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IMF Executive Board Concludes 2008 Article IV Consultation with Dominica

On July 30, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Dominica.[1]

Background

Dominica's economy has weathered well the effects of Hurricane Dean that struck the country in August last year, causing damage estimated at about 20 percent of GDP. Real output growth slowed to 1½ percent in 2007, after reaching a decade high 4 percent in 2006. The economy is expected to grow by 2½ percent in 2008 supported by the recovery in agriculture and reconstruction efforts. Inflation accelerated to 5½ percent in 2007, mainly reflecting international energy and food price increases, and is projected to rise to about 6½ percent in 2008.

Public finances remained strong during FY 2007/08 and a primary surplus of 1½ percent of GDP was achieved, despite the 50 percent reduction of the excise tax on fuel for electricity generation and the implementation of the first phase of the income tax reform. The creditable revenue performance was driven by VAT collection and import duties due to the surge in imports related to reconstruction. The scale up in capital expenditure to rehabilitate damaged infrastructure was largely financed by external grants, while the increase in primary current expenditure was

[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.

compensated by the increase in revenue. In parallel with the maintenance of a primary fiscal surplus, the public debt/GDP is estimated to have declined to 95 percent of GDP at the end of the fiscal year.

The real effective exchange rate continued to decline, partly reflecting weakness in the U.S. dollar, and remains broadly in line with macroeconomic fundamentals, despite a widening in the external current account deficit to 24 percent of GDP. The increase in the external current account deficit reflects a surge in imports related to post-hurricane reconstruction and a rising food and fuel import bill. Higher government grant inflows, foreign direct investment and private capital inflows facilitated the financing of the larger current account deficit.

The banking sector experienced robust growth in deposits while credit growth slowed following the rapid expansion in 2006, resulting in an accumulation of net foreign assets by commercial banks. The rapid growth in deposits, due in part to higher family remittances, has boosted liquidity levels, and the banking system's profitability and overall asset quality have been maintained. Meanwhile, efforts are being made to strengthen the regulatory and prudential framework for nonbank financial institutions which are unevenly regulated.

The authorities continue to focus on improving the business climate and reducing the cost of doing business to enhance competitiveness given the regional currency peg. The creation of one-stop agencies for tourism and investment promotion and simplification of business procedures have aided Dominica's steady advancement in world rankings in this area.

Executive Board Assessment

Directors noted the strong recovery of the economy from the damage caused by Hurricane Dean, despite the weakening external environment and the negative effects of rising international commodity prices, given Dominica's high dependence on imported food and fuel.

Directors commended the authorities for their commitment to implement sound economic policies while addressing the challenges arising from the oil and food price surge, and for their medium-term agenda focused on reducing vulnerabilities, including the reduction of public debt ratios. They welcomed efforts to improve existing mechanisms to better target assistance to the poor and to maintain the flexible fuel pricing regime to help ease the adjustment of the economy to higher international commodity prices.

Directors welcomed the government's commitment to a medium-term primary surplus target of 3 percent of GDP, consistent with the authorities' strategy of gradually reducing the public debt/GDP ratio. In the event of a deeper-than-expected global slowdown, the authorities could consider contingent measures, such as a more extended phasing-in of the planned income tax reform while maintaining the integrity of the VAT. This would facilitate a return to the medium-term primary surplus target, following a temporary easing of the fiscal stance to accommodate the current commodity price shocks. They also recommended modification of the tax incentive regime and broadening the income tax base to strengthen the tax system.

Directors supported saving the bulk of the concessional financing for fuel consumption under the PetroCaribe initiative. They welcomed the setting up of an investment fund and restricting the spending on social projects from this source to the net return derived from the investment fund. Given the volatility associated with recent scaled-up aid flows, Directors called on the donors to make their disbursements more predictable, and encouraged the authorities to develop a framework to smooth the associated spending. Directors supported the authorities' intention to improve budget management.

Directors supported the authorities' strengthening of the regulation and supervision of nonbank financial institutions, and welcomed the recent introduction of the Financial Services Act in the parliament. Directors encouraged the authorities to quickly build capacity in the Financial Services Unit to regulate effectively nonbanks, particularly credit unions and insurance companies.

Directors agreed that the overall level of external competitiveness is adequate. They considered that the real exchange rate is broadly in equilibrium, in part reflecting the EC dollar depreciation against the currencies of trading partners. Nevertheless, Directors noted that the high external current account deficit poses risks that need to be carefully monitored and accompanied by efforts in the fiscal area.

Directors concurred with the authorities' focus on implementation of the structural reforms envisaged in Dominica's Growth and Social Protection Strategy. They also agreed with the high priority given to efforts to reduce the cost of doing business, including improving the efficiency of the energy sector.

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Dominica: Selected Economic and Social Indicators

	2004	2005	2006 Prog. 1/	2006 Prel.	2007 Est.	2008 Proj.
(Annual percentage change, unless otherwise specified)						
Output and prices						
Real GDP (factor cost)	3.0	3.3	4.1	4.0	1.5	2.6
GDP deflator (factor cost)	2.1	1.5	1.2	0.6	2.9	6.3
Consumer prices (end of period)	0.8	2.7	2.0	1.6	5.7	6.7
Money and credit 2/						
Net foreign assets of the banking system	8.1	-8.0	5.1	17.6	7.2	-3.7
Net domestic assets of the banking system	-2.1	14.7	2.9	-8.0	1.9	8.4
Of which						
Net credit to the nonfinancial public sector	-5.1	-1.2	-2.0	-10.8	-7.0	-0.3
Credit to the private sector	5.4	4.6	6.1	8.5	4.0	5.7
Liabilities to the private sector (M2)	5.9	6.7	8.0	9.6	9.0	4.7
Balance of payments						
Merchandise exports, f.o.b.	4.5	0.4	-1.0	-1.1	-4.5	-12.1
Merchandise imports, f.o.b.	14.2	14.2	0.5	0.6	11.6	13.4
Real effective exchange rate						
(end of period, depreciation -)	-6.0	2.0	…	-3.4	-1.6	…
(In percent of GDP, unless otherwise specified)						
Central government 3/						
Savings (including grants)	7.6	10.0	11.5	13.5	13.9	11.1
Of which						
Primary savings (before grants)	7.8	8.1	5.5	8.3	5.4	4.4
Grants 4/	5.9	7.2	8.5	7.6	10.8	8.5
Capital expenditure and net lending	8.8	9.0	10.1	10.0	14.8	10.5
Primary balance 4/	3.5	6.9	4.0	6.3	1.5	2.4
Overall balance 4/	-0.9	1.2	1.6	3.7	-0.9	0.6
Nonfinancial public sector debt (gross) 5/						
Total	110.5	103.6	101.4	102.0	94.3	86.3
External	76.8	71.1	70.8	70.0	65.0	59.3
Domestic	33.7	32.5	30.6	32.0	29.4	27.0
External sector						
Current account balance	-16.5	-28.0	-21.3	-18.3	-23.6	-28.4
External public debt service 6/	20.7	17.5	13.1	13.0	7.2	11.5
Amortization	14.0	9.1	8.4	8.3	3.9	7.7
Interest	6.7	8.4	4.7	4.7	3.3	3.7
Memorandum items:						
Nominal GDP at market prices (EC$ millions)						
Calendar year	770.1	808.0	809.5	856.5	906.4	982.6
Net international reserves						
(US$ millions; end-of-period)	33.6	37.6	44.2	51.0	50.4	52.5

Sources: Dominica authorities; Eastern Caribbean Central Bank ECCB; and IMF staff estimates and projections.

1/ IMF Country Report No. 07/1, Seventh PRGF Review (November 2006).

2/ Percentage changes relative to the stock of M2 at the beginning of the period.

3/ Figures shown for a given calendar year relate to the fiscal year (July–June) beginning on July 1 of that year.

4/ Does not include grants that were received but not spent, in line with IMF Country Report No. 05/384.

5/ For 2005, it includes the reallocation of part of an external bond (around 4 percent of GDP) from external to domestic.

6/ In percent of exports of goods and nonfactor services. Up to 2005 data are on pre-restructuring terms. After that, data are on post-restructuring terms for creditors participating in the debt restructuring and on pre-restructuring terms for creditors not participating.