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IMF Concludes Article IV Consultation with Grenada

The IMF Executive Board on October 6, 1997 concluded the 1997 Article IV consultation[1] with Grenada.

Background

Generally sound macroeconomic policies and structural reforms have contributed to improved private sector confidence and economic performance in recent years. Although the government that took office in mid-1995 has continued the reform efforts, it has also granted a net tax cut, generous wage increases for central government employees and adopted a relatively large investment program. This fiscal stance has helped strengthen economic activity and employment in the short term, but it has also led to a deterioration in the fiscal and external accounts.

Following little change in 1992 and a slight contraction in 1993, real GDP grew by 3.3 percent in 1994, led by a strong increase in tourism and manufacturing production. In 1995–96, real GDP continued to expand at an average annual rate of around 3 percent, mainly because of a substantial increase in construction activity related to public capital expenditure and private investment in hotel and residential accommodations. After reaching 4.6 percent during 1992, inflation fell to 2 percent during 1994–95, and rose to 3.2 percent during 1996 in part due to the effect of new indirect taxes. With a favorable trend in import prices, particularly of fuels, the 12-month rate of inflation fell below 1 percent in June 1997. Unemployment, reportedly declined from 27 percent in 1994 to 18 percent in 1996.

Following adjustment measures in 1992, the public finances strengthened in 1992–93, and remained generally sound in the following three years. Public sector saving rose more or less

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussion are described.

steadily from 3½ percent of GDP in 1992 to over 5 percent of GDP in 1995–96. The overall balance of the public sector registered surpluses in 1992–93 and in 1995, but deficits were recorded in 1994 and 1996, when capital expenditure of the central government grew sharply. In addition, in 1996, revenue fell in part due to the virtual elimination of the personal income tax. The public sector deficit is projected to widen from 1.4 percent of GDP in 1996 to 2.3 of GDP in 1997 with financing from privatization proceeds and net external borrowing sufficient to permit a reduction in net domestic indebtedness.

During the period 1992–96, broad money grew by an average of 9 percent a year, nearly twice the rate of growth of nominal GDP, and it continued to grow apace through end-June 1997. The growth of credit to the private sector accelerated from an annual average of around 4 percent during 1994–95 to 11 percent during 1996. Notwithstanding a reduction in the Eastern Caribbean Central Bank's discount rate from 9 percent to 8 percent effective August 1, 1996, commercial banks' interest rates changed little in 1996.

The external current account deficit, which had widened to 16 percent of GDP in 1993, fell steadily to 2 percent of GDP in 1995, but widened again in 1996, to 9 percent of GDP, reflecting a sharp rise in imports. While the capital and financial account surplus rose in 1996, the overall balance of payments posted a small deficit. The current account deficit is projected to widen further in 1997 to over 11 percent of GDP and is expected to be largely covered by capital inflows, including privatization proceeds.

Recent progress in the area of structural reform has included the downsizing of the public sector through privatization and the reduction of the size of the civil service. Also, the trade system is being liberalized through the implementation of reductions of the common external tariff of the Caribbean Community (CARICOM).

Executive Board Assessment

Executive Directors observed that sound economic policies and structural reforms pursued in recent years had contributed to growth, relatively stable prices, and improved private sector confidence. However, they noted that unemployment is still high and that efforts are needed to improve infrastructure and export performance. Directors also expressed concern about the recent weakening of the public finances and the external current account.

Directors stressed the need for vigilance in the management of the public finances. They were concerned about the sustainability of the current high level of public investment and of the public finances over the medium term. As the remaining assets available for privatization and the prospect for increased external assistance are limited, they stressed that actions would be needed in the 1998 budget to raise public saving significantly and improve the external position.

Directors stressed the need to maintain expenditure control, and particularly through wage restraint and continued civil service reform to reduce the size of the public sector. They endorsed efforts to improve tax administration, but noted that action to raise tax revenue would also be necessary, particularly through the elimination of tax exemptions and the broadening of the tax base.

Directors underlined the importance of improving the efficiency of public investment by strengthening physical and human capital, through education and training programs.

Directors noted that the monetary and exchange rate arrangements of the Eastern Caribbean Currency Union have served Grenada well, and that relatively low rates of inflation have been maintained. They welcomed the reduction in the common external tariff of the Caribbean Community, and emphasized the need to maintain firm control over domestic costs—particularly labor costs—to improve competitiveness and economic growth prospects over the medium term and to help increase employment. Directors also urged the authorities to intensify efforts to eliminate Grenada's remaining external arrears.

Press Information Notices (PINs) are a new series of IMF press notices (see Press Release 97/21). PINs are issued, at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies.

Grenada: Selected Economic Indicators

	1992	1993	1994	1995	1996
			Annual percent change 1/		
Domestic economy					
Real GDP	1.1	-1.2	3.3	3.1	3.5
Consumer price index	4.6	3.5	1.8	2.1	3.2
External economy					
Export volume	-7.7	9.8	-0.2	-11.2	-3.1
Import volume	-9.5	20.9	-6.1	2.7	16.7
Current account balance 2/	-9.9	-16.1	-3.5	-2.1	-9.1
Overall balance 2/	3.2	0.7	3.8	1.7	-0.5
External public debt 2/	37.0	34.9	32.2	30.6	28.6
Public external debt service (in percent of exports of goods and nonfactor services)	8.2	6.6	5.2	5.8	7.3
Real effective exchange rate (depreciation -)	4.8	5.1	-4.6	-2.0	2.0
Financial variables					
Public sector balance (after grants) 2/	1.4	2.5	-3.2	1.8	-1.4
Public sector saving 2/	3.4	5.2	4.0	5.4	5.1
Broad money	8.3	7.2	10.9	9.4	9.1
Average interest rate on commercial bank deposits (end of period, in percent)	5.7	5.2	5.1	5.0	5.3

Sources: Ministry of Finance; Eastern Caribbean Central Bank; and IMF staff estimates.

1/ Unless otherwise noted.
2/ As a percent of GDP.