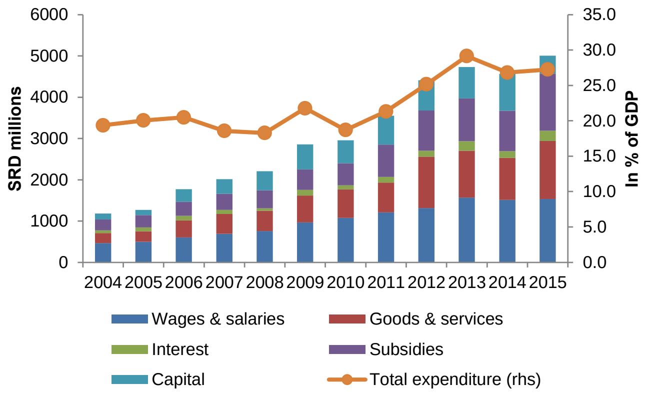
Government expenditure as a share of GDP declined over time before increasing at the onset of the super commodity cycle. Total government expenditures decreased from an average of 45 percent of GDP in the 1980s to 21.5 percent and 20.6 percent in the 1990s and 2000–09 periods, respectively. In the past six years,

[8] The public sector employs 60 percent of the formal w orkforce.
[9] Although government investment in education and health facilities improves human capital formation, it can also be unproductive and generate high inefficiencies (IMF, 1995).
[10] The Hodrick-Prescott filter w as used to extract this trend.

[11] These tw o sectors are dominated by bauxite refining for foreign markets and food processing of local agricultural products (mainly for the local market).
[12] There is no official data on total government consumption to GDP, therefore, calculations are based on authors' estimation.

average government expenditure to GDP increased to 25 percent given capital investment in various infrastructural projects. Government expenditure is driven mainly by wages and salaries. Wages and salaries account for 34 percent of total public expenditure and 9 percent of GDP (Figure 5),[13] which is relatively high compared to other Caribbean countries. The large public sector suggests that the impact of government spending on aggregate demand is relatively larger. With regard to functional expenditure, the principal spending areas in the past five years are in finance and planning (14.3 percent of total), education (13.4 percent), civil engineering works (13.2 percent), and social affairs (10.8 percent). Capital spending is small and more volatile, with large spending cuts occurring mainly during fiscal consolidation periods.[14]

Figure 5: Annual Government Expenditures



Sources: Central Bank of Suriname, WEO (October 2016), and IDB.

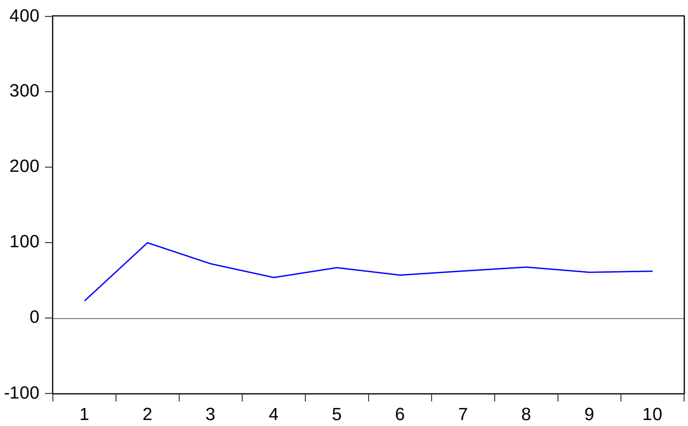
Primary Expenditure Impact on Economic Growth

The impulse response functions (IRFs) of the VECM show the effects of shocks on the adjustment path of variables.[15] Preliminary findings from the IRFs hint to a positive impact of primary expenditure on economic growth. A one standard deviation shock to primary expenditure has a positive effect on economic growth in the first two years before declining to year four and then leveling off for the remainder of the 10-year period (Figure 6).

When expenditure is disaggregated into current and capital expenditure, current expenditure is found to positively influence real GDP. Surprisingly, capital expenditure negatively affects economic growth until period three before demonstrating an increasing effect (Figure 7). These results were consistent using the ordinary least squares (OLS) technique.

Figure 6: Impulse of Real GDP to Primary Expenditure

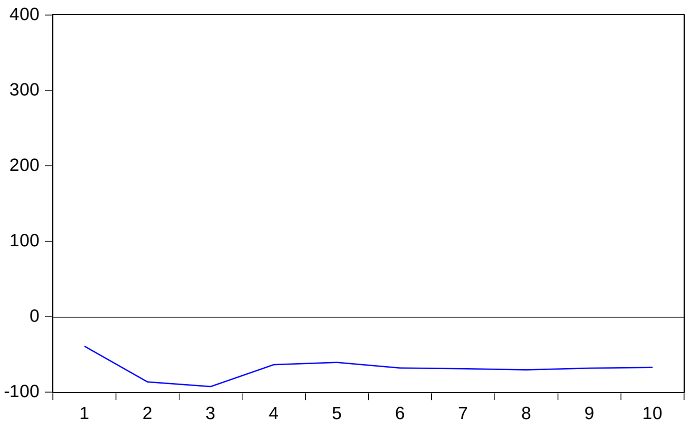
Response of DRY to DPGE



Source: Output from VECM using Eviews.

Figure 7: Impulse of Real GDP to Capital Expenditure

Response of DRY to DCAP



Source: Output from VECM using Eviews.

Conclusion

This note looked at the impact of primary expenditures on economic growth. Similar to Alshahrani and Alsadiq (2014), primary expenditure was found to positively influence real GDP, with current expenditure having a greater influence. Surprisingly, capital expenditure on economic services had a negative impact on economic growth, suggesting a review of the core growth sectors and choosing areas that have a larger effect on growth. For public investment or expenditure to play an important

---

[13] For additional discussion on expenditure composition, see Caribbean Region Quarterly Bulletin Volume 5(2): 34–36.

[14] The government's fiscal consolidation program in 2015 saw capital expenditure falling by about 3 percent of GDP.

[15] For this note, the variables used were primary expenditure (also decomposed by current and capital), consumer price index, and real GDP.

role in sustaining economic growth, sound technical and institutional capacities are required to ensure the prioritization and selection of investment projects with the highest economic and social rates of return.

The approach adopted is limited by the following: valuing public sector outputs; estimating separately the impact of how public expenditures are financed; and measuring the effects of other factors on economic growth (IMF, 1995). Also, with more available data, it would be beneficial to investigate the relationship between expenditure by functional classification (e.g., health, education, etc.) on real GDP growth to allow for improved public investment decisions. Pursuing private sector opportunities can also help stimulate growth, especially in an economy with a large public sector.

References

Alshahrani, S. A., and A. J. Alsadiq. 2014. “Economic Growth and Government Spending in Saudi Arabia: an Empirical Investigation.” IMF Working Paper WP 14/3. Washington, DC: International Monetary Fund.

Inter-American Development Bank. 2013. “Approximating the Informal Economy in Suriname.” *Caribbean Region Quarterly Bulletin* 2 (3).

Inter-American Development Bank. 2016. “The Key to Debt Sustainability: The Primary Balance.” *Caribbean Region Quarterly Bulletin* 5 (2).

International Monetary Fund. 1995. “Unproductive Public Expenditures: A Pragmatic Approach to Policy Analysis.” Pamphlet Series No. 48. Washington, DC: International Monetary Fund. https://www.imf.org/external/pubs/ft/pam/pam48/pam48con.htm.

Niloy, B., M. H. Emranul, and R. O. Denise. 2003 “Public Expenditure and Economic Growth: A Disaggregated Analysis for Developing Countries.” *JEL*.

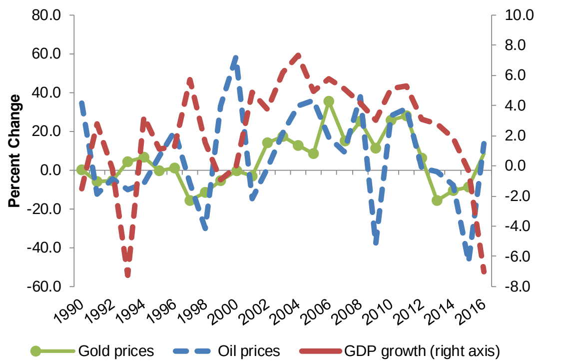
Ram, R. 1986. “Government Size and Economic Growth: A New Framework and Some Evidence from Cross Sectional and Time Series Data.” *American Economic Review* 76: 191–203.

Wu, S-Y., J-H. Tang, and E. S. Lin. 2010. “The impact of government expenditure on economic growth: How sensitive to the level of development?” *Journal of Policy Modeling* 32(6): 804–817.

Suriname's Macroeconomic Snapshot

Low commodity prices restricted economic growth...

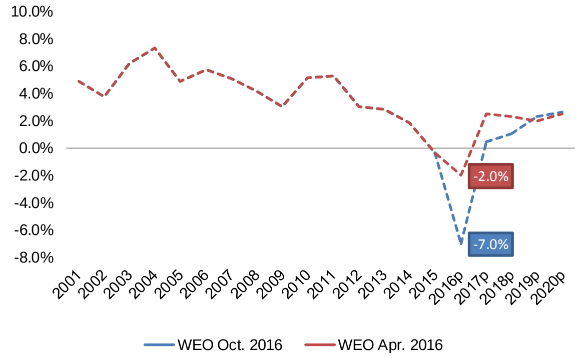
Figure A. Real GDP, and Commodity Prices



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

… and slow progress in the reform agenda will contract growth further.

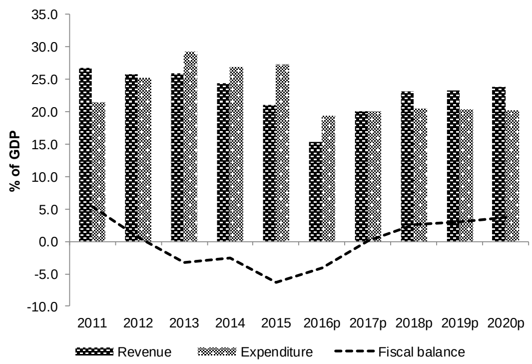
Figure B. GDP Growth



Source: World Economic Outlook (October 2016) .

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

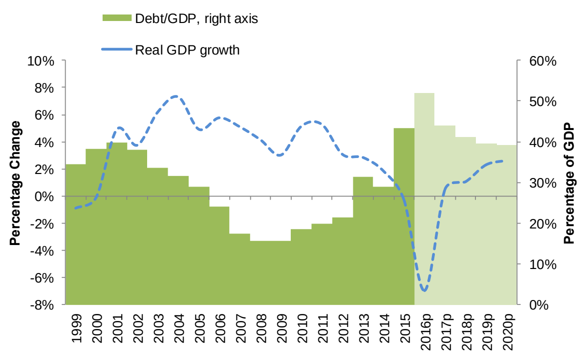
Figure C. Fiscal Performance



Source: World Economic Outlook (October 2016) .

… and the stock of debt will decrease in the medium term.

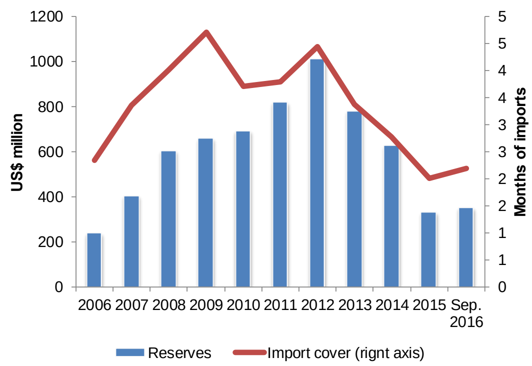
Figure D. Debt Evolution



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

International reserves fell with low oil prices and the hold in disbursements of the IMF program.

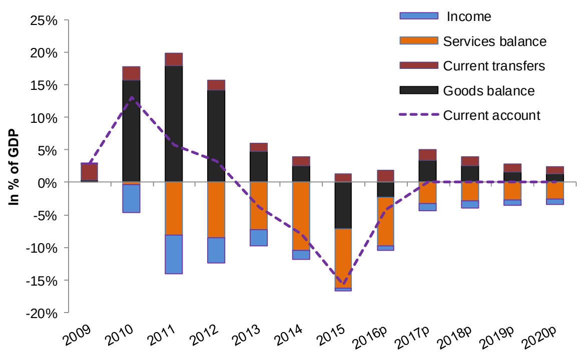
Figure E. International Reserves



Source: Central Bank of Suriname.

… and the current account balance should improve in the medium term with the start of mining operations.

Figure F. Current Account Balance



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

Suriname: Selected Indicators

	2008	2009	2010	2011	2012	2013	2014	2015	2016(e)
(Annual percentage changes, unless otherwise indicated)									
Real sector									
Real GDP	4.1	3.0	5.1	5.3	3.1	2.8	1.8	-0.3	-9.0
Nominal GDP	20.3	9.7	12.7	20.5	13.7	3.0	1.5	2.3	49.1
Inflation (end of period)	9.3	1.0	8.7	17.0	4.4	0.6	3.9	25.0	60.0
Unemployment	9.4	8.7	7.6	8.0	8.0	6.0	7.0	8.9	11.9
Exchange rates (end of period)	2.8	2.8	2.8	3.3	3.3	3.3	3.3	3.4	7.4*
(In percent of GDP, unless otherwise indicated, on a calendar year basis)									
External sector									
Exports of goods and services	56.9	44.1	52.5	60.3	57.7	50.6	45.2	36.0	42.2
Imports of goods and services	52.3	43.8	38.4	50.7	52.1	53.1	53.2	52.5	47.2
Current account	9.2	2.9	13.0	5.7	3.3	-3.8	-8.0	-15.7	-4.2
Gross international reserves (US$ millions)	602.5	657.0	690.8	816.9	1008.4	775.4	621.8	330.2	350.1**
Savings and Investment									
Private sector savings	45.5	47.0	50.5	57.2	60.3	59.9	64.9	56.4	63.0
Public sector savings	9.2	2.9	0.0	6.1	0.3	-1.6	-2.2	-5.4	-6.0
Private gross capital formation	38.7	35.2	29.1	48.7	49.9	54.1	63.3	64.2	58.5
Public gross capital formation	6.7	11.9	8.5	8.9	7.5	8.1	7.4	2.5	2.7
Central government									
Revenue and grants	23.8	25.1	20.2	26.7	25.7	25.9	24.2	21.0	15.2
Commodity-related revenues	7.8	7.4	5.3	10.7	10.1	9.0	7.0	3.1	2.0
Total expenditure	18.3	21.8	18.7	21.3	25.2	29.2	26.8	27.3	19.3
Primary balance	6.1	4.5	2.3	6.3	1.5	-1.9	-1.7	-4.9	-2.6
Overall balance	5.5	3.3	1.5	5.3	0.6	-3.3	-2.6	-6.3	-4.1
Debt indicators									
Total government debt	15.6	15.6	18.5	19.8	21.4	31.4	29.0	43.5	70.0
Government debt over revenues	65.6	62.0	91.6	74.4	83.1	121.4	119.7	207.4	341.4
Debt in foreign currency	9.0	6.9	7.7	10.4	11.3	14.7	15.9	21.6	35.8
Debt in domestic currency	6.6	8.6	10.8	9.4	10.1	16.8	13.1	21.8	16.3
Foreign currency debt as percent of exports of goods and services	15.9	15.7	14.6	17.3	19.6	29.0	35.1	60.0	84.8

Sources: Central Bank of Suriname; General Bureau of Statistics; World Economic Outlook, IMF (October 2016); IMF Press Release (November 17, 2016); IDB.

Notes: (e) denotes estimated figures; * data for November 21, 2016; ** data to September.

Contributor: Juan Pradelli

Overview

Economic activity contracted in 2016 but is likely to rebound in 2017. Petroleum industries, particularly natural gas-based output, were affected by temporary disruptions in 2016 but are expected to normalize production next year. Stagnated non-energy activity is likely to continue. Expenditure cuts introduced recently are maintained in the FY2016/17 Budget and thus fiscal policy remains austere. Monetary policy supports recovery with an unchanged repo rate.

Highlights

Energy sector will normalize in 2017 and ignite economic recovery.

Austerity continues in FY2016/17 as the Budget basically freezes nominal expenditure at the level achieved after recent cuts.

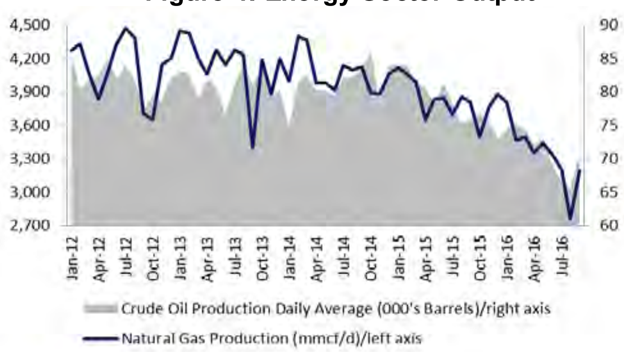
Monetary policy supports economic activity by keeping repo rate unchanged and managing liquidity.

Recent Developments and Outlook

Economic growth is expected to revive in 2017. According to the Central Statistical Office, economic activity will contract by 2.3 percent in 2016, with energy and non-energy output falling by 9.6 percent and 1.8 percent, respectively. Going forward, the FY2016/17 Budget Statement envisages a gradual recovery, with an annual growth forecast of 1 percent for 2017 and 2 percent for 2018–20. Domestic energy production will normalise in 2017 after several shutdowns for maintenance, and investment upgrading occurred in 2015–16. On the other hand, non-energy activities will remain depressed, as household and business confidence is feeble and the FY2016/17 Budget prolongs the spending cuts undertaken in the last few months.

Petroleum industries were severely affected by temporary disruptions in 2016 (Figure 1). Because of plant shutdowns, natural gas production fell to 3.8 billion cf/d in 2015 and further to 3.3 billion cf/d in the first nine months of 2016. Gas shortages spilled over to petrochemicals and LNG, negatively affecting their activity levels. Due to maturing fields and a secular reduction in extraction rates, crude oil production dropped to 78,700 b/d in 2015 and 71,200 b/d in January-September 2016. Current volumes of natural gas and oil are 10 percent below the average daily output observed in 2010–14.

Figure 1. Energy Sector Output

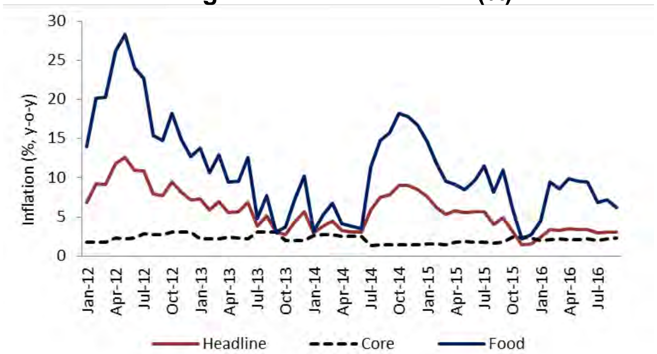


Source: Central Bank of Trinidad and Tobago.

Labour market conditions deteriorated with significant job losses. According to the Central Statistical Office, 16,200 jobs were lost (in net terms) between Q2:2015 and Q2:2016 and the unemployment rate rose from 3.2 percent to 4.4 percent in the same period. Outright job losses are hitting petroleum, manufacturing, transport, and construction.

Recession has contained price inflation (Figure 2). Using the Index of Retail Prices, headline inflation was 3 percent (y-o-y) in September 2016 against 4.9 percent (y-o-y) in September 2015. Despite the discrete policy-driven price adjustments in recent months (e.g., extension of VAT base and increases in fuel prices), the economic recession contains inflationary pressures. Going forward, it is uncertain whether the higher price level of food and fuel 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 (%)



Source: Central Bank of Trinidad and Tobago.

FY2016/17 Budget presented on September 30 remains austere. Its underlying assumptions are conservative: real GDP growth at 1 percent in 2017, WTI crude oil price at 48US$/bl and Henry Hub natural gas price at 2.25US$/mmbtu (i.e., close to current levels). Budgeted revenue is TT$47.4 billion (31 percent of GDP), including a very conservative estimate of energy revenue (TT$2.6 billion) and large receipts from one-off asset sales (TT$5 billion). Budgeted expenditure is TT$53.4

billion (35 percent of GDP), including reduced capital spending (TT$5.4 billion) and significant interest payments (nearly TT$7 billion). The resulting budget deficit is TT$6 billion (3.9 percent of GDP). For practical purposes, the Government intends to freeze selected operational and capital expenditures at the lower levels achieved in the last few months. With the FY2016/17 budgeted spending close to the preliminary estimate for FY2015/16, no stimulus on the non-energy activity is to be expected in 2017.

New revenue measures introduced in the FY2016/17 Budget. The Budget further raises diesel prices and thus reduces fuel subsidies. It envisages a new income tax bracket, higher taxes on alcohol and tobacco, and a levy on online purchases, with an expected revenue gain of nearly TT$750 million. The Government expressed its intention to establish a single Revenue Authority in 2017 to strengthen tax administration. As in 2015 and 2016, large receipts are expected from one-off asset sales, including IPOs for TTNGL (TT$1.5 billion), First Citizen Holdings (TT$1.5 billion), industrial estates of eTecK and Trinidad Generation Unlimited (TT$1.1 billion), and a divestment of Lake Asphalt.

Monetary policy continues to be cautious. In 2016, the Central Bank has argued that both the slow global growth and the weak performance of the domestic economy do warrant a more cautious approach, particularly when the lagged effects of the 2014–15 tightening cycle are materialising. On this basis, the monetary authority maintained the policy rate unchanged in the last five Monetary Policy Committee meetings. Such a cautious approach, which is in line with decisions made by other central banks in advanced economies, is likely to continue throughout 2017.

Trade imbalances persisted in 2016. In January-September 2016, the export volumes of LNG and crude oil declined by 18 percent relative to the same period in 2015. In addition, the averages of Henry Hub natural gas price and the WTI crude oil price (often used as price references in export contracts) were slightly lower than their average level in 2015. As a consequence, total exports in the first half of 2016 were US$4 billion, against US$5.5 billion in the first half of 2015. Total imports, instead, only declined (y-o-y) to US$4.4 billion from US$4.7 billion.

Pressures in the foreign exchange market continue. The currency peg to the U.S. dollar, a long-standing macroeconomic fundamental, has been preserved despite of the loss of foreign exchange earnings. With reduced hard-currency flows supplied by energy companies to the foreign exchange market, and increased demand for speculative and precautionary motives given an uncertain outlook, shortages have been recurrent since late-2014. To preserve the *de facto* currency peg, the Central Bank has sold international reserves in an amount of US$2 billion between December 2014 and July 2016. Facing large reserve losses, in late-2015 the authorities announced their intention to intervene in the foreign exchange market to manage a currency depreciation capped at 7 percent throughout FY2015/16. Eventually, the exchange rate against the U.S. dollar was allowed to depreciate by 6 percent since November 2015 to date. Net official reserves stood at US$9.8 billion at end-October 2016, including the US$1 billion proceeds of the global sovereign bond issued in July 2016.

Conclusion

Trinidad and Tobago faces the challenge to support economic activity with a narrow fiscal space. In a context of fiscal austerity and reduced margin for expansionary monetary policy, serious reforms are necessary to help the domestic economy recover. Reallocating government expenditure towards growth-friendly investment spending and away from transfers and subsidies (which are no longer affordable with lower energy revenues), as well as eliminating inefficiencies in expenditure management, are options to use a narrow fiscal space to stimulate output, income, and employment.

High-Frequency Macroeconomic Indicators

	Latest data	Period	Prior data	Period
Real GDP Growth (%, y-o-y)	-2.3	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, %)	6.2	Q1 2016	6.1	Q4 2015
Inflation (headline, % yoy change)	3.4	Jun.2016	3.4	May.2016
Exchange rate TT$/US$ (end of period)	6.70	Jul.2016	6.66	Jun.2016
Unemployment rate (%)	3.4	Q3 2015	3.2	Q2 2015

Source: Central Bank of Trinidad and Tobago.

Economic Recession and Fiscal Adjustment in the Era of Cheap Oil and Natural Gas

Trinidad and Tobago's economy is depressed, and growth anemic. At aggregate levels, the output gains achieved during the 2010–14 commodity boom have been wiped out since global prices of oil and natural gas collapsed in late-2014. In 2015–16, economic activity contracted by 2.9 percent (cumulative), and thus the real GDP in 2016 went back to the level observed in 2011. Energy output fell by 13.6 percent, largely due to the ongoing maturation of existing oil fields and the temporary disruptions in natural gas production associated with plant shutdowns and maintenance work. Spil-over effects—which operate through lower government revenue and expenditure, shrinking foreign-trade activity, and waning business confidence—constrained the non-energy output, which dropped by 0.6 percent.

Fiscal revenue losses put strain on public finances and government expenditure.[1] In the last two years, the government budget suffered an energy-revenue loss of TT$20.7 billion while the real economy activity contracted in all sectors. As a consequence, fiscal policy had to strike a balance between consolidating public finances (i.e., austerity) and stimulating the domestic economy (i.e., macroeconomic stabilization). By and large, austerity has prevailed in the formulation of fiscal measures inasmuch as three-quarters of the energy-revenue loss was absorbed by reducing government expenditures (with savings of TT$10.6 billion) and increasing non-energy recurrent revenues (with additional receipts of TT$4.6 billion). Arguably, the austerity-driven spending cuts contributed to weakening domestic demand and output in non-energy sectors. Contractive effects of budget consolidation operated through both direct channels (e.g., the TT$3.4 billion reduction in capital expenses negatively affected construction activity) and indirect effects (e.g., the TT$13.2 billion cut in transfers and subsidies reduced households' disposable income, which next impacted retail and distribution activity). Overall, the government expenditure fell by 18 percent in real terms in FY2015/16 and the non-energy output contracted by 1.8 percent in 2016. Ostensibly, the objective of macroeconomic stabilization has been less prominent in shaping fiscal policy because just one-quarter of the energy-revenue loss was offset by expanding deficit financing (with additional borrowings and one-off assets sales amounting to TT$2.9 billion and TT$2.6 billion, respectively).

Public debt is on a rising path, albeit it still remains manageable. In the context of a depressed economy and mounting budget deficits, the public debt increased from TT$70 billion in 2014 to TT$90 billion in 2016 (or 62 percent of GDP).[2] Credit ratings deteriorated but nevertheless the country firmly maintains its investment-grade status. The risk of debt distress is negligible in view of the hefty foreign assets in the public-sector balance sheet, including the Heritage and Stabilization Fund and the international reserves, which jointly total US$15 billion. In addition, the public debt portfolio remains within manageable margins and narrowly exposed to exchange-rate and rollover risks.[3]

Preserving the sustainability of public finances has become an explicit motivation for fiscal austerity and expenditure rationalisation. There are legitimate concerns about the medium-term sustainability of current budget policies in Trinidad and Tobago, notwithstanding the fact that the Government does have capacity to service the public debt in the near future. The FY2016/17 Budget Statement boldly acknowledged that on the back of commodity prices and energy revenue expected to remain depressed over the next few years, the expenditure policy underlying the existing welfare state can no longer be afforded in a sustainable manner and hence must be adjusted.[4]

The specifics of an expenditure adjustment program do matter. The Government's target of achieving a balanced budget by 2020 provides some guidance for the fiscal consolidation program. But admittedly it lacks details on the specific expenditure measures that should be adopted going forward. And the specifics do matter

[1] Figures reported in this paragraph refer to a comparison between budget aggregates for FY2013/14 (actuals) and FY2015/16 (estimates).

[2] Public debt includes guarantees extended to state-owned companies and statutory bodies, and excludes instruments used for monetary policy transactions. As National Accounts are being rebased by the Central Statistical Office, it is difficult to compare debt-to-GDP ratios over time. For instance, prior to rebasing, the initial estimate of 2015 nominal GDP was TT$165 billion; next, the figure after rebasing was TT$150 billion.

[3] The foreign currency-denominated external public debt is less than 12 percent of GDP; the international bonds and foreign loans exhibit long maturities; and the local currency-denominated domestic securities are held by banks that have plenty of liquidity and often oversubscribe the regular Treasury paper auctions.

[4] The welfare state was built during the commodity booms of 2004–08 and 2010–14 in order to redistribute the natural-resource wealth among the citizenry at large. In 2004–14, on average, the energy revenue represented 17 percent of GDP and provided at least half of the Central Government income. Budget expenditures could then expand from 27 percent of GDP to 36 percent in that period, with fairly small fiscal deficits often below 3 percent of GDP (except in 2009). Nowadays, with energy revenues falling below 5 percent of GDP in 2016, a failure to rationalize government spending would entail an imprudent widening of budget imbalances, growing borrowing requirements, and the attendant accumulation of public debt. Austerity measures introduced in 2015–16 already sought to preserve debt sustainability by allowing for a modest increase in fiscal deficits, and in addition, by resorting to sizable one-off asset sales to fund budget imbalances (and not solely relying on new borrowings).

because reducing the level (or growth) of government spending will impact the performance of non-energy sectors and the fiscal revenues collected out of them, as observed in 2016. In addition, since the multiplier effects differ across the types of spending, the composition of the expenditure adjustment program can exacerbate or mitigate the adverse impact on non-energy output and revenue growth. These macroeconomic interactions should be assessed when formulating a strategy to rationalise public expenditure.

Assessing Effects of Expenditure Adjustment Programs on Growth, Fiscal Balance, and Debt

Government spending significantly affects non-energy economic activity. The relationship between real public expenditure and non-energy economic activity is estimated econometrically using a Vector Autoregression (VAR) model. Non-energy output and the real exchange rate are treated as endogenous variables, while real government spending is assumed to be policy-driven and exogenous. The VAR model is specified in terms of annual percentage changes (i.e., growth rates) and estimated using historical data for the 1966–2015 period.[5] According to the estimated VAR's impulse-response function, a 10 percentage point (p.p.) reduction in the growth rate of real government spending in 2017 (equivalent to a TT$5.2 billion expenditure cut) causes a decline in the growth rate of non-energy output by 0.6 p.p. in the same year, 1.2 p.p. in 2018, 0.5 p.p. in 2019, and 0.3 p.p. in 2020.

Medium-term outlook for non-energy output growth depends on how austere an expenditure adjustment program is. For illustrative purposes, we consider two adjustment programs for the period 2017–20: a freezing of nominal spending at TT$53.4 billion (i.e., the expenditure level budgeted for FY2016/17); and a freezing of spending in real terms (i.e., adjusted by domestic inflation, assumed to be 5 percent per year). The former program is more austere than the later one. The average annual growth of non-energy output in 2017–20 estimated using the VAR model is 0.4 percent under the nominal spending freeze, or 1 percent under the real spending freeze. Austerity driving public expenditure policy therefore matters for the growth outlook of non-energy sectors. Overall economic performance in the next few years, however, will be largely supported by the recovery of the energy sector: according to the IMF 2016 Art. IV, the average annual growth of energy output in 2017–20 is expected to be 4.7 percent, i.e., much better than any possible growth outlook for the non-energy output.[6] Thus, putting both sectors together, real GDP is expected to increase by 1.8 percent per annum—on average—until 2020 if expenditure remains unchanged in nominal terms, or by 2.2 percent if expenditure remains unchanged in real terms.

An expenditure adjustment program affects budget balances and debt through both reduced spending and lower non-energy revenue growth. Government revenue is projected conservatively assuming that non-energy recurrent revenue expands in tandem with non-energy output and domestic inflation in 2017–20, and thus these receipts are affected by the public expenditure policy. It is also assumed that the energy revenue increases from TT$2.6 billion in 2017 to TT$16 billion in 2020 and the one-off asset sales are discontinued in 2018. Thus, the nominal spending freeze is expected to improve budget balances from a deficit of 3.9 percent of GDP in 2017 to a surplus of 2.3 percent of GDP by 2020. In addition, it will maintain the level of public debt around 62–65 percent of GDP until 2019 and bring it down to 58 percent by 2020. On the other hand, the real spending freeze is expected to narrow budget imbalances slightly less and achieve a deficit of 1.9 percent of GDP by 2020—which implies not meeting the fiscal target of a balanced budget. Besides, it will lead the public debt to exceed 65 percent of GDP throughout 2018–20, albeit on a decreasing path thereafter.

Assessing Effects of Expenditure Reallocation Programs on Growth, Fiscal Balance, and Debt

The structure of government spending also affects non-energy economic activity. Another VAR model is estimated to assess the relationship between major components of the real public expenditure and non-energy economic activity. Four spending categories are introduced into the VAR model as exogenous variables: capital investment; transfers and subsidies; goods and services; and wages and salaries. Model specification and data are similar to the VAR model described earlier.[7]

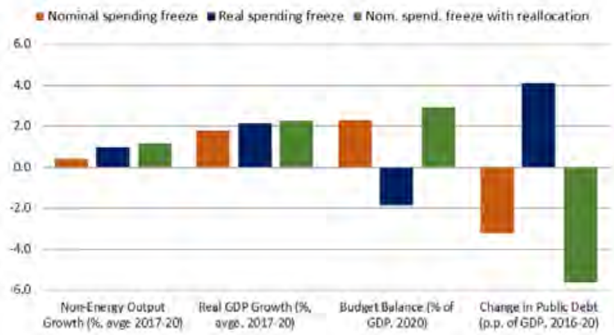
[5] The VAR's specification includes two lags of the endogenous variables, one lag of the exogenous variable, and time dummies to capture four particular events—the crises of 1983 and 2009, and the currency devaluations of 1986 and 1993–94. Data are from the Central Bank of Trinidad and Tobago online database and fiscal variables correspond to the Central Government.

[6] Arguably, the performance of the energy sector hinges upon global and domestic conditions unaffected by the expenditure adjustment program, e.g., suspension of plant shutdowns in 2017, new gas fields coming on stream in 2017–20, and the still uncertain dynamics of world prices of oil and natural gas in the medium-term.

[7] The model is specified in terms of annual percentage changes and estimated using 1966–2015 data. It includes two lags of the endogenous

Growth effect differs across spending categories. The VAR's impulse-response functions suggest the effect on non-energy output varies across the four types of real expenditure. Thus, for instance, a 10 p.p. reduction in the growth rate of real capital spending in 2017 (equivalent to a TT$0.5 billion cut) causes a decline in the growth rate of non-energy output by 0.3 p.p. in the same year, 0.3 p.p. in 2018, 0.2 p.p. in 2019, and 0.1 p.p. in 2020. Instead, if the growth rate of real spending in transfers and subsidies is reduced by 10 p.p. in 2017 (equivalent to a TT$2.2 billion cut), the growth rate of non-energy output declines by 0.1 p.p. in 2017 but increases by 0.3 p.p. in 2018 and 0.1 p.p. in 2019 and 2020. It is then possible to exploit the different multiplier effects and introduce a reallocation of resources among spending categories into an expenditure adjustment program.

Figure 3. Expenditure Programs - Performance



Source: Author's calculations.

A program reallocating spending can help mitigate the adverse growth effect of an austerity-driven adjustment in the level of government expenditure. For illustrative purposes, we reconsider the adjustment program freezing nominal spending in 2017–20 at TT$53.4 billion by assuming the annual capital expenditure is increased by TT$1 billion per year from 2018 to 2020, while the annual expenditure in subsidies and transfers is reduced by an identical amount.[8] Under this adjustment-cum-reallocation program, the average annual growth of non-energy output in 2017–20 estimated using the VAR model is 1.2 percent and the corresponding annual real GDP growth is 2.3 percent. These figures exceed those obtained earlier under a pure nominal spending freeze; therefore, the austerity-led growth effect can be significantly mitigated by a strategic reassignment of spending priorities.

variables, one lag of the exogenous variable, and time dummies to capture events of crises and currency devaluations.

[8] Capital expenditure increases to TT$8.4 billion by 2020 while subsidies and transfers decrease to TT$19 billion. The VAR model's forecasts in 2017 are adjusted so they match the forecasts obtained with the VAR model using total real expenditure.

A program reallocating spending can also improve budget and debt outcomes. The adjustment-cum-reallocation program both tightens nominal expenditure and mitigates output losses, and hence it can largely improve budget and debt outcomes. Budget balances are expected to improve from a deficit of 3.9 percent of GDP in 2017 to a surplus of 2.9 percent of GDP by 2020, while the public debt peaks at 65 percent of GDP in 2018 and decreases to 56 percent by 2020. Again, these results compare favorably vis-à-vis those found under a pure nominal spending freeze.

Policy Implications

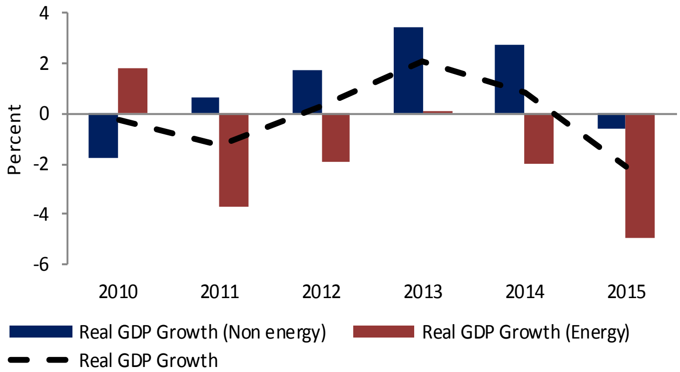
To a significant extent, Trinidad and Tobago has already adjusted government expenditure downward, and thus the policy challenge going forward is to strictly control the growth of spending programs. It is a fact that budget spending declined by 18 percent in real terms in FY2015/16, contributing to a large contraction in domestic economy activity.[9] This consolidation effort sets a solid initial condition for public expenditure policy going forward. The challenge now is to establish a strict control on spending programs in order to maintain their current level for a while (along the lines of the more austere expenditure adjustment program discussed above). As long as there are legitimate concerns about the negative effect on economic growth of freezing nominal spending, the Government should consider either allowing some modest expansion of expenditures (in the spirit of the freezing of real spending), or reallocating budgetary resources towards investment and away from subsidies and transfers. The later option is preferable on grounds of fiscal sustainability.

Another policy challenge is to resist temptation to expand government expenditure if and when energy revenues increase. Although in 2015–16 the budget deficits widened to nearly 5 percent of GDP (or even higher at 8–9 percent of GDP if one-off asset sales are excluded), it will be possible to narrow down these imbalances once the expected normalisation of natural gas production yields higher energy revenue. For this to happen, however, expenditures must be maintained under control and not increase in tandem with energy revenues. It is worth noting all the three expenditure programs analysed do lead to a gradual improvement in budget balances and debt sustainability precisely because the likely recovery in government revenues is not used to bring spending back to the high, no longer affordable levels achieved during the commodity booms.

[9] Expenditure fell from 41 percent of GDP in 2015 to 36 percent in 2016.

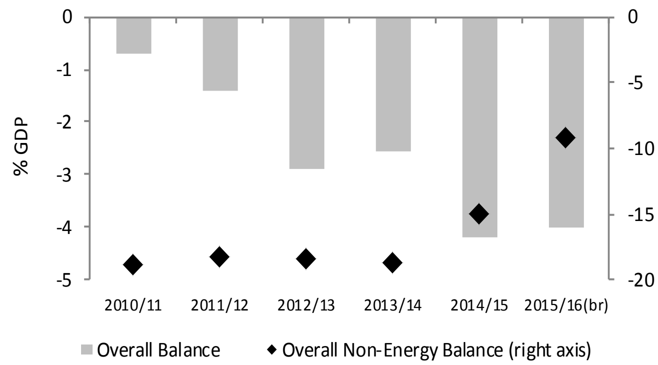
Trinidad and Tobago: A Snapshot of the Economy

The economy entered in a recession in 2015 ...

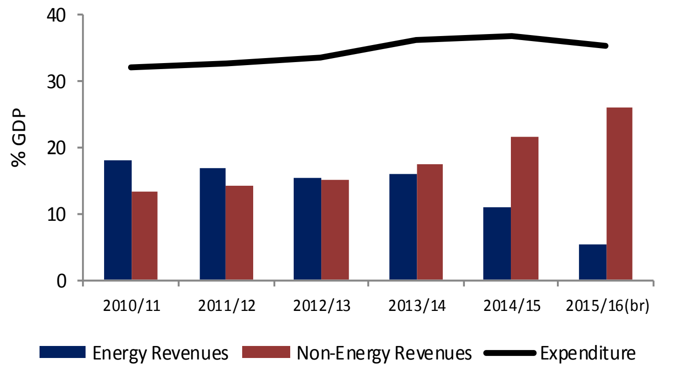


... and the labour market no longer creates jobs.

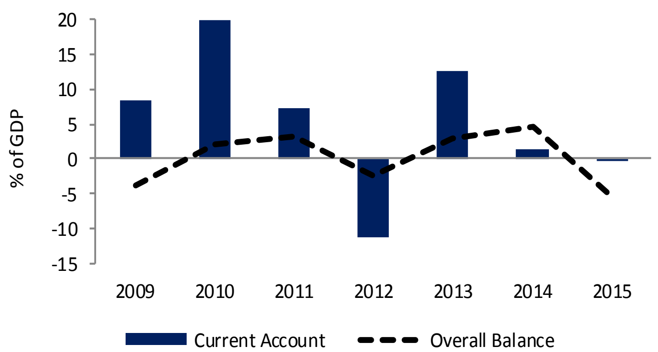
Government's fiscal policy gears towards consolidation ...



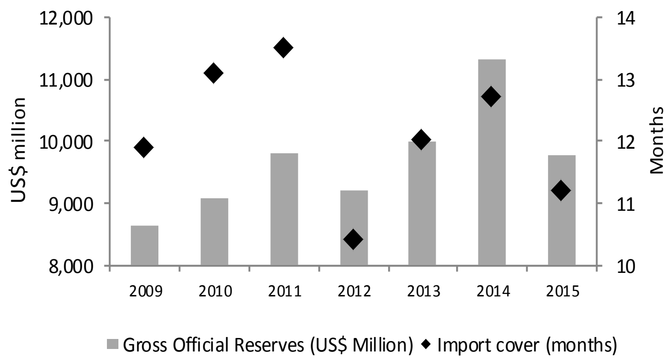
...with initiatives to boost non-energy revenue and cut expenditure.



External position deteriorates due to lower energy exports ...



... and further tightens the foreign exchange market.



Source: Central Bank of Trinidad and Tobago

Notes: Figures in FY2015/16 refer to Mid-Year Budget Review

Trinidad and Tobago: Selected Indicators

	2010	2011	2012	2013	2014	2015
	(Annual percentage changes, unless otherwise specified)					
Real Sector and Prices						
Real GDP /1	-0.2	-1.3	0.3	2.1	0.8	-2.1
Real GDP - Energy /1	1.8	-3.7	-1.9	0.1	-1.9	-4.9
Real GDP - Non-energy /1	-1.8	0.6	1.8	3.4	2.8	-0.6
Headline Inflation	10.5	5.1	9.3	5.2	5.7	4.7
	(In percentage of GDP, unless otherwise specified)					
External Sector						
Exports (merchandise)	53.4	61.2	52.5	68.8	50.4	39.0
o.w. Energy Exports	44.8	51.6	39.8	55.7	41.9	30.4
Imports (merchandise)	30.9	38.9	47.4	46.3	39.1	34.2
o.w. Energy Imports	12.7	17.6	22.7	26.2	19.3	11.9
Trade Balance (merchandise)	22.5	22.3	5.2	22.4	11.4	4.8
Services Balance	2.3	-2.6	-2.7	-1.6	-1.6	-2.7
Income Balance	-5.1	-12.6	-13.8	-8.3	-8.4	-2.3
Current Transfers (net)	0.1	0.1	0.1	0.1	-0.1	-0.2
Current Account	19.8	7.3	-11.1	12.5	1.3	-0.4
Capital and Financial Account	-17.8	-4.2	8.6	-9.7	3.3	-5.2
Overall Balance	2.0	3.1	-2.5	2.9	4.6	-5.5
Variation in Int'l Reserves (US$ billion)	0.4	0.8	-0.6	0.8	1.3	-1.5
	(In percentage of FY GDP)					
Central Government (on a FY basis) /2						
Revenue and Grants	34.0	31.5	31.3	30.8	33.6	32.7
o.w. 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
o.w. Transfers and Subsidies	17.4	16.6	17.3	17.6	20.0	18.8
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 (on a FY basis) /2						
Net Public Sector Debt	35.3	31.2	39.4	39.1	40.9	45.4
CG External Debt	7.7	7.2	5.9	8.2	7.9	8.2
CG External Debt Service	1.1	1.0	1.3	0.8	1.1	1.3

Source: Central Bank of Trinidad and Tobago

Notes: 1/ CBTT estimates using QGDP Index

2/ E.g., the figures reported in 2015 correspond to FY2014/15

Contributors: Camilo Gomez Osorio and Kimberly Waithe

Recent Developments[1]

Tourism performance across the OECS was mixed in 2016. Antigua and Barbuda, Grenada and St. Vincent saw dynamic growth in tourist arrivals at 9 percent, 3.6 percent and 9.2 percent, respectively. The robust performance in Antigua and St. Vincent were attributed to a pick-up in arrivals from the United States by 18.7 percent and 10.4 percent, respectively. Grenada and St. Vincent led the recovery in the cruise passenger segment, with growth of 34.2 percent and 8.7 percent, respectively, according to the Caribbean Tourism Organization (CTO). St. Lucia saw fewer cruise stops, recording a decline of 18.1 percent, compared to the first eight months of 2015. In Dominica, long stay arrivals declined by 11 percent with storm Erika, and in St. Kitts they declined by 3.2 percent. (Table 1).

Table 1: Tourism Statistics (% change)

	Long-Stay Visitors by Air		Cruise Ship Passengers		Total Visitor Expenditure
	2015	Jan- Sep 2016	2015	Jan- Sep 2016	Jan- Jun 2015
Antigua	0.5	9.0	22.4	-5.8	7.7
Dominica*	-2.9	-11.1	-7.6	-4.6	-7.7
Grenada**	4.4	3.6	3.6	34.2	1.0
St.Kitts*	4.4	-3.2	30.9	-7.3	-2.7
St.Lucia**	2.0	0.3	5.6	-18.1	-8.7
St.Vincent*	6.6	9.2	-3.6	8.7	8.7

Source: ECCB and CTO.
*Long stay and cruise arrivals data up to June 2016.
**Long stay and cruise arrivals data up to August 2016.

Fiscal consolidation continued in 2016 in the union. Since 2013, efforts to rein in fiscal deficits have been bearing fruit. The average primary balance improved from -0.5 to 2.1 percent of GDP between 2013 and 2015, while the overall balance narrowed from -3.3 to -0.5 percent of GDP. St. Kitts maintained an overall fiscal surplus at US$34.8 million for 2016 relative to US$27.5 million for June 2015, while Antigua's surplus declined by US$17 million. Dominica saw its fiscal deficit fall to US$3.6 million in June 2016 from US$18.3 million 12 months earlier. Similarly, St. Vincent and the Grenadines' deficit fell to US$0.6 million from US$9 million. Grenada and St. Lucia also saw an improvement from a deficit of US$1.3 million and US$11.8 million to a surplus of US$16.5 million and US$11.4 million, respectively.

[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. ECCU: Eastern Caribbean Currency Union.

Highlights

The growth outlook for the OECS is positive with gradual tourism recovery and a dynamic construction sector.

Fiscal consolidation in the OECS continued in 2016.

New cruise ships will arrive in Antigua and more flights will land in Grenada during early 2017.

Tropical Storm Matthew had an adverse impact on St. Lucia's agriculture sector.

Reconstruction continues in Dominica. A new hospital and newly approved private investment projects.

New cruise ships to Antigua. A number of new cruise lines will make inaugural calls in Antigua and Barbuda over the coming months. Viking Cruises will make 13 calls with 900 passengers each and Pullmantur will make 19 calls with 1,800 passengers each. The MSC Armonia with 2,679 passengers and the Carnival Vista with 5,000 passengers will follow. In addition, Columbia Cruise Services, with its Thompson Discovery will have a weekly visit with 1,800 passengers. This would contribute to reverse the contraction in cruise passenger arrivals of 5.6 percent that was evident from January to September 2016, compared to the same period a year earlier.

Business process outsourcing (BPO) center to open in Antigua and Barbuda. In October, Antigua and Barbuda broke ground on new US$25 million call center. Construction of this facility has commenced and it is expected to provide up to 150 construction jobs and 800 permanent jobs.

Dominica will construct a new hospital. The ground-breaking ceremony was held in August and the construction of the new national hospital was slated to begin at the end of October. China is funding the EC$40 million (US$14.8 million) facility.

Dominica signed agreements with developers of three projects approved under the Citizenship by Investment Program (CBI). Following a 5 September agreement signing, three projects were approved: the Silver Beach Resort and Spa, to be constructed at Picard, Portsmouth; the new Jungle Bay Resort at Morne Aucouma, Soufriere; and Bois Cotlette Estate development in Soufriere. Ground is expected to be broken on the Bois Cotlette Estate in March 2017. Jungle Bay Resort is expected to feature 120 eco villas and would employ around 100 people, while Silver Beach

Resort would employ 600 workers upon opening. The CBI program in Dominica requires a contribution of US$100,000 or a real estate investment of a minimum US$200,000.

World Bank funds a water project in Dominica. The World Bank Disaster Vulnerability Reduction Project (DVRP) is funding a US$2.5 million project that will fortify the water supply for 10,000 residents in over 20 communities. On a national level, the beneficiaries account for an estimated 15 percent of the population. The Dominica Water and Sewerage Company (DOWASCO) will conduct the tender process for the construction of eight 30,000–100,000gallon water tanks. A number of communities have struggled with water shortages since Tropical Storm Erika hit Dominica in August 2015.

Dominica will receive technical assistance on geothermal energy from New Zealand. The donor country signed a US$1.5 million Partnership Agreement in support of a 7 MW geothermal plant for Dominica. The agreement, active for the period 2016–2019, includes technical advice for engineering and design; project management support; an environmental and social impact assessment; management plan and management system; and a 24-month project manager.

Grenada will see more flights and frequencies from New York in 2017. In the first seven months of 2016, there was a 19 percent increase in arrivals from New York. Starting in January 2017, JetBlue will add a weekly flight, increasing its flight service from New York to Grenada to five nonstop roundtrip flights a week and its weekly capacity to 750 passengers. It is estimated that New York contributed 19,000 stay-over arrivals to Grenada last year, making it the most important tourist provider.

Park Hyatt is expected to create jobs in St. Kitts and Nevis. The resort at Christophe Harbour is seeking to add 150 additional workers across a full spectrum of job skills. The resort provided over 550 construction jobs, a number likely to increase to complete the project by the end of the year. In addition to the more than 300 permanent positions that the hotel has filled, the Park Hyatt will be responsible for a total of more than 1,000 jobs. The five-star hotel will feature 126 guest rooms, outdoor infinity pools, a fitness center, spa, three restaurant and beverage options, and 7,000 square feet of meeting/banquet space. The Park Hyatt is scheduled to open in March 2017.

Tropical Storm Matthew affected the agriculture sector in St. Lucia. The agricultural sector suffered with the tropical storm Matthew, with up to 85 percent of farms reporting losses, according to the National Emergency Management Organization (NEMO). Other sectors reported minor to moderate damage. St. Lucia's agricultural sector, which accounts for around 3 percent of GDP, has been adversely impacted by a number of weather-related events consecutively over the last few years.

CARICOM Development Fund (CDF) will invest in a solar project in St. Vincent and the Grenadines. An agreement was signed between the Government and the CDF for a concessionary loan for the Solar Photovoltaic Renewable Energy Project at Argyle International Airport. The project will produce 281 kW of power and will increase SVG's solar capacity to more than 1,000 kW. The solar project brings the total amount of CDF loan assistance to more than US$8 million. The plant will save SVG between EC$3 to 3.5 million (US$1.1–1.3 million) annually.

Outlook

The growth outlook for the OECS is positive. The gradual tourism recovery and a dynamic construction sector will be conducive to growth with spillover effects into the services sectors. Private tourism projects and Citizenship-by-Investment real estate projects would continue to drive construction. Output for the union would average around 3 percent in 2016. Growth in St. Kitts may reach 5.1 percent in 2016, Antigua estimates at 2.1 percent, St. Lucia at 2.3 percent, and St. Vincent at 1.5 percent. In the case of Dominica, the contraction would be reversed by 2016 and subject to the impact from reconstruction efforts and donor grants. While the ECCB forecasts a contraction of 1.1 percent in Grenada, the IMF projects positive growth of 3 percent, with agriculture and tourism leading the way.

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

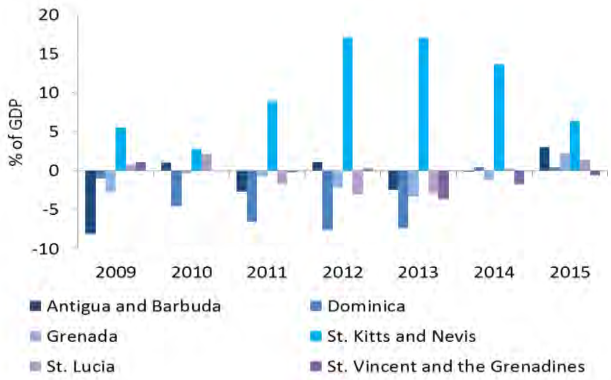
High-Frequency Marcoeconomic Indicators				
	Last Data	Period	Last Data	Period
Annual GDP growth (%)	1.9	Dec-15	3.4	Dec-14
Tourism arrivals (annual % change)	(1.0)	Jun-16	5.6	Mar-16
Inflation (end of period)	(0.06)	Jun-16	(1.34)	Mar-16

Is the Eastern Caribbean Living Within its Means?

For the tourism–based economies of the Eastern Caribbean, the 2009 global downturn brought contraction in economic activity, which translated into lower revenues, higher spending, and rapid accumulation of public debt. Frequent natural disasters, in particular hurricanes and floods, left high reconstruction bills on a recurring basis for countries that had no fiscal space and contingency funds. However, these costly adverse external shocks were only half of the region's fiscal story. At the heart of the deterioration of the Eastern Caribbean's fiscal position were domestic developments and loose fiscal policy.

The growth of public spending outpaced revenue collection and widened primary deficits. Since the 2009 downturn, all islands with the exception of St. Kitts and Nevis sustained fiscal deficits, the union's annual average stood at -2.5 percent of GDP from 2009–2015, and islands borrowed to close the revenue gap. The lower revenue collection came with double-digit wage bills in some countries, significant capital investment in others, and contingent liabilities. Sustained primary deficits at a time of higher interest rates and stagnant GDP growth contributed to rising trends. The fact that union members have limited financial market access and do not benefit from concessional financing meant that portfolios carried greater risk with higher interest rates and shorter maturities. (Figure 1).

Figure 1. Primary Deficits 2009–2015 (% of GDP)



Source: Eastern Caribbean Central Bank.

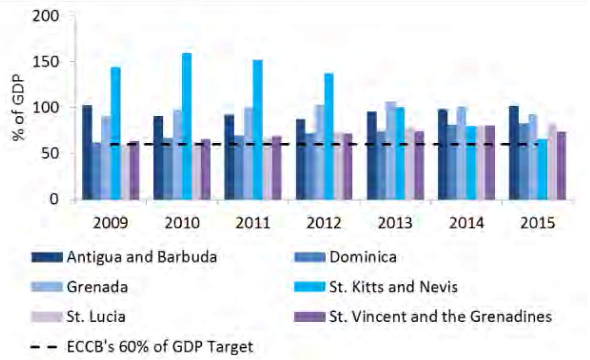
The public sector wage bill grew to become the largest budget item, averaging 45 percent of total expenditures in 2015. The average public sector wage bill in the union, at the two-digit level, is amongst the highest in the world. These numbers are also on the low side because they exclude other "benefits" and contractuals that perform civil service duties, but are paid through the "goods and services" budget. St. Vincent and St. Kitts lead the way with the most expensive wage bills, at 12.6 percent and 11 percent of GDP in 2015. (See Annex I on composition of public spending)

Transfers and subsidies are the second public spending priority in the OECS. The budget for transfers and subsidies increased to 5.7 percent of GDP in 2015. St. Kitts allocated 7 percent of GDP in 2015, followed by Antigua and St. Vincent at 6.8 percent of GDP, respectively.

Capital expenditures have widened the fiscal position of the Eastern Caribbean. In the absence of monetary policy instruments to stimulate output, the OECS countries pursued expansionary fiscal policy in years of stagnant tourism growth after the 2009 downturn. This led to above average share of capital investment at above 5–6 percent after 2007. In 2015, Dominica reported capital expenditures at 8.7 percent, the highest in the region and a trend evident since 2010 (its average public investment stood at 11.6 percent of GDP annually for the period 2010–2014). The exception was Antigua where capital expenditure averaged 1.3 percent of GDP annually during 2011–2015. While these investments were growth-positive, the issue was one of affordability, and they contributed to higher public debt across the union.

Today, debt levels across the union are high at an average 80 percent of GDP in 2015 and at 102 percent of GDP in Antigua alone. Compared to other Caribbean islands, these levels may seem lower but are above the ECCB debt target of 60 percent of GDP (by 2030) and above the thresholds on the levels of debt that upper-middle-income countries may carry before obligations become a drag on growth.

Figure 2. Public Debt in the OECS, 2009–2015 (% of GDP)

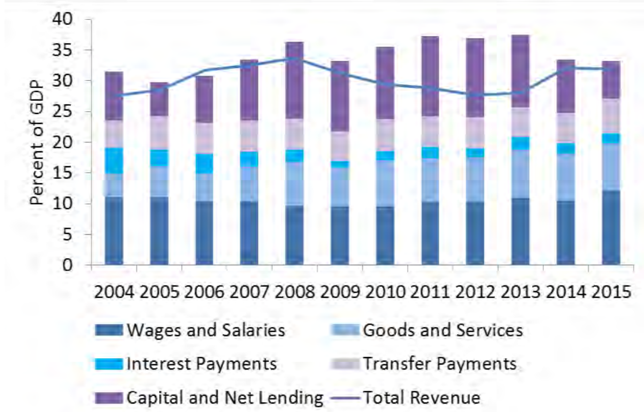


Source: ECCB.

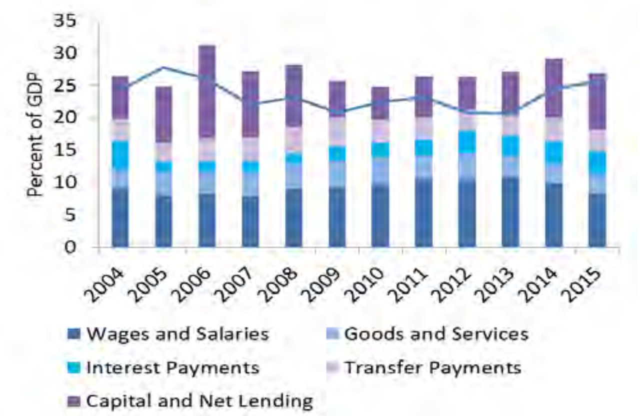
Annex I. Public Spending Composition in the OECS

Antigua and Barbuda

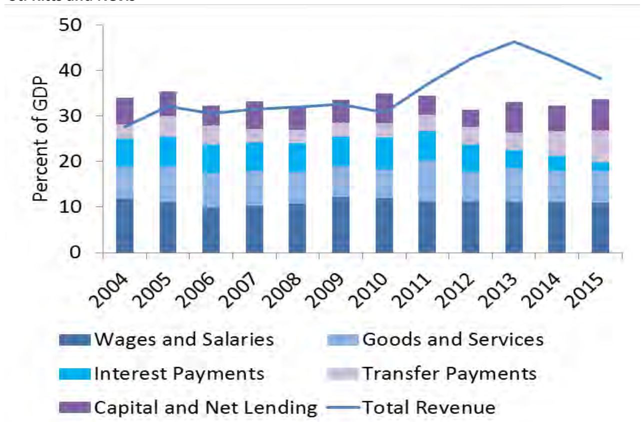
Dominica



Grenada

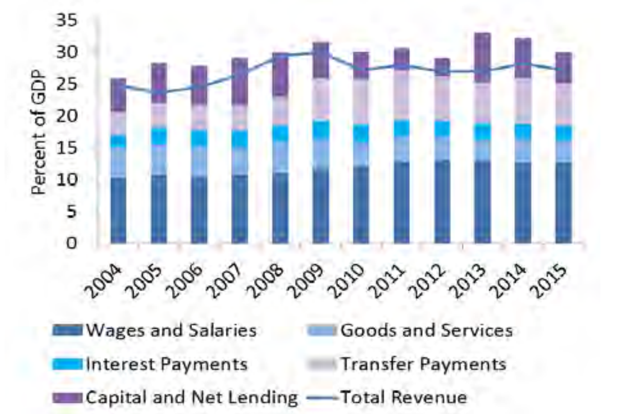


St. Kitts and Nevis



St. Lucia

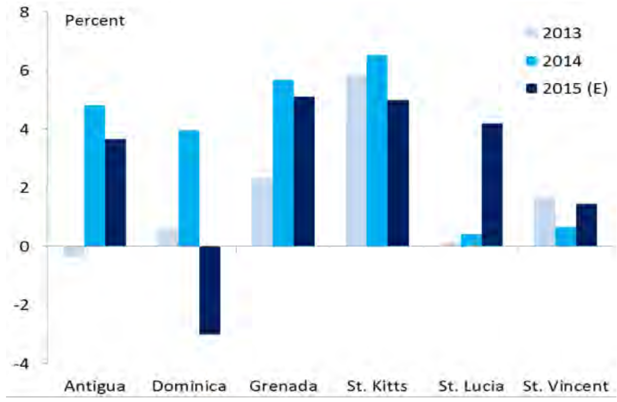
St. Vincent and the Grenadines



Annex II. The OECS Countries at a Glance

Growth is sustaining in the OEC countries…

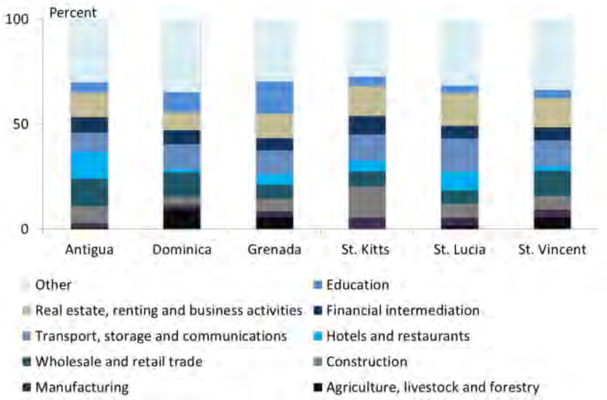
Figure 1: Real GDP Growth



Source: ECCB

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

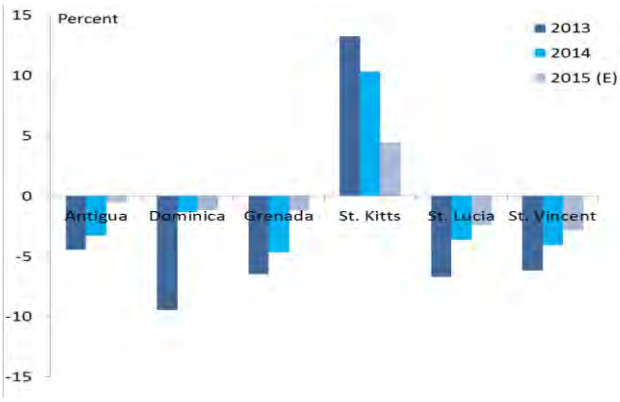
Figure 2: Contribution to GDP, 2015



Source: ECCB

Fiscal deficits are declining…

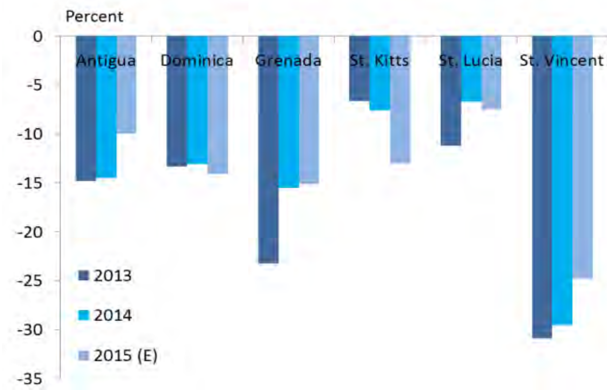
Figure 3: Fiscal Deficit (% of GDP)



Source: ECCB

... current account deficits remain high…

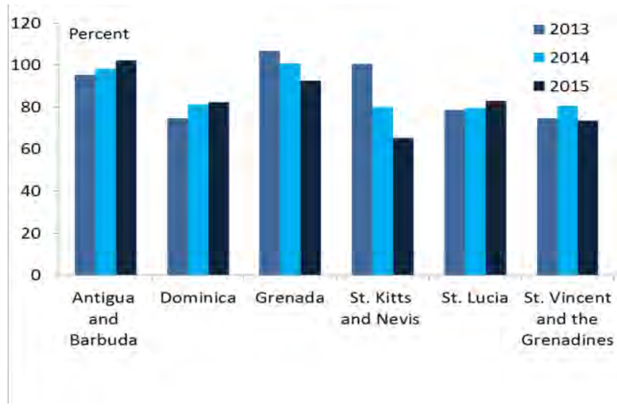
Figure 4: Current Account Balance (% of GDP)



Source: World Economic Outlook, April 2016

…and debt continues to accumulate…

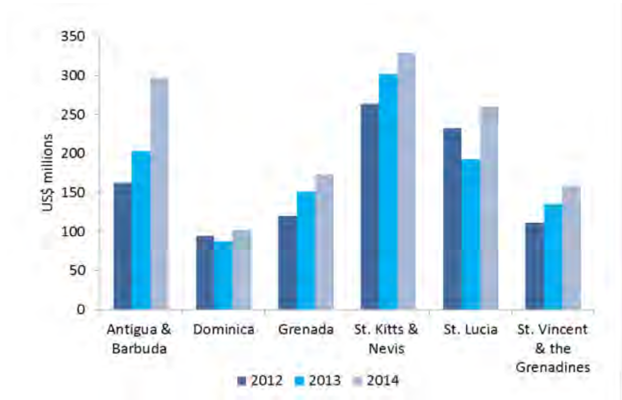
Figure 5: Central Government Debt (% of GDP)



Source: World Economic Outlook, April 2016

…but reserves have improved over time.

Figure 6: Gross International Reserves (US$ millions)



Source: ECCB

	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)	162.0	202.6	297.0	355.7	94.6	87.1	101.7	126.2	119.5	150.6	169.9	198.0
International reserves cover (months)	2.6	3.4	4.9	6.1	4.1	4.3	4.9	6.0	3.3	4.3	5.1	6.0
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

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

	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	327.3	288.4	232.0	192.2	257.7	317.5	111.0	135.1	157.4	166.0
International reserves cover (months)/1	8.4	9.4	9.4	8.2	3.4	3.1	4.4	5.3	3.2	3.9	4.6	5.0
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

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

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

The Bulletin's production team is headed by Inder Ruprah (director), and includes Juan Pedro Schmid (editor and coordinator), and Dana Payne (editor and distributor).

The contributors were Inder Ruprah, Allan Wright, Chrystol Thomas, Mark Wenner, Juan Pedro Schmid, Camilo Gomez Osorio, and Juan Pradelli. Dillon Clarke and Kimberly Waithe also contributed.

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

For questions or comments please email CET@iadb.org

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

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

IDB