IMMEDIATE ATTENTION

SM/14/211
Supplement 2

July 14, 2014

To: Members of the Executive Board

From: The Secretary

Subject: **Kingdom of the Netherlands—Curaçao and Sint Maarten—Staff Report for the 2014 Article IV Consultation—Debt Sustainability Analysis**

The attached debt sustainability analysis is being issued as a supplement to the staff report for the 2014 Article IV consultation with the Kingdom of the Netherlands—Curaçao and Sint Maarten (SM/14/211, 7/14/14), which is being considered on a lapse of time basis. Unless an objection from the authorities of the Kingdom of the Netherlands—Curaçao and Sint Maarten is received prior to the conclusion of the Board's consideration, the document will be published. Any requests for modifications for publication are expected to be received two days before the Board concludes its consideration.

Questions may be referred to Mr. Lombardo, EUR (ext. 39937) and Mr. Quayyum, FIN (ext. 30578).

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the European Commission, following its consideration by the Executive Board.

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

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS – CURAÇAO AND SINT MAARTEN

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION DISCUSSIONS— DEBT SUSTAINABILITY ANALYSIS

July 11, 2014

Approved By
Ranjit Teja (EUR) and Bob Traa (SPR)

Prepared by the Staff of the International Monetary Fund

PUBLIC DEBT SUSTAINABILITY ANALYSIS

Curaçao and Sint Maarten experienced a significant debt relief upon their independence in October 2010, when the Netherlands took over all of the existing Netherlands Antilles' debt in exchange for a significantly smaller amount of very long-term/low-cost debt issued by the two new countries. Under the baseline scenario, public debt will jump in 2014 in light of significant borrowing needs in both countries but will then stabilize throughout the projection horizon and even decline in outer years. The debt path is somewhat sensitive to adverse growth, fiscal, and interest rate shocks. Overall, risks of public debt distress are low, in light of the low debt levels, manageable gross financing needs, and a growing share of long-term, local currency debt. However, contingent liabilities associated with state owned enterprises and exogenous shocks, such as weather, add certain risks to debt sustainability.

1. **Starting off from a low base, thanks to the 2010 debt relief, under the baseline scenario the public debt ratio in both countries would see an uptick in 2014 before stabilizing, with manageable gross financing needs and a growing share of long-term, local currency debt representing key strengths.** After a steep increase in 2014 as a result of the need to finance the new hospital in Curaçao (NAf 436 million) and replenish dilapidated cash deposits in Sint Maarten (NAf 60 million), the debt ratio would stabilize and even fall in outer years thanks to less capital expenditures. A forecast pick-up in growth, moderate in Curaçao and more pronounced in Sint Maarten, would also underpin the benign evolution of the public debt ratio. In addition, the golden rule (enforced by the CFT) safeguards debt sustainability through two channels: (i) it ensures that the current balance is, at a minimum, in balance; and (ii) it guarantees the two countries access to long-term/low-cost funding as any new debt issuance is essentially picked up by the Netherlands at Dutch public sector borrowing rates (the Netherlands also assumes the FX risk, as it lends in *guilders*).

2. **The analysis is based on the following main assumptions:**

- **Real GDP growth** will remain positive in both countries in the medium term (around 1 percent in Curaçao and slightly above 2 percent in Sint Maarten) as public investment projects kick off in Curaçao and a pick-up in tourism supports economic activity in Sint Maarten. Both growth forecasts face some downside risks (e.g., public investments projects in Curaçao might continue to stall, negotiations to upgrade Curacao's Isla refinery in time for the 2019 expiration of the current lease to Venezuela's PdVSA might fail, and weather-related disruptions might hurt tourism in Sint Maarten).
- **Inflation** (as measured by the change in the CPI), is expected to accelerate again and hover around 2 percent throughout the forecast horizon.
- **Fiscal consolidation** will continue to play an important role in ensuring debt sustainability. Both authorities have plans and significant scope to increase revenues (Sint Maarten) and decrease expenditures (Curaçao).

- **Market access** is assumed to remain adequate to cover maturing debt and the flow of deficits under the presumption that the arrangement with the Netherlands and CFT will remain in place, though interest rates will gradually increase over time in line with the forecast for the Netherlands' long-term borrowing rates.

3. **The analysis focuses on the central government as no separate data for other entities is available.** Important fiscal risks arise from contingent liabilities of state-owned enterprises (SOEs) and, as mentioned above, from potential sizable calls on public finances for either the necessary upgrade or the demolition/clean-up of the refinery in Curaçao or for weather-related shocks to Sint Maarten. For the latter shocks, a 10 percentage point increase in expenditures would translate into a 5-percentage point increase in the steady state levels of the public debt ratios. Recent reports indicate that, for some individual SOEs, debt could amount to as much as 5 percent of GDP. However, a fuller assessment of the actual risk is not possible, as financial statements are either not available or outdated due to very long publication delays.

4. **Sensitivity analysis shows that the debt path is somewhat susceptive to adverse growth and fiscal policy shocks.** In particular:

- The debt ratio would enter an increasing path and reach around 45 percent in Curaçao and 42 percent in Sint Maarten in 2019 if growth is temporarily (in 2015 and 2016) lower by one historical standard deviation.
- Similarly, a standard combined macro-fiscal shock would gradually bring the debt ratio to around 46 percent in Curaçao and 42 percent in Sint Maarten.
- The materialization of a debt shock (from unexpected expenditures on the refinery or because of other contingent liabilities in Curaçao, or a weather-related expenditure shock in Sint Maarten), as captured by a one-off 10 percent increase in expenditures in 2017 (Curaçao) and 2015 (Sint Maarten) respectively, would result in a debt path qualitatively similar to that in the baseline scenario, but correspondingly higher.

5. **The reliability of the assessment depends on the realism of assumptions/forecasts on the evolution of key economic variables.** With this in mind, the results have to be interpreted with caution. Data reliability and availability is a significant problem in both countries. For example, expenditure-side data for Sint Maarten have only recently become available and still have significant gaps. Regardless of the data shortcomings, staff considers that public debt should remain manageable in both countries as long as their policies are bound by the current rule-based framework. Compliance with said framework is currently enforced by the Dutch oversight council CFT. This arrangement is expected to be reviewed in 2015, and it would be important that the existing safeguards and the process improvements achieved under the oversight of the CFT are not foregone.

6. **The template's heat map underscores that the public debt held by non-residents could be a vulnerability.** However, it is important to note that this results from the peculiar institutional set-up, by virtue of which the Netherlands automatically subscribes to the full amount of debt issued by both countries once the CFT approves the budget as in line with the golden rule. A key concern is that the current arrangement may run out at some point, exposing both countries to significantly higher borrowing costs.

7. **The authorities broadly agree with staff's assessment that overperforming on the current budget rule is needed to safeguard debt sustainability in light of potential shocks.** Both authorities have plans for revenue and expenditure-side reforms that should help create and maintain fiscal space to keep public debt low even in the presence of shocks.

Figure 1. Curaçao: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(in percent of GDP unless otherwise indicated)

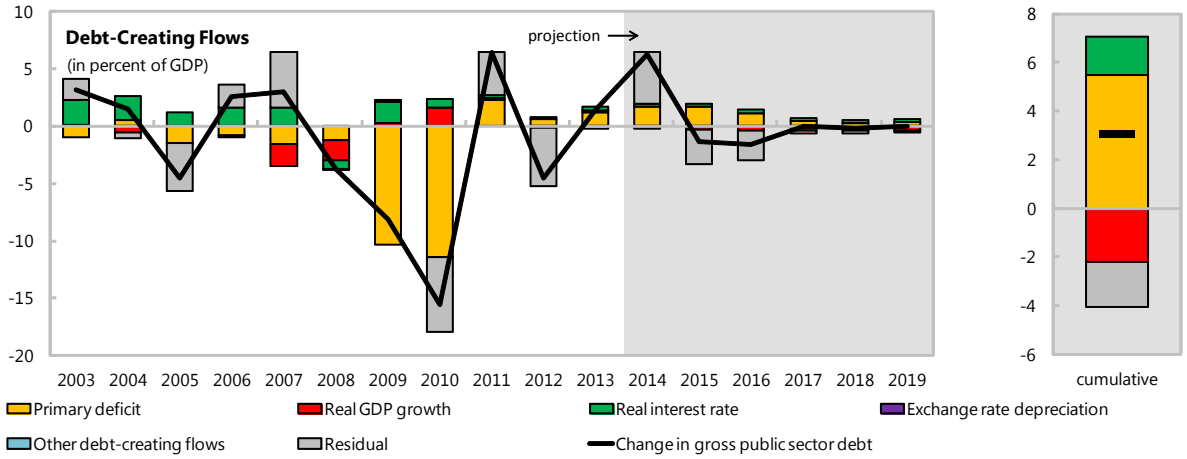
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	47.0	29.9	31.3	37.6	36.2	34.6	34.6	34.4	34.4
Public gross financing needs	-2.8	0.6	1.1	2.5	2.7	2.1	1.4	1.2	1.3
Real GDP growth (in percent)	0.5	-0.5	-0.6	0.7	0.9	1.1	1.1	1.3	1.3
Inflation (GDP deflator, in percent)	3.0	3.2	1.9	1.9	2.0	2.0	2.1	2.1	2.1
Nominal GDP growth (in percent)	3.9	3.0	1.0	3.8	3.8	3.2	3.3	3.1	2.9
Effective interest rate (in percent) [4/]	5.5	2.6	3.0	2.8	2.8	2.8	2.8	2.8	2.8

As of March 31, 2014		
Sovereign Spreads		
EMBIG (bp) 3/		35
5Y CDS (bp)		35
Ratings	Foreign	Local
Moody's	n.a.	n.a.
S&Ps	A-	A-
Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-1.7	-4.5	1.4	6.2	-1.4	-1.6	0.0	-0.1	0.0	3.0	-0.2
Identified debt-creating flows	-1.9	0.6	1.7	1.8	1.6	1.0	0.3	0.1	0.1	4.9	
Primary deficit	-2.8	0.6	1.1	1.7	1.7	1.1	0.4	0.3	0.3	5.5	
Primary (noninterest) revenue and grants	23.5	29.7	28.5	28.2	28.2	28.2	28.1	28.1	28.1	168.9	
Primary (noninterest) expenditure	20.7	30.3	29.7	29.9	29.8	29.3	28.6	28.4	28.5	174.4	
Automatic debt dynamics [5/]	0.9	0.0	0.5	0.1	0.0	-0.1	-0.1	-0.2	-0.2	-0.6	
Interest rate/growth differential [6/]	0.9	0.0	0.5	0.1	0.0	-0.1	-0.1	-0.2	-0.2	-0.6	
Of which: real interest rate	1.2	-0.2	0.3	0.3	0.3	0.3	0.2	0.2	0.2	1.6	
Of which: real GDP growth	-0.3	0.2	0.2	-0.2	-0.3	-0.4	-0.4	-0.4	-0.4	-2.2	
Exchange rate depreciation [7/]	0.0	0.0	0.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (1) (e.g., drawdown of de	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroan	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	0.2	-5.1	-0.3	4.5	-3.0	-2.6	-0.3	-0.2	-0.2	-1.8	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

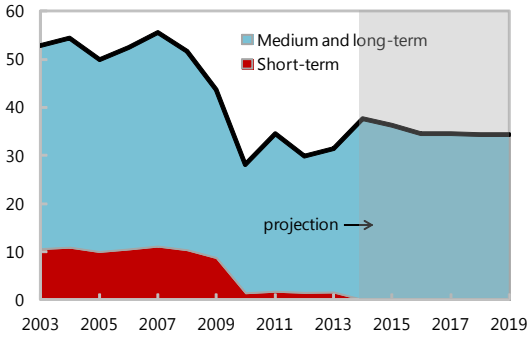
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

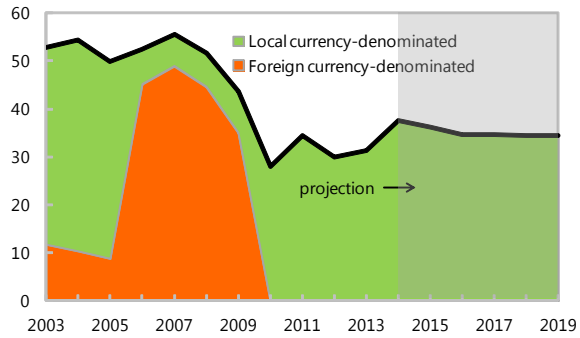
Figure 2. Curaçao: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

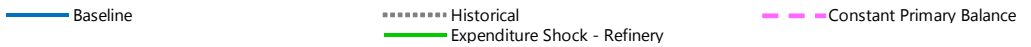
By Maturity
(in percent of GDP)



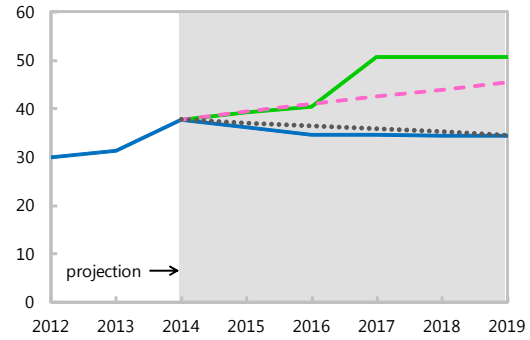
By Currency
(in percent of GDP)



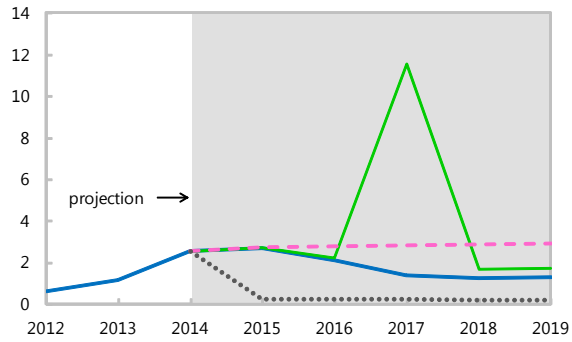
Alternative Scenarios



Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



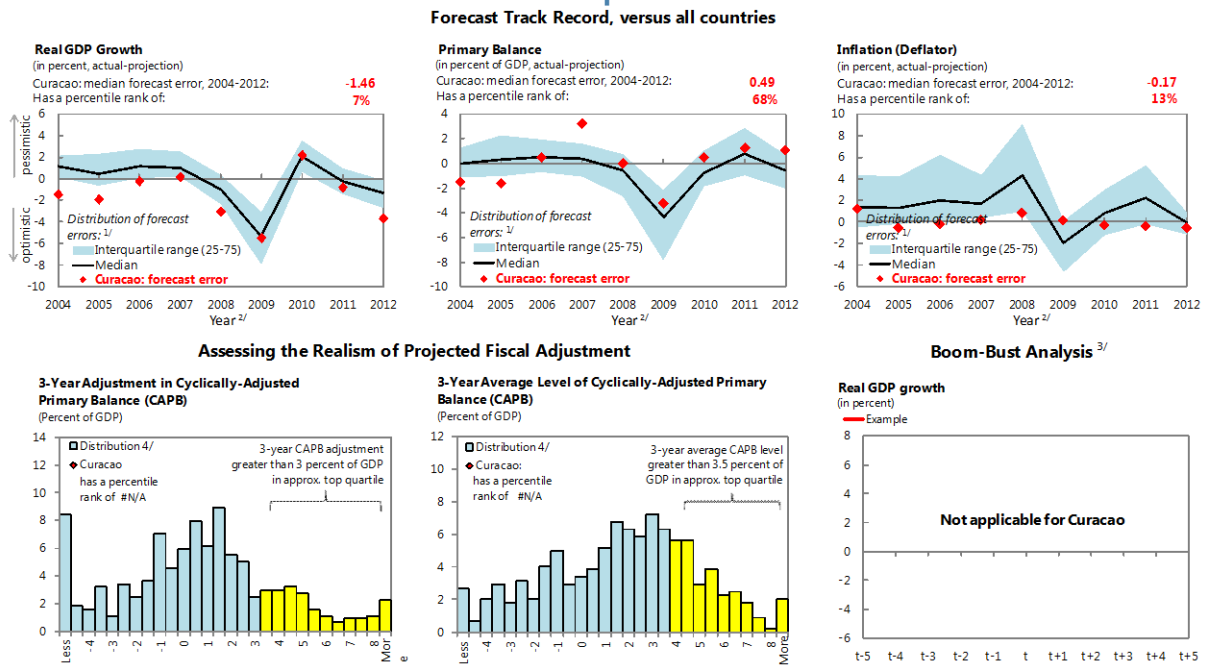
Underlying Assumptions
(in percent)

Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	0.7	0.9	1.1	1.1	1.3	1.3
Inflation	1.9	2.0	2.0	2.1	2.1	2.1
Primary Balance	-1.7	-1.7	-1.1	-0.4	-0.3	-0.3
Effective interest rate	2.8	2.8	2.8	2.8	2.8	2.8
Constant Primary Balance Scenario						
Real GDP growth	0.7	0.9	1.1	1.1	1.3	1.3
Inflation	1.9	2.0	2.0	2.1	2.1	2.1
Primary Balance	-1.7	-1.7	-1.7	-1.7	-1.7	-1.7
Effective interest rate	2.8	2.8	2.8	2.8	2.8	2.9

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	0.7	0.3	0.3	0.3	0.3	0.3
Inflation	1.9	2.0	2.0	2.1	2.1	2.1
Primary Balance	-1.7	0.8	0.8	0.8	0.8	0.8
Effective interest rate	2.8	2.8	2.8	2.8	2.9	2.9

Source: IMF staff.

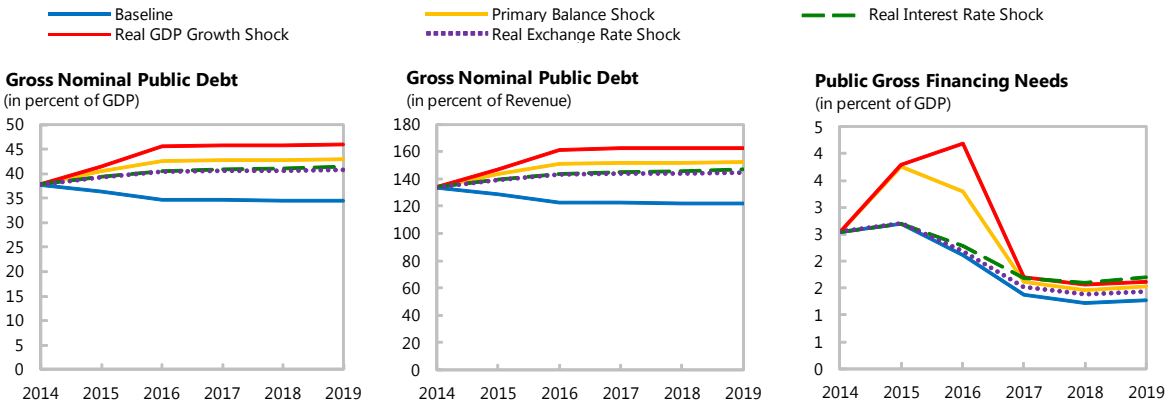
Figure 3. Curaçao: Public Sector Debt Sustainability Analysis (DSA) – Realism of Baseline Assumptions



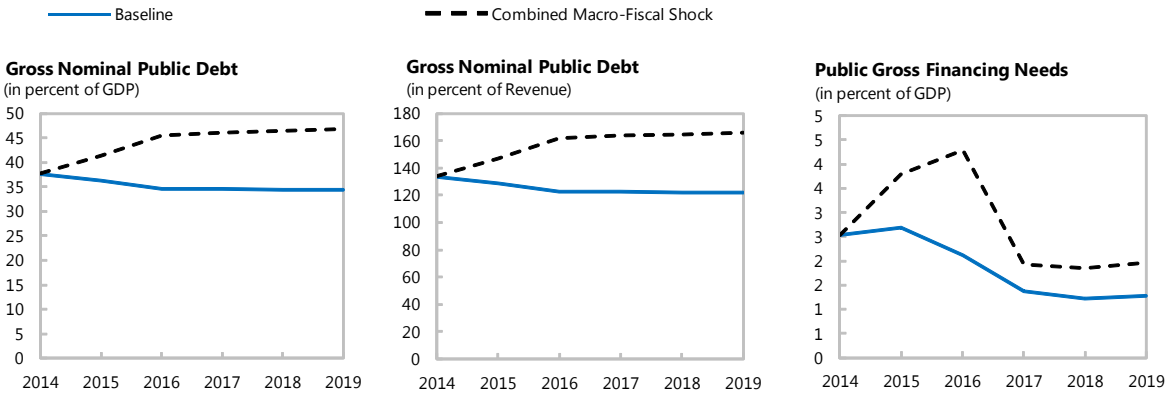
Source : IMF Staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for Example, as it meets neither the positive output gap criterion nor the private credit growth criterion.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 4. Curaçao: Public Sector Debt Sustainability Analysis (DSA) – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	0.7	0.9	1.1	1.1	1.3	1.3
Inflation	1.9	2.0	2.0	2.1	2.1	2.1
Primary balance	-1.7	-2.7	-2.2	-0.4	-0.3	-0.3
Effective interest rate	2.8	2.8	2.9	2.9	2.9	2.9
Real Interest Rate Shock						
Real GDP growth	0.7	0.9	1.1	1.1	1.3	1.3
Inflation	1.9	2.0	2.0	2.1	2.1	2.1
Primary balance	-1.7	-1.7	-1.1	-0.4	-0.3	-0.3
Effective interest rate	2.8	2.8	3.1	3.2	3.4	3.5
Combined Shock						
Real GDP growth	0.7	-1.2	-1.0	1.1	1.3	1.3
Inflation	1.9	1.5	1.5	2.1	2.1	2.1
Primary balance	-1.7	-2.7	-3.0	-0.4	-0.3	-0.3
Effective interest rate	2.8	2.8	3.1	3.4	3.5	3.7

Real GDP Growth Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	0.7	-1.2	-1.0	1.1	1.3	1.3
Inflation	1.9	1.5	1.5	2.1	2.1	2.1
Primary balance	-1.7	-2.7	-3.0	-0.4	-0.3	-0.3
Effective interest rate	2.8	2.8	2.9	2.9	2.9	2.9
Real Exchange Rate Shock						
Real GDP growth	0.7	0.9	1.1	1.1	1.3	1.3
Inflation	1.9	2.2	2.0	2.1	2.1	2.1
Primary balance	-1.7	-1.7	-1.1	-0.4	-0.3	-0.3
Effective interest rate	2.8	2.8	2.8	2.8	2.8	2.9

Source: IMF staff.

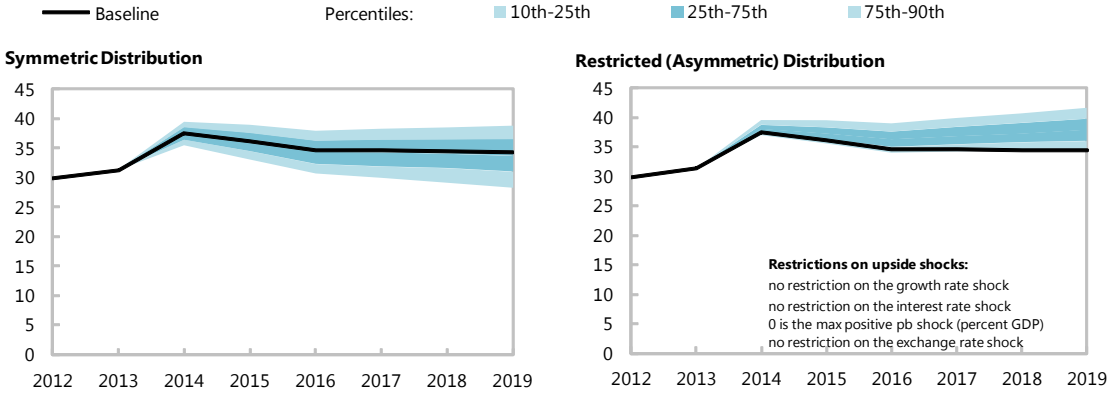
Figure 5. Curaçao: Public Sector Debt Sustainability Analysis (DSA) – Heat Map

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

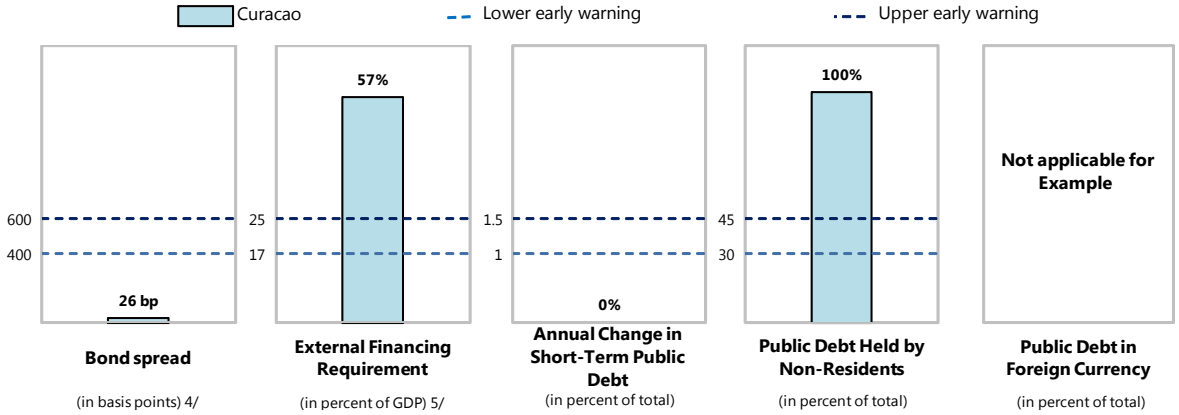
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2013)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 31-Dec-13 through 31-Mar-14.
5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Figure 6. Sint Maarten: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(in percent of GDP unless otherwise indicated)

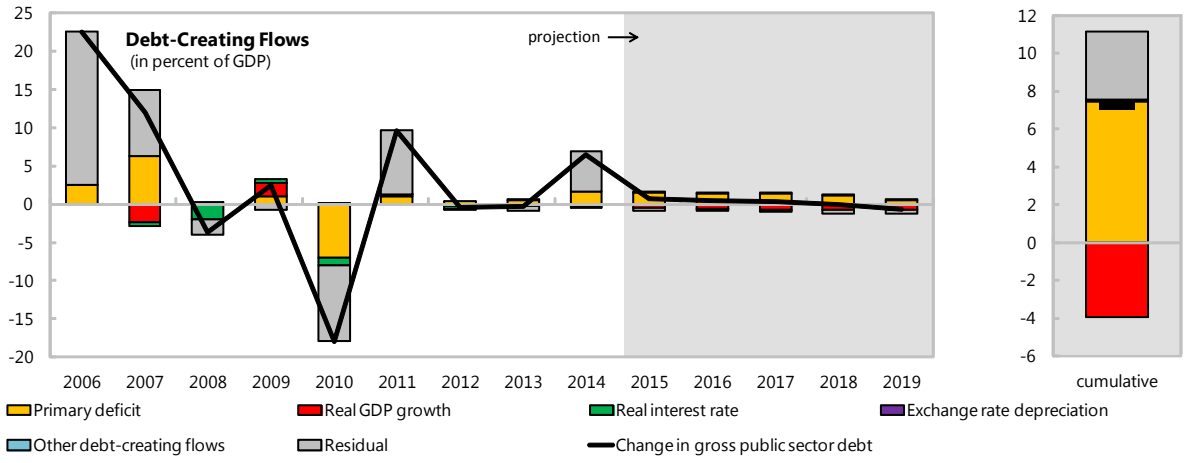
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2006-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	27.0	24.6	24.3	30.8	31.5	32.0	32.3	32.3	31.6
Public gross financing needs	0.7	0.3	0.5	2.0	2.2	1.9	1.8	1.5	0.9
Real GDP growth (in percent)	1.4	1.3	0.9	1.7	1.8	2.2	2.4	2.6	2.5
Inflation (GDP deflator, in percent)	2.7	4.0	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Nominal GDP growth (in percent)	4.8	5.5	3.8	4.8	4.4	4.3	4.5	5.0	5.0
Effective interest rate (in percent) [4/]	0.8	2.8	2.5	1.9	2.2	2.2	2.2	2.3	2.3

As of March 31, 2014		
Sovereign Spreads		
EMBIG (bp) 3/		35
5Y CDS (bp)		35
Ratings	Foreign	Local
Moody's	Baa1	Baa1
S&Ps	n.a.	n.a.
Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	4.2	-0.5	-0.2	6.5	0.7	0.5	0.3	-0.1	-0.7	7.2	
Identified debt-creating flows	0.1	-0.3	0.4	1.1	1.0	0.8	0.6	0.4	-0.2	3.6	
Primary deficit	0.7	0.3	0.5	1.6	1.5	1.4	1.3	1.1	0.5	7.5	-0.7
Primary (noninterest) revenue and grants	18.5	25.6	23.1	23.1	23.3	23.5	23.7	23.8	23.9	141.4	
Primary (noninterest) expenditure	19.1	25.9	23.6	24.7	24.8	24.9	25.1	25.0	24.4	148.8	
Automatic debt dynamics [5/]	-0.6	-0.6	-0.1	-0.5	-0.5	-0.6	-0.7	-0.8	-0.7	-3.8	
Interest rate/growth differential [6/]	-0.6	-0.6	-0.1	-0.5	-0.5	-0.6	-0.7	-0.8	-0.7	-3.8	
Of which: real interest rate	-0.5	-0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	
Of which: real GDP growth	-0.1	-0.3	-0.2	-0.4	-0.5	-0.7	-0.7	-0.8	-0.8	-3.9	
Exchange rate depreciation [7/]	0.0	0.0	0.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (1) (e.g., drawdown of de	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroan	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	4.1	-0.1	-0.6	5.3	-0.3	-0.2	-0.3	-0.4	-0.5	3.6	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

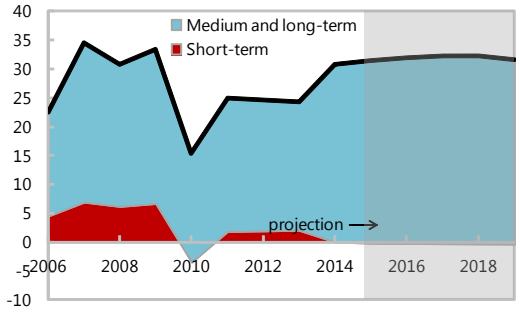
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

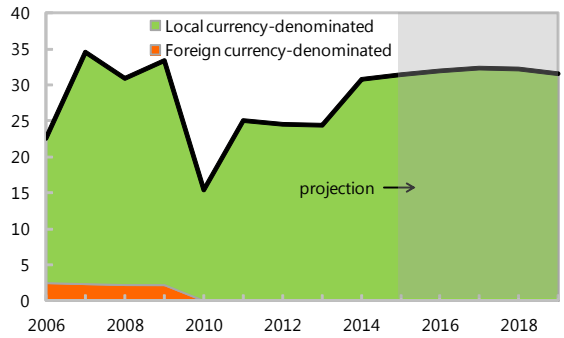
Figure 7. Sint Maarten: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

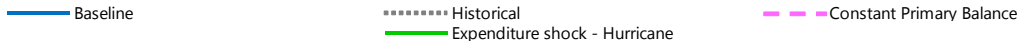
By Maturity
(in percent of GDP)



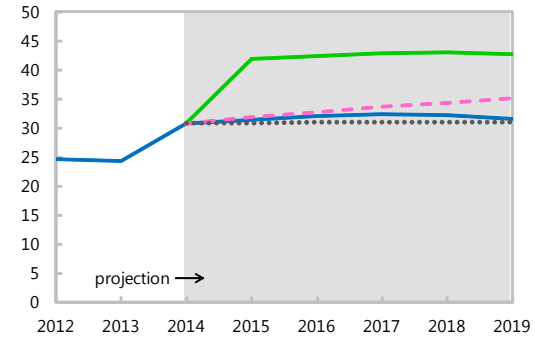
By Currency
(in percent of GDP)



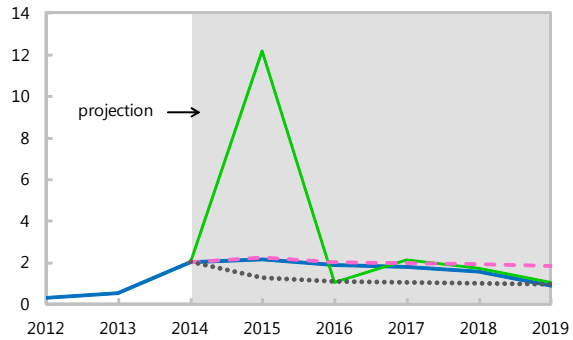
Alternative Scenarios



Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions

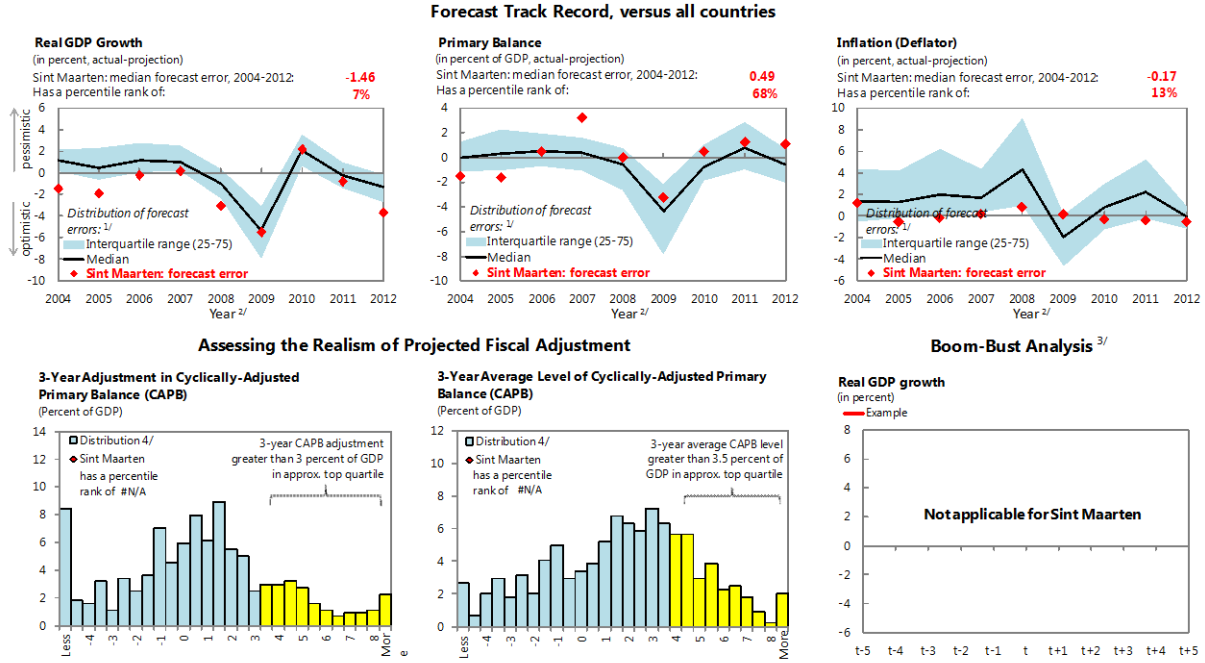
(in percent)

Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	1.7	1.8	2.2	2.4	2.6	2.5
Inflation	2.1	2.1	2.1	2.1	2.1	2.1
Primary Balance	-1.6	-1.5	-1.4	-1.3	-1.1	-0.5
Effective interest rate	1.9	2.2	2.2	2.2	2.3	2.3
Constant Primary Balance Scenario						
Real GDP growth	1.7	1.8	2.2	2.4	2.6	2.5
Inflation	2.1	2.1	2.1	2.1	2.1	2.1
Primary Balance	-1.6	-1.6	-1.6	-1.6	-1.6	-1.6
Effective interest rate	1.9	2.2	2.2	2.2	2.3	2.3

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	1.7	1.9	1.9	1.9	1.9	1.9
Inflation	2.1	2.1	2.1	2.1	2.1	2.1
Primary Balance	-1.6	-0.6	-0.6	-0.6	-0.6	-0.6
Effective interest rate	1.9	2.2	2.2	2.1	2.0	2.0

Source: IMF staff.

Figure 8. Sint Maarten: Public Sector DSA – Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

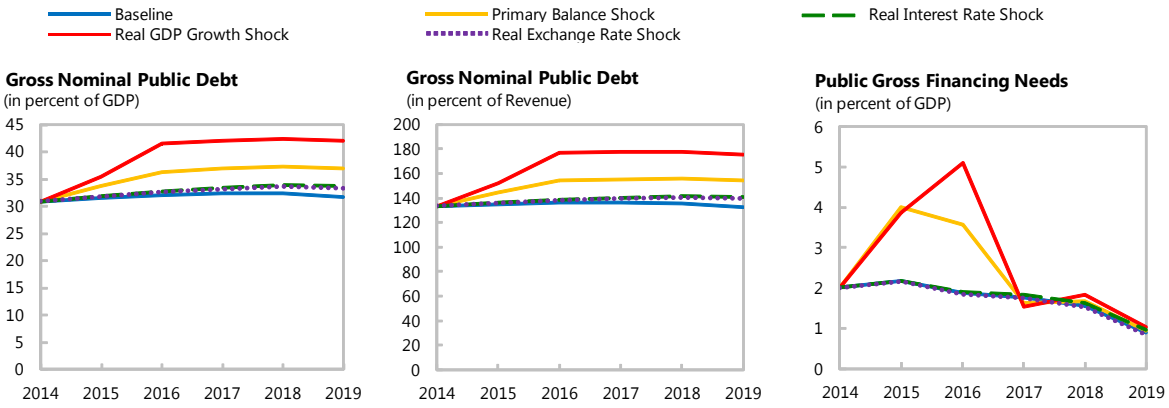
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Example, as it meets neither the positive output gap criterion nor the private credit growth criterion.

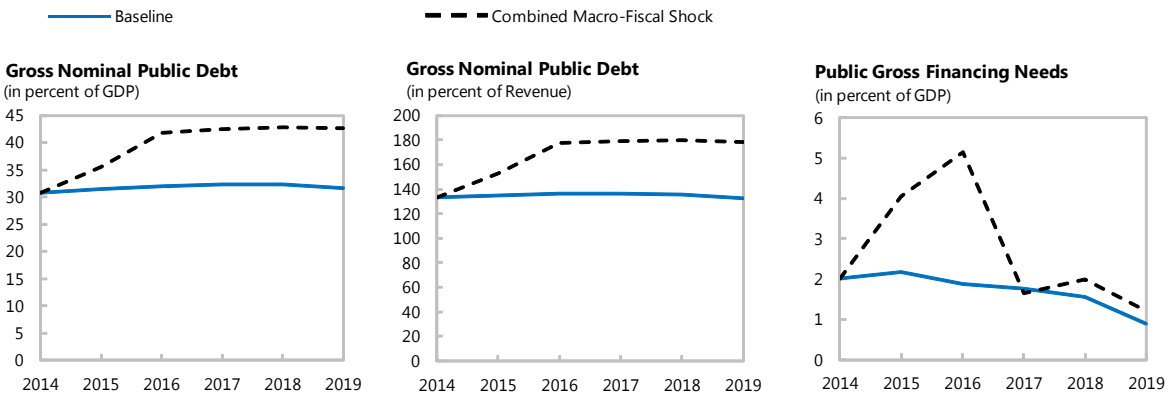
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 9. Sint Maarten: Public Sector Debt Sustainability Analysis (DSA) – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	1.7	1.8	2.2	2.4	2.6	2.5
Inflation	2.1	2.1	2.1	2.1	2.1	2.1
Primary balance	-1.6	-3.4	-3.2	-1.3	-1.1	-0.5
Effective interest rate	1.9	2.2	2.3	2.4	2.4	2.5
Real Interest Rate Shock						
Real GDP growth	1.7	1.8	2.2	2.4	2.6	2.5
Inflation	2.1	2.1	2.1	2.1	2.1	2.1
Primary balance	-1.6	-1.5	-1.4	-1.3	-1.1	-0.5
Effective interest rate	1.9	2.2	2.4	2.5	2.6	2.8
Combined Shock						
Real GDP growth	1.7	-3.0	-2.6	2.4	2.6	2.5
Inflation	2.1	0.9	0.9	2.1	2.1	2.1
Primary balance	-1.6	-3.4	-4.7	-1.3	-1.1	-0.5
Effective interest rate	1.9	2.2	2.5	2.8	2.9	3.0

Real GDP Growth Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	1.7	-3.0	-2.6	2.4	2.6	2.5
Inflation	2.1	0.9	0.9	2.1	2.1	2.1
Primary balance	-1.6	-3.2	-4.7	-1.3	-1.1	-0.5
Effective interest rate	1.9	2.2	2.3	2.4	2.5	2.5
Real Exchange Rate Shock						
Real GDP growth	1.7	1.8	2.2	2.4	2.6	2.5
Inflation	2.1	2.3	2.1	2.1	2.1	2.1
Primary balance	-1.6	-1.5	-1.4	-1.3	-1.1	-0.5
Effective interest rate	1.9	2.2	2.2	2.2	2.3	2.3

Source: IMF staff.

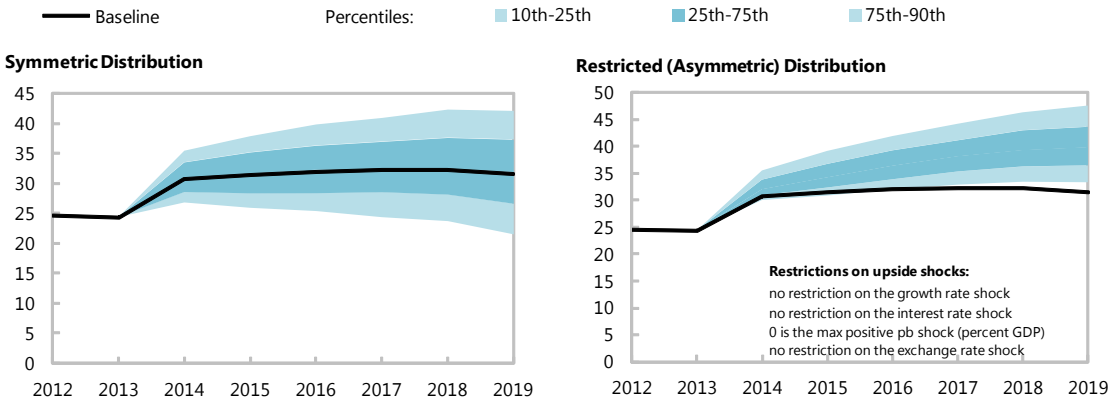
Figure 10. Sint Maarten: Public Sector Debt Sustainability Analysis (DSA) – Heat Map

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

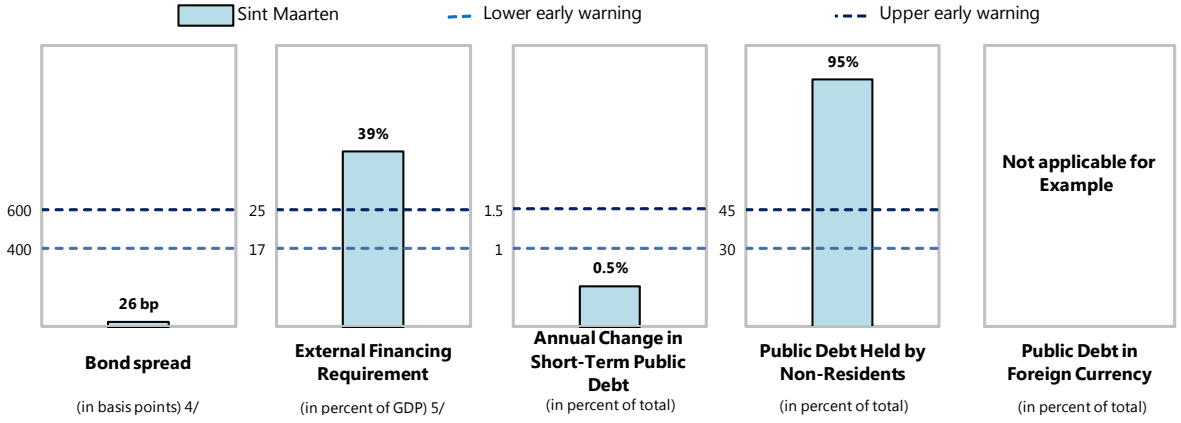
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2013)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 31-Dec-13 through 31-Mar-14.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

1. **The need to finance large external deficits and public investment budgets will push gross external debt higher over the projection horizon**. Under the baseline scenario, gross external debt would increase from 98 percent of the union's combined GDP to 110 percent in 2018, from where it would embark on a gradual decline. This forecast is based on the following assumptions:

1) Average non-debt creating FDI of about 2.5 percent of GDP, versus an average of 1.7% of GDP in the post-independence (2010-13) period, reflecting some increased appeal of the two islands to foreign investors from the pick-up in global tourism demand and assumed progress on structural reforms;

2) An average of about 3 percent over 2014-2018 in inflows associated to the repayment by the Netherlands of the Netherlands' Antilles' debt. This financing source is a reduction of the union's external assets and thus results in an increase of *net* external debt, but not of gross external debt.

3) Other macroeconomic variables as per the baseline macroeconomic framework.

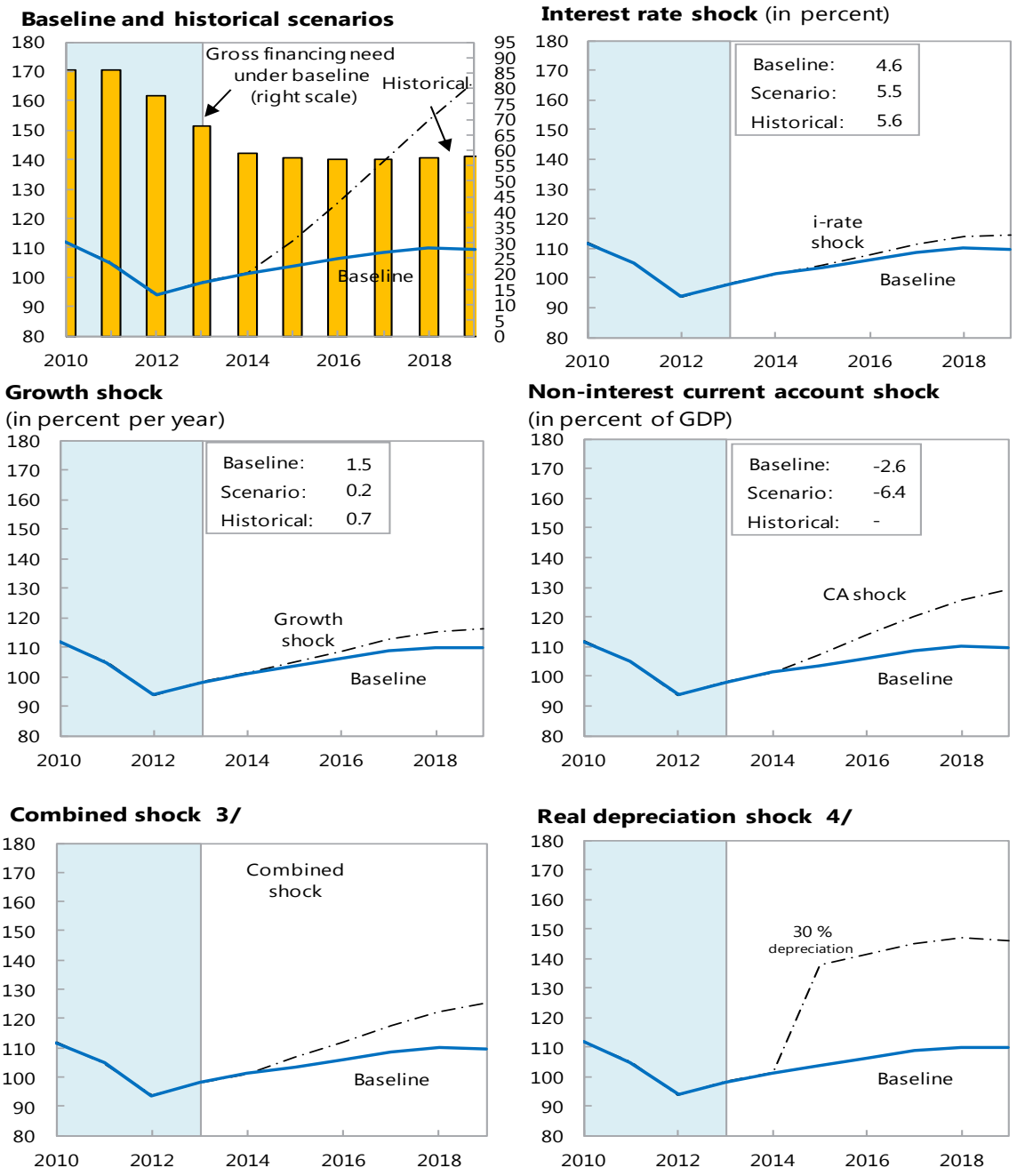
2. **A full assessment of whether this constitutes a threat to debt sustainability is hampered, however, by lack of information on the two countries' external assets.** These are presumed to be large, in line with the two countries' high per-capita income.[1] However, the fact that the gross debt is projected to reach levels in line with pre-debt relief peaks suggests that the associated vulnerabilities may stay in the period ahead.

3. **Gross external debt is sensitive to growth and especially current account shocks**, which further underscores the importance of flexibility- and competitiveness-enhancing reforms for overall sustainability. The impact of an exchange rate depreciation would be attenuated by the fact that public external debt is in local currency (and at very long maturities).

[1] In its March 2014 reaffirmation of Curacao's 'A-/A-2' (investment grade) ratings, Standard and Poor's indicated that it "estimates that Curacao is a large net external creditor, which mitigates its weak liquidity position," while noting that "official data on Curacao's international investment position are lacking, representing a significant gap in terms of statistical coverage."

Figure 11. Curaçao and Sint Maarten: External Debt Sustainability: Bound Tests 1/2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

Table 1. Curaçao and Sint Maarten: External Debt Sustainability Framework, 2009–19

(In percent of GDP, unless otherwise indicated)

	Actual						Projections						
	2010	2011	2012	2013			2014	2015	2016	2017	2018	2019	Debt-stabilizing non-interest current account 6/
Baseline: External debt	111.7	104.8	93.7	98.1			**101.2**	**103.5**	**106.0**	**108.5**	**110.0**	**109.6**	**-1.7**
Change in external debt	28.6	-6.9	-11.1	4.4			3.1	2.4	2.5	2.4	1.5	-0.4	
Identified external debt-creating flows (4+8+9)	19.9	16.2	13.9	12.6			9.0	5.6	3.8	2.5	2.0	1.5	
Current account deficit, excluding interest payments	22.3	15.9	14.7	11.0			7.8	4.7	3.3	1.9	1.6	1.3	
Deficit in balance of goods and services	25.2	17.9	15.0	11.4			8.8	6.8	5.5	4.4	3.6	3.2	
Exports	66.9	80.2	86.0	84.2			85.2	86.3	87.3	87.9	88.6	89.4	
Imports	92.1	98.1	101.1	95.6			94.0	93.1	92.8	92.4	92.2	92.6	
Net non-debt creating capital inflows (negative)	-2.7	-1.2	-1.5	-1.5			-2.6	-2.7	-2.7	-2.6	-2.6	-2.6	
Automatic debt dynamics 1/	0.3	1.5	0.7	3.1			3.9	3.6	3.2	3.2	3.0	2.8	
Contribution from nominal interest rate	2.9	5.0	4.3	4.7			4.8	4.7	4.6	4.7	4.7	4.6	
Contribution from real GDP growth	2.2	0.9	0.1	0.2			-0.9	-1.1	-1.4	-1.5	-1.7	-1.7	
Contribution from price and exchange rate changes 2/	-4.8	-4.5	-3.7	-1.8			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	8.6	-23.1	-25.0	-8.2			-5.9	-3.3	-1.3	-0.1	-0.5	-2.0	
External debt-to-exports ratio (in percent)	167.0	130.6	108.9	116.5			118.8	120.0	121.5	123.3	124.1	122.5	
Gross external financing need (in billions of US dollars) 4	3.3	3.4	3.2	2.8			2.6	2.6	2.7	2.8	2.9	3.0	
in percent of GDP	86.0	85.8	77.6	67.6	10-Year	10-Year	59.2	57.4	57.1	57.0	57.7	57.8	
Scenario with key variables at their historical averages 5/							**101.2**	**112.5**	**125.3**	**139.5**	**153.6**	**166.2**	**1.0**
Key Macroeconomic Assumptions Underlying Baseline					Historical Average	Standard Deviation							
Real GDP growth (in percent)	-2.8	-0.8	-0.1	-0.3	0.7	2.5	0.9	1.2	1.4	1.4	1.6	1.6	
GDP deflator in US dollars (change in percent)	6.1	4.2	3.7	1.9	3.3	2.1	3.1	2.7	2.0	2.1	2.0	1.8	
Nominal external interest rate (in percent)	3.6	4.7	4.3	5.1	5.6	1.8	5.1	4.8	4.6	4.6	4.5	4.3	
Growth of exports (US dollar terms, in percent)	-2.4	23.9	11.1	-0.5	6.2	9.7	5.3	5.3	4.7	4.4	4.4	4.4	
Growth of imports (US dollar terms, in percent)	5.1	10.0	6.8	-3.9	6.7	8.7	2.3	3.0	3.2	3.1	3.5	3.8	
Current account balance, excluding interest payments	-22.3	-15.9	-14.7	-11.0	-11.9	7.6	-7.8	-4.7	-3.3	-1.9	-1.6	-1.3	
Net non-debt creating capital inflows	2.7	1.2	1.5	1.5	1.6	2.2	2.6	2.7	2.7	2.6	2.6	2.6	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.