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August 3, 2004

Statement by the Staff Representative on Dominica
Executive Board Meeting 04/77
August 4, 2004

This statement provides additional information on developments since the issuance of the staff report for the second PRGF review for Dominica (EBS/04/109). This information does not materially change the staff appraisal.

1. Recent Developments and Performance under the Program

Macroeconomic conditions continued to improve with output growth accelerating rapidly and inflation under tight control in the first half of 2004. Data through May indicate that output recovery is more broad-based and stronger than previously anticipated. The growth in the banana sector observed at the beginning of the year has firmed up, and the strong growth in manufacturing and tourism has persisted. In all likelihood, real GDP growth for 2004 will surpass program projections. The uptick in inflation observed in the second half of 2003 continues to unwind with the price level flat in the first six months of the year.

Social and political conditions continue to be calm. The budget address was well-received by the public. The budget in line with the program was approved by Parliament on July 8, this was a prior action for this review. There were concerns about the population's reaction to the fiscal measures, especially the retrenchment exercise. However, as in last year's budget, the authorities showed a high level of ownership and diffused potential problems by coherently explaining the rationale of their policies.

Performance under the program for end-June continues to be strong. While this review is not associated with performance for end-June, preliminary indications are that, with the exception of the external arrears target (for which a waiver is requested), all performance criteria for end-June were observed. The large margins observed in the fiscal accounts through end-March were not reversed by end-June as anticipated. Strong revenue collections and tight expenditure controls, in anticipation of further expenditure cuts for 2004/05, were responsible for these margins.

2. Debt Strategy Update

There has been significant progress towards restructuring the public debt.

- ***Considerable progress has been made in restructuring the claims of bilateral creditors***. The UK, one of the largest bilateral creditors, agreed in principle in early July to provide a debt restructuring with a NPV debt reduction of 50 percent. Other bilateral creditors have also expressed their willingness to participate in the

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restructuring exercise, including Bahamas, Barbados, Belize, Grenada, and Venezuela. Agreement was reached yesterday on a debt deal with France.

- ***The CDB agreed to restructure its exposure***. The Caribbean Development Bank (CDB), the largest creditor, agreed in mid-July to restructure the bulk of their exposure to Dominica, involving longer maturities and lower interest rates as well as providing a grant to finance the debt service to CDB in the next three years. The staff estimates that this proposal entails NPV debt reduction of at least 50 percent.

- ***One of the two large private bonds has already been restructured***. The holders of participating rights on the bond originally purchased and stripped by Citibank, agreed in mid-July to participate in the debt exchange offer. Participating rights holders have tendered their exposure and the bond exchange will take place shortly.

- ***The bulk of domestic creditors have already agreed to the exchange offer***. The largest creditors include Dominica's Social Security and the National Bank of Dominica. However, some further reconciliation is still needed before the debt exchange takes place.

All in all, the staff estimates that over 60 percent of the eligible debt has already been restructured or have been agreed in principle to be restructured. The authorities continue to negotiate with other creditors, especially the holders of the other large external bond (i.e., the RBTT bond). The authorities are in the process of drafting legislation to stop the earmarking of a special tax account that services this particular bond.

The authorities have instructed the ECCB to open a special escrow account for debt payments. While the authorities continue to work constructively and in good faith with the remaining creditors, the purpose of the new ECCB account is to deposit interest earnings on claims held by creditors that have not yet participated in the restructuring exercise (on the assumption that they will eventually participate). This is done in accordance with the 2004/05 budget and in anticipation of a possible change in debt service payments strategy on creditors that have not yet participated.