Office Memorandum

To: Members of the Executive Board — May 27, 2014

From: The Secretary

Subject: **Grenada—Assessment Letter for the World Bank**

Attached for the **information** of Executive Directors is the Fund's assessment letter on the macroeconomic conditions in Grenada, which was requested by the World Bank.

If the authorities of Grenada consent to the publication of this assessment, it may be published by the World Bank.

Questions may be referred to Ms. Cebotari, WHD (ext. 35417).

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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Grenada—Assessment Letter for the World Bank
May 27, 2014

1. ***Most recent Article IV consultation.*** The most recent Article IV consultation was concluded in July 2012, with Directors emphasizing the need for a vigorous domestic policy response to improve weakening competitiveness and foster private-sector-led growth, while undertaking the needed consolidation to ensure fiscal sustainability. Directors acknowledged the challenge of achieving lasting fiscal consolidation while protecting the fragile recovery, and stressed the need to protect social spending and public investment, while focusing the adjustment efforts on widening the revenue base and streamlining current spending.

2. ***Recent engagement***. On January 13, 2014, the IMF Executive Board discussed Grenada's Ex Post Assessment (EPA), a requirement for Board approval of new arrangements with countries under longer-term program engagement with the Fund. The EPA concluded that overall economic performance under the Fund-supported programs had proved uneven, and the key program objectives of securing a sustainable fiscal position and a higher growth path had largely been missed. The IMF Executive Board highlighted the importance of choosing program objectives that are consistent with extensive capacity and institutional constraints and the critical need of securing program ownership by country authorities. The IMF Executive Board also agreed that a new program should support urgently needed fiscal consolidation, promote faster and more inclusive growth, and focus on a few macro-critical reform. In February 2014, the authorities and Fund staff have reached understandings on macroeconomic policies for the period 2014-2017 that could be supported by a Fund arrangement. Discussions for the 2014 Article IV consultation were also held recently.

3. ***Recent developments***. The economy appears to have bottomed out in 2013 with a massive private construction project and a strong performance in the offshore education sector. Growth is estimated at about 1½ percent in 2013, but unemployment remains high and inflation has been on a declining trend over the past two years and is now hovering in deflation territory. Over the past few years, the fiscal situation deteriorated rapidly, with the overall deficit reaching 7 percent of GDP in 2013 and driving public debt up to 115 percent of GDP. The government's cash flows have come under severe pressure even following the cessation of debt service payments in early 2013, as a result of the deteriorating fiscal position.

4. ***Debt restructuring.*** Faced with a severe fiscal crisis, the newly elected government announced on March 8, 2013 that it will seek a "comprehensive and collaborative" restructuring of its public debt. The government is in discussions with the creditor groups, including through the creditor representative committee. In early April 2014, the government published restructuring scenarios for a first group of creditors, which are indicative of the restructuring terms that the government is seeking to bridge its multi-year financing gaps and achieve a meaningful debt reduction.

5. ***Proposed new program***. The authorities have requested support for their proposed new program through a three-year Extended Credit Facility arrangement in the amount equivalent to SDR14.04 million (about US$21.9 million or 120 percent of Grenada's quota). The proposed program will aim at putting public debt on a sustainable downward path, while implementing structural measures to boost growth and safeguarding the social safety net. The authorities are already implementing reforms, which is a testament to their strong commitment to the proposed program.

- ***Macroeconomic outlook***. The pace of recovery in the near term is expected to be modest, at 1.2-1.7 percent, supported by spillovers from recovering sectors and the easing of government financing constraints. A faster recovery will be held back by the drag of the fiscal adjustment in 2014-16 and the likely weak credit growth as banks repair their balance sheets. Over the longer-term, growth is projected to recover steadily as domestic and external conditions normalize. Inflation is projected to remain subdued in the near-term in the face of weak demand, and to remain in line with imported inflation over the medium-term. The external current account deficit is projected to narrow over the medium-term as public demand eases and competitiveness improves.
- ***Fiscal policies***. The cornerstone of the proposed program is a strong fiscal adjustment aimed at achieving a primary fiscal surplus of 3.5 percent of GDP by 2016, focused on curbing current spending, including the wage bill, and widening the revenue base, while maintaining space for infrastructure spending and social safety nets. Ambitious public financial management reforms will support the durability of the adjustment.
- ***Debt restructuring***. The fiscal adjustment is to be complemented by a comprehensive debt restructuring, which will aim to secure meaningful debt reduction, address financing shortfalls, and put Grenada's public debt firmly on a downward path to the ECCU regional target of 60 percent of GDP by 2020. The debt restructuring is critical for fiscal sustainability.
- ***Structural reforms*** will be critical in boosting competitiveness and hence medium-term growth. Grenada's potential output lost significant ground in the past decade due to weak competitiveness and structural bottlenecks. Reforms will focus on removing constraints to growth through the liberalization of the renewable energy and other strategic sectors, improving the investment environment, and putting in place the legal infrastructure for public private partnerships.
- ***Financial sector.*** The proposed program will also focus on the health of the financial sector, to ensure that the impact of the debt restructuring on the financial system is contained, the solvency of the system is safeguarded and its regulation and supervision are strengthened.

Table 1. Grenada: Selected Economic and Financial Indicators, 2008–19

Rank in UNDP Human Development Index	63	Infant mortality rate per '000 births (2011)	10.3
out of 179 countries (2012)		Adult illiteracy rate in percent (2004)	4
Life expectancy at birth in years (2011)	76	Poverty headcount index (2008)	38
GDP per capita in US$ (2011)	7,378	Unemployment rate (2013)	33.5
Population in millions (2011)	0.11		

	2008	2009	2010	2011	2012 Est.	2013 Prel.	2014 Proj.	2015 Proj.
	(Annual percentage change, unless otherwise specified)							
Output and prices								
Real GDP	0.9	-6.6	-0.5	0.8	-1.8	1.5	1.1	1.2
Nominal GDP	8.9	-6.6	0.0	1.0	2.9	1.5	3.1	3.2
Consumer prices, end of period	5.2	-2.3	4.2	3.5	1.8	-1.2	1.7	1.6
Consumer prices, period average	8.0	-0.3	3.4	3.0	2.4	0.0	1.6	1.7
Output gap (percent of potential GDP)	6.8	-0.9	-1.8	-1.4	-3.5	-2.6	-2.2	-2.0
Real effective exchange rate	6.4	-8.8	3.1	-0.9	-1.0	-2.3	…	…
(annual average, depreciation -)								
	(In percent of GDP, unless otherwise specified)							
Central government balances (accrual) 1/								
Revenue	24.2	22.8	24.6	23.6	20.8	21.5	24.9	24.9
Taxes	18.7	17.5	18.7	18.4	17.9	17.2	18.7	20.0
Non-tax revenue	2.1	2.0	1.9	1.8	1.7	2.9	1.6	1.6
Grants	3.3	3.3	4.0	3.4	1.1	1.4	4.6	3.3
Expenditure	28.3	28.0	27.8	28.3	26.1	28.5	30.9	27.4
Current primary expenditure	17.0	18.2	18.3	18.1	17.7	17.8	17.9	16.0
Interest payments	1.7	2.2	2.2	2.5	3.4	3.4	3.6	3.9
Capital expenditure	9.6	7.6	7.3	7.8	5.0	7.3	9.5	7.5
Primary balance	-2.4	-3.0	-1.0	-2.2	-2.0	-3.7	-2.4	1.3
Overall balance	-4.1	-5.2	-3.1	-4.7	-5.4	-7.1	-6.0	-2.5
Public debt (incl. guaranteed)	86.9	95.0	100.9	106.5	108.5	114.9	117.0	116.0
Domestic	22.8	27.2	28.0	31.7	34.8	37.2	32.2	29.8
External	64.1	67.8	72.9	74.8	73.7	77.8	84.8	86.2
Money and credit, end of period (annual percent change)								
Broad money (M2)	4.1	3.3	0.4	1.0	0.9	4.0	1.4	…
Credit to private sector	10.2	4.1	5.2	2.1	0.2	-5.5	1.0	…
Balance of payments								
Current account balance, o/w:	-28.0	-22.2	-22.1	-21.8	-19.2	-27.1	-23.9	-20.5
Exports of goods and services	27.7	27.6	28.2	30.0	30.7	31.5	32.9	33.1
Imports of goods and services	54.7	46.8	49.2	50.8	49.4	57.3	54.7	50.8
Capital and financial account balances	32.7	30.3	24.1	27.3	19.7	29.7	14.4	16.9
Overall balance	-1.6	2.1	-2.1	0.1	-1.1	2.6	-9.5	-3.5
Overall financing	1.6	-2.1	2.1	-0.1	1.1	-2.6	-2.9	-0.7
Financing gap 2/	…	…	…	…	…	…	12.4	4.2
External debt (gross)	104.2	114.8	123.7	135.7	142.5	153.1	158.6	160.3
Savings-Investment balance	-28.0	-22.2	-22.1	-21.8	-19.2	-27.1	-23.9	-20.5
Savings	3.1	1.7	-0.1	-1.3	-1.9	2.5	1.9	2.4
Investment	31.1	23.9	22.0	20.5	17.3	29.6	25.8	22.9
Memorandum items:								
Underlying primary balance 3/	-2.4	-3.0	-1.0	-2.2	-2.0	-4.0	-1.3	1.3
Nominal GDP (EC$ million)	2,230	2,082	2,082	2,102	2,164	2,197	2,265	2,338
Nominal GDP (US$ million)	826	771	771	779	802	814	839	866
Net imputed international reserves								
Months of imports of goods and services	3.5	3.6	3.1	3.2	2.6	3.5	3.7	3.7

Sources: Ministry of Finance; Eastern Caribbean Central Bank; United Nations, Human Development Report 2008; World Bank WDI 2007; and Fund staff estimates and projections.

1/ Assumes an adjustment of 7.5 percent of GDP during 2014-16 but no debt restructuring.

2/ To be closed through IMF and other IFIs financing and debt restructuring.

3/ Excluding one-off items (oil exploration license in 2013 and retroactive wage and pension payments in 2013 and 2014).