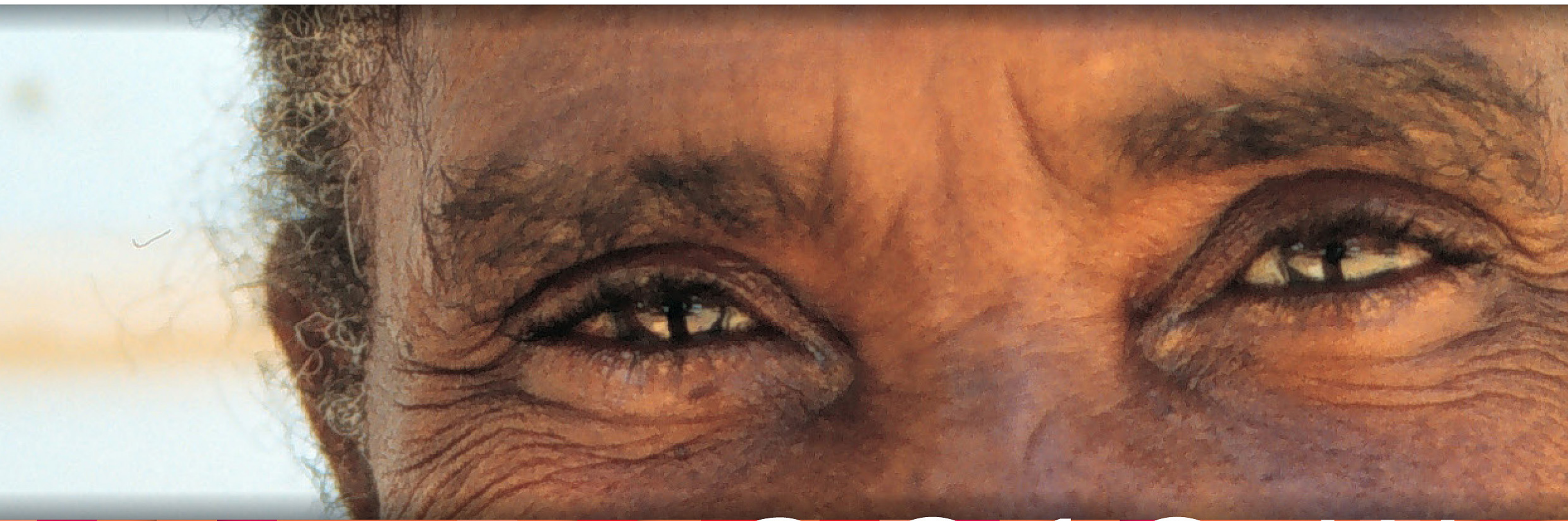
Caribbean Region Quarterly Bulletin



2016:III

Brexit: Economic Consequences for the Caribbean

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IDB Country Department Caribbean

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The Consequences of Brexit for the Caribbean

British voters suprised the world when they voted to leave the European Union in June 2016. Markets reacted heavily to the surprise resulting in high volatility in all major stock indices as well as bond and foreign exchange markets. Many observers predicted a dire impact on UK, EU and the world economy.

Anxiety also rose in the Caribbean. For instance, the highly influential Sir Ronald Sanders predicted that 'Brexit creates a nightmare for the Caribbean'.[1]

Around three months into the vote, markets have calmed down. Stock and bond indices are back to levels similar or higher than before the vote, although there are signs of an economic slowdown in the UK. Unlike many commentators, we find that Brexit and subsequent slow down in economic growth will have only marginal impact on the Caribbean's economic growth, tourism, remittances and exports, during 2016 and 2017.

This edition of the Quarterly Bulletin not only explores possible consequenses from Brexit on the Caribbean but also, as usual, *provides an overview of recent economic developments in the Caribbean.*

Selected Indicators	Real Growth Rate	Annual Inflation (% end of period)	General Government Primary Balance (% of GDP)	General Government Overall Balance	Current Account balance (% of GDP)	General Government Gross Debt (% of GDP)
Jamaica 1/	1.0	3.0	7.1	-0.3	-2.2	120.3
Barbados 2/	1.5	-0.2	0.2	-7.8	-6.8	144.1
The Bahamas	-1.7	2.0	-0.1	-3.0	-15.3	66.6
Guyana	3.0	-1.8	-0.4	-1.4	-5.7	48.6
Trinidad and Tobago	0.2	4.7	-2.4	-4.2	-0.4	45.3
Suriname	0.1	25	-7.4	-8.8	-15.6	43.3
CCB Average	0.7	5.5	-0.5	-4.3	-7.7	78.0

Source: International Monetary Fund and country authorities.
Notes: Year is 2015 or closest available date. 1/Year is FY2015/16, 2/ Barbados debt figure includes holding of NIS.

Summary of Economic Update by Country

Economic activity in the ***Bahamian*** *economy remains sluggish, with growth projected at 0.5 percent in 2016. The International rating agency Moody's downgraded The Bahamas' sovereign ratings a single notch to Baa3 with a stable outlook. Gross international reserves are forecasted to remain at stable levels; inflation is projected to be lower than the previous year-end period; however, double-digit unemployment and the elevated share of non-performing loans continue to constrain private credit.*

A favorable external environment was growth positive for ***Barbados*** *in 2015. Tourism arrivals rebounded and lower oil prices contributed to improve the external position. However, debt continues to rise and further fiscal consolidation is expected over the next few years.*

Guyana's *economy remains tethered to gold, which has supported both real GDP growth and contributed to improvements in the external current account, along with low oil prices. Fiscal stimulus is heavy on transfer payments while severe challenges remain in implementing the public sector investment program (PSIP). The financial sector remains sound despite mounting non-performing loan performance.*

The economy remains stable with a positive outlook in ***Jamaica****. The change of government introduced some uncertainty early in the year but expectations are of a continuation of the successful strategy of fiscal prudence while trying to accelerate economic growth. The IMF-supported Extended Fund Faculty will end in March 2017, however a follow up program is anticipated.*

The government of ***Suriname*** *is implementing its macroeconomic stabilization and reform agenda, with contribution from the IMF and multilaterals. The external situation has improved somewhat given efforts to control imports and increases in commodity prices, with the volatility in exchange rate movements between the official and parallel markets decreasing.*

The economic situation in ***Trinidad and Tobago*** *was marked by lower oil and gas prices, forcing the country to adjust policies to the new circumstances. The Trinidadian economy contracted in 2015 and the recession continues in 2016. The government has been introducing several measures to constrain expenditures and increase non-energy revenues in reaction to the fall in energy-related revenues.*

The Eastern Caribbean is experiencing a tourism-led recovery and fiscal consolidation efforts are paying off with countries achieving primary surpluses. Dominica made progress on its reconstruction and infrastructure rehabilitation efforts as a result of Tropical Storm Erika.

Special Regional Report: The Effect from Brexit on the Caribbean

The regional supplement presents some key results of a forthcoming policy brief that explores the effects of Brexit for the countries of the Caribbean Country Department. We expect only small and concentrated effects on Caribbean economies from the Brexit vote during 2016 and 2017.

[1] Article can be found under http://www.sirronaldsanders.com/viewarticle.aspx?ID=563

Contributors: Jeetendra Khadan, Inder Ruprah and Juan Pedro Schmid

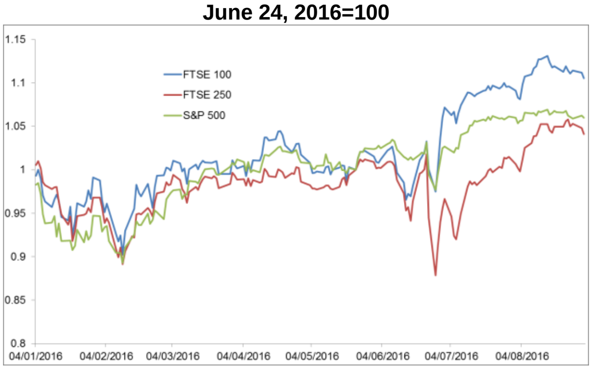
Introduction

The UK stunned the world when it voted to leave the European Union (EU). Contrary to most projections, the Leave voters in the United Kingdom won by a margin of 51.9 to 48.1 percent. Markets reacted heavily to the surprise result with the GBP and the domestic oriented FTSE 250 experiencing the strongest declines. However, other currencies, bond and stock markets also exhibited higher than usual volatility.

Around three months into the vote, markets have calmed down. Stock and bond indices are back to levels similar or higher than before the vote. At the same time, the GBP remains depressed and signs of economic slowdown in the UK are emerging.

Figure 1: Stock Market Index S&P 500, FTSE 100 and FTSE 250

June 24, 2016=100



Source: Yahoo Finance and London Stock Exchange

The exact consequences from the leave vote remain unclear. A proper assessment, including of the magnitude of the shock, is challenged by the uncertainty about the follow up arrangement between the UK and the EU. Possibilities range from the Norwegian/Switzerland type solutions to a shunning of the UK by the EU. In the former, little would change as the UK may keep full access to the European market, while its obligations also remain in place, including on migration. This option is thus likely to be unattractive for the leave voters who perceive the EU migration policy as too permissive and socially disruptive. At the other end of the spectrum, the EU countries could punish the UK to show other EU members the cost of leaving the economic and political union. Given the strong linkages between the two economic zones, trade and GDP would be severely affected with likely spillovers to other economies in the world. Finally, there is also the possibility that the UK would remain in the EU. The referendum was not binding and could be repeated with a potentially different outcome if and when the British realize the disadvantages of leaving the EU.

Whatever the final arrangement between the UK and the EU, the vote has increased uncertainty. Uncertainty is likely to remain because of the lengthy process for a secession from the EU and the lags with which its effects and the information about it emerge. The future shape of the EU is unpredictable as Brexit has opened the door for further secessions. All of this has erected vulnerabilities, not only directly for countries with links to the UK but also for the world economy in general through indirect effects.

In what follows, we explore potential consequences for the countries in the Caribbean, a region with strong historical links as former colonies that are, however, not always reflected in economic links. Nevertheless, the Caribbean could suffer disproportionally from potential Brexit turmoil. First, some countries have strong linkages, especially through tourism but also trade and remittances. Second, lacking a large domestic market, Caribbean countries are very open and deeply integrated into the global economy. Third, several countries are already vulnerable with fiscal challenges and low growth rates, and thus have a narrow margin of maneuver to accommodate adverse consequences of the UK-EU separation. However, a benign outcome is also possible. Under such a scenario, tourism arrivals from the UK would decline in the short term but would be replaced by visitors from other regions. In terms of trade, the EU and the UK could reach an agreement that provides access to the European market similar to the pre-Brexit vote. Finally, the break with the EU might give rise to a stronger union within the Commonwealth, benefiting the Caribbean countries that form part of it.

Consequences

Except for the Pound, the consequences of Brexit have so far been small. Turbulences have subsided in spite of the strong initial reaction of financial markets to the referendum results. As of end-August, major stock and bond markets are at similar levels than before the vote. Even the FTSE 250, a UK stock index with a heavy weight on domestic companies, has climbed to levels exceeding those prior to the referendum (Figure 1). In addition, the FTSE 100 index— which includes UK-listed companies with global operations that may benefit from a weaker Pound—, is almost 10 percent above the day of the vote. On the other hand, the GBP depreciated by around 12 percent since July. (Figure 2).

Uncertainty has increased. In spite of the muted reaction, uncertainty has increased, including in relation to the magnitude of the effect. Impacts are still unfolding and might intensify with time. Given the uncertainties,

forecasts vary. For instance, in the July 19, 2016 World Economic Outlook, the IMF assumes a moderate baseline effect from the Brexit, which would be concentrated in advanced economies, mostly the UK and the EU, and to a lesser degree in emerging markets. However, as the details of the final relation between the UK and the EU are worked out, the IMF also formulates two additional scenarios, labeled "downside" and "severe", whose likelihood is admittedly low inasmuch as "financial markets have continued to stabilize following the Brexit referendum". The stronger negative impact of the latter two scenarios would result from difficult and protracted negations, which could affect financial conditions as well as business and consumer confidence.[1]

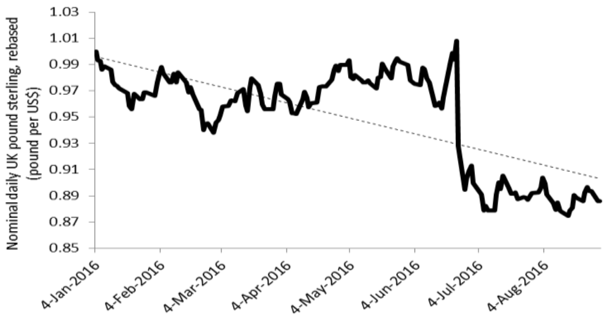
Table 1: June 2016 WEO update Growth rates for selected economies

	Estimates		Projections Baseline		Difference from April 2016 WEO Projections	
	2014	2015	2016	2017	2016	2017
Advanced Economies	**1.9**	**1.9**	**1.8**	**1.8**	**-0.1**	**-0.2**
United States	2.4	2.4	2.2	2.5	-0.2	0
Euro Area	0.9	1.7	1.6	1.4	0.1	-0.2
United Kingdom	3.1	2.2	1.7	1.3	-0.2	-0.9
Emerging Market and Developing Economies	**4.6**	**4.0**	**4.1**	**4.6**	**0**	**0**
Latin America and the Caribbean	1.3	0	-0.4	1.6	0.1	0.1

Source: IMF, July WEO update

Brexit had a clear impact on the GBP. The pound was volatile before the referendum but appreciated days prior in expectation of a victory of the remain campaign. The currency started sliding down sharply as soon as the polls revealed a victory of the leave vote, and it reached levels last seen in the mid-1980s (Figure 2). The fall in the currency reflects expectations of an economic slowdown in the UK as well as the policy reaction by the Bank of England–lower interest rates to counter the deterioration of domestic conditions.

Figure 2: GPB/USD Exchange Rate



Source: Khadan and Ruprah 2016

A weaker Pound can have quick repercussions. The weaker Pound should benefit the UK by making exports more competitive,[2] while reducing imports. UK tourism imports (i.e., British travelers abroad) are likely to decline quickly. The number of travelers might remain stable for a short while as the flights and trips already booked take place, but will decline once new bookings become more expensive at the prevailing weaker currency. Tourism demand through total spending can decline faster as the British cut expenditures while travelling abroad.

Remittances are a fast channel through which the weaker Pound will have a worldwide effect. The UK is among the 10 top remittances-sending countries in the world, with the top three destinations being Nigeria, India and Pakistan. Countries in Latin American and the Caribbean also receive important shares of remittances from the UK, notably Guyana and Jamaica.

The uncertainties since the leave vote have indirect consequences relevant for the world economy, and especially for emerging markets. Lower demand from the UK can affect trading partners' growth performance, which in turn would lower demand for imports from other countries. Such an economic slowdown could also affect labor markets and remittances. In addition, as Brexit adds further vulnerabilities to the world economy and contributes to a strong US$, it may be perceived by the US Federal Reserve as a factor justifying slowing the pace of monetary tightening over the short to medium term.

Vulnerability of the Caribbean

For the economies of the Caribbean, the expectation is that the leave vote will have a small but sustained impact. Remittances, trade and tourism are all expected to be affected, at least in the medium term. Development finance, aid programs and foreign investment could also be impacted. One recent study estimates total Brexit cost to developing countries at approximately US$3.8 billion.[3]

Historical links of the English-speaking Caribbean to the UK are not completely reflected in economic links. All countries in the IDB's Caribbean Country Department (CCB)[4] were former colonies of the UK with the exception of Suriname, which is a former Dutch colony. However, in spite of the shared history, the economic weight and geographical closeness of the United States has made it the main trade partner. In terms of goods trade, between 0.02 percent in Suriname

[1] See July 19, 2016 WEO update for further details on the scenarios and for the severe scenario, IMF 2016 United Kingdom Staff Report.

[2] However, the effect is not one-to-one given the import content of many exports, estimated at 25 percent.

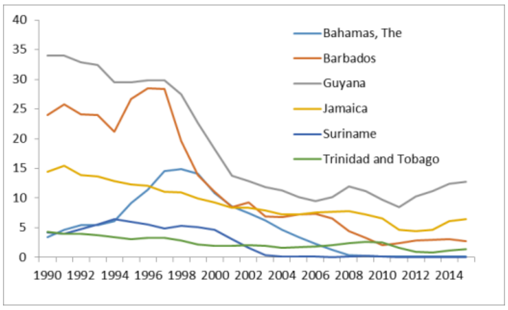
[3] Overseas Development Institute 2016

[4] The Bahamas, Barbados, Guyana, Jamaica, Suriname and Trinidad and Tobago

and 14 percent in Guyana are destined for the United Kingdom.

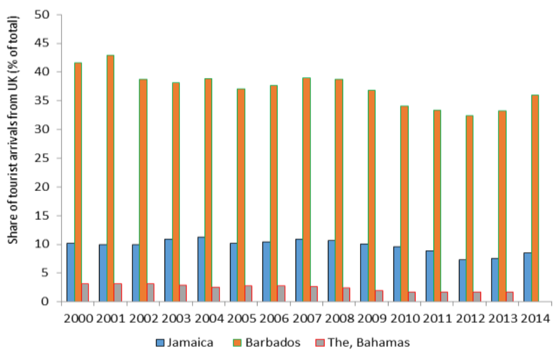
A similar dependence on the United States emerges for tourism countries. Barbados is an exception in this respect as UK tourism accounts for almost 40 percent of total stayover tourism, which is high compared to 2 percent and 8.5 percent for The Bahamas and Jamaica, respectively. In addition, reflecting the recent lowering of the Air Passenger Duty and fear of terrorist violence in several typical tourist destinations, British tourism has increased over the last few years. As such, UK tourism was one of the drivers of the strong performance of tourism in countries including Jamaica, Barbados and several OECS countries.

Figure 3: UK Exports from CCB



Source: United NationsTrade Database.

Figure 4: UK Tourism in CCB

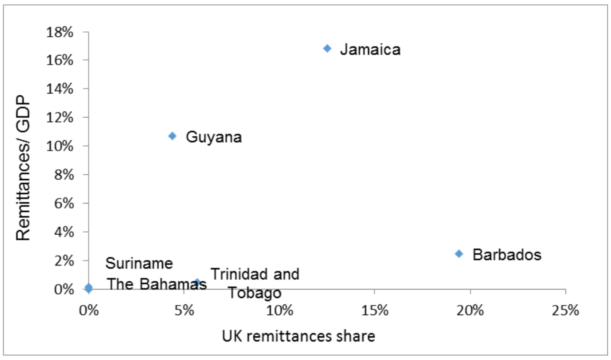


Source: The Bahamas, Barbados and Jamaica Tourism Authorities

The repercussions through remittances will be concentrated. Among the six CCB countries, Jamaica with the equivalent of 16.8 percent of GDP followed by Guyana (10.5 percent) have the highest inflows of remittances. Among these, Jamaica will be affected more strongly as UK remittances constitute one fifth of total remittances compared to Guyana's 4.4 percent. UK remittances to Barbados are also high, registering almost 20 percent of total remittances, however overall remittances into the country are smaller at 2.5 percent of GDP (Figure 5).

Other channels through which the leave vote could impact the Caribbean include changes in aid, trade agreements and migration policy. However, discussion of these issues is beyond the purpose of this article.

Figure 5: Remittances as a Share of GDP versus share Remittances from UK, 2015



Source: World Bank remittances database.

Quantifying the impact[5]

The direct impact will be muted. With the caveat of the uncertainty of the final agreement on the secession, simple simulations indicate the range of the effects on the Caribbean economy using two approaches: direct estimations of cross-movements of Caribbean GDP with UK and US GDP; and estimations of the impact of the depreciation of the GBP on tourism and remittances.

Table 2: Economic Impact of Brexit

	Remittances	Tourism	Trade	Total
Barbados	-0.076%	-0.310%	-0.001%	**-0.387%**
Jamaica	-0.139%	-0.037%	-0.003%	**-0.179%**
Guyana	-0.069%	0.000%	-0.016%	**-0.085%**
Trinidad and Tobago	-0.005%	0.000%	-0.004%	**-0.009%**
Bahamas, The	0.000%	0.000%	0.000%	**0.000%**
Suriname	0.000%	0.000%	0.000%	**0.000%**

Source: Khadan and Ruprah and own calculations based on April and July update WEO.

A decline in UK GDP has a small direct effect on GDP in the Caribbean countries. The effects are strongest in Barbados and Jamaica but small in the other countries.[6]

Tourism and remittances are the main channels through which Brexit will affect the Caribbean. A country's outbound tourism depends on its economic

[5] For a deeper analysis, see Khadan and Ruprah (2016), The Short-Term Macro-Economic Consequences of Brexit on the Caribbean: Much Ado About Nothing?

[6] The results were obtained using a Vector Auto Correction model that relates GDP in Caribbean countries to GDP in the UK and the United States, See *Ibid*.

performance and labor market conditions and the relative price. Both determinants are likely to be affected as the British economy is slowing down and the GBP depreciated. As a consequence, the decline in GDP growth from a decline in tourism demand could be as much as 0.31 percent and 0.04 percent in Barbados and Jamaica.[7] The effects could be smaller if tourists from other destinations replace the loss in UK arrivals.[8] The effect from tourism for The Bahamas is expected to be small as UK tourists constitute only around 2 percent of arrivals. The effect is also negligible in the other countries that have very small tourism sectors.

Remittances are expected to decline. Remittances will likely decline for two reasons: a slowdown in the UK GDP (that would in turn affect labor markets), and depreciation of the UK currency. However, the overall impact will be small given the low level in remittances for all countries other than Jamaica and Guyana, which themselves depend on other countries.[9]

Conclusions

The Global Recession is an ever present reminder of the vulnerability of Caribbean economies to a fluctuating global outlook. In this context, the decision of the UK to leave the European Union led to anxiety in the Caribbean as in other parts of the world. Worries were also accentuated by the fact that a still vulnerable world economy was again shocked and a new source of uncertainty created.

Volatility has subsided, for now. Almost three months into the decision, international markets have returned to pre-Brexit levels. Several studies have explored the potential impact from the vote, including for Emerging Markets and the Caribbean, and most agree that effects should be minimal, especially for regions such as the Caribbean that only have loose linkages to the United Kingdom.

Volatility could increase again. Article 50 of the Lisbon treaty, which outlines how a country might voluntarily leave the Union, gives a two-year timeline from notification until conclusion of a new agreement. Depending on the result of the negotiations and the form of final agreement, new economic uncertainties could emerge.

Taken together, the Caribbean is not completely isolated from the consequences of the Brexit vote. The expected economic slowdown in the UK, accentuated by the weaker GBP, will affect demand for goods and tourism and the ability to send remittances. The strongest effect will be felt in Barbados, followed by Jamaica. In the other countries, the effects should be negligible in the absence of a stronger fallout of the world economy.

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[7] The analysis was done in four steps. First, the decline in arrivals from the slowdown on the British economy was estimated using the results from a Vector Auto Correction model that relates British Tourist arrivals in Caribbean countries to GDP in the UK. These arrivals under a weaker UK economy were then corrected to take into account the weaker GBP using elasticities from Laframboise et al 2014. Using also Laframboise et al 2014, elasticities were then used to estimate the decline in expenditures of the remaining UK arrivals. Finally, the decline in GDP was calculated as proportional to the decline in total tourist expenditures from lower UK tourist expenditures.

[8] A decline in tourism demand could be partly compensated by lowering prices. Similarly, both countries can not satisfy demand in the peak seasons, which would lower the impact from decrease UK demand.

[9] The decline in GDP from lower remittances was calculated by assuming that UK remittances remain the same in GBP, thus leading to proportionally lower remittances in the local currency. The assumption was that the decline in GDP is equivalent to the decline in remittances in local currency.

Contributor: Allan Wright

Overview

Growth is expected to be stable but low. Preliminary estimates suggest that real GDP is expected to grow by 0.5 percent in the current period with long-term average projection at 1.5 percent.[1] Improvements in air tourist arrivals, private consumption and investment are expected to be the biggest contributors to growth. The current period growth prospects have been impacted by the Baha Mar related uncertainties, however, the Prime Minister recently announced an agreement with the Export-Import Bank of China to complete and have the project operational by the end of the 2016/17 winter season. The smooth implementation of VAT has aided the government's fiscal consolidation program, however, the central government debt ratio remains high. The international rating agency Moody's downgraded The Bahamas' sovereign rating a single notch to Baa3 with a stable outlook. Gross international reserves are forecasted to remain at stable levels and are improving. Inflation is projected to be lower than the previous year-end period; however, double-digit unemployment and the elevated share of non-performing loans continue to constrain private credit.

Recent Developments

Growth for the period remains low, as a contribution in tourism value added to GDP continues to be smaller than anticipated Increased air arrivals (2.2 percent) have not been able to adequately compensate for lower occupancy and average daily room (ADR) rates, as total rooms' revenues fell by approximately 7 percent for the first four months. There is an expectation that air arrivals will improve further as the Ministry of Tourism has recently upped its efforts by adding new connections and direct flights from Europe and the USA. The construction sector received improved support from seemingly varied scaled foreign investments, as the value of permits issued and started increased, especially in Grand Bahama and the other Family Islands.

Construction sector improved from varied scale foreign investments. The construction sector represents approximately 9.5 percent of total GDP. With the delay in the Baha Mar project, the government of The Bahamas (GoBH) has been promoting growth through varied scaled private capital investments. The number of construction permits issued rose for the first three months of the year, compared with the last period. An increase was observed in the Grand Bahama (80 vs 59 for the same period last year). The value of the current permits granted was almost 84 percent greater than the same period last year, with Grand Bahama and the Family Islands providing the greatest contribution to this growth. Over the current period, construction permits for the commercial and industrial segments were the largest contributors to growth. Among actual construction starts, Grand Bahama was noted to contribute the biggest percentage increase, with overall starts for the period growing by 20 percent and the corresponding value of 7 percent. This improved construction activity should help to stabilize the growth rate within the period.

Highlights

Real GDP expected to grow by 0.5 percent, with long-term projections at 1.5 percent.

Baha Mar Hotel and Casino project expected to be operational by end of 2016/17 winter season.

Construction sector improved from seemingly varied scaled foreign investments (Grand Bahama and other Family Islands).

International reserves remain stable and improving.

Sovereign rating downgraded to Baa3, with a stable outlook

With increased uncertainty from the Brexit vote, minor medium-term negative impacts could be expected.

International reserves have improved. Net international reserves for the first quarter of the current period remain at higher levels than the same period last year. The current month (June 2016) has seen a 10 percent growth in reserves. External reserves expanded to $1,053.8M million at the end of the current period.

Sovereign ratings downgraded by a single notch to Baa3, with a stable outlook. Based on continued low growth and a high debt level, limiting fiscal space, the sovereign ratings were downgraded from Baa2. Moody's noted that expectation of the economy achieving higher growth rates in the medium term and the continuation of the current fiscal consolidation efforts have contributed to its opinion of a stable outlook. Further strengthening of the budgetary process and structural reforms to the labor market and the ease of doing business could be credit positive for the economy.

Inflation has remained low. Up to the period ended March 2016, inflation, as reflected by the retail price index, fell to 1.13 percent driven primarily by lower international oil prices. The major contributors were

[1] IMF July 2016

transportation and housing, water, gas, electricity and "other" fuels which fell by 6.6 percent and 3.6 percent, respectively. Housing, water, gas, electricity and other fuels have the largest component of the current index.

Fiscal deficit deteriorated. With the expansion of short-term financing to the public sector, the ten months of FY2015/16 showed a 16.1 percent widening in the deficit relative to the prior year and eclipsed the 14.3 percent growth in total revenue. A decomposition of the spending and revenues showed significant increases in transfer payments, debt service obligations, purchases of goods and services and wages and salary payments, while capital expenditures declined. For revenues, robust VAT collections have continued at pace, reflecting almost-full fiscal year targets, while a rebalancing of several indirect taxes to VAT has led to the decline in receipts from import duties and excise, and property transfers. As the government consolidation program continues, increasing VAT receipts will aid the program, as well as better control of current expenditure.

Public debt increased. As at the first quarter of 2016, central government and publicly guaranteed debt rose to approximately 76 percent of GDP. Interest payments represented 2.1 percent of GDP for FY2015/16 and 14 percent of revenues. From internal simulations, an approximate adjustment of the primary balance by 1.9 percentage points of GDP is needed to stabilize its debt-to-GDP ratio, in the long run.

The average interest rate spread increased slightly for the period April 2016, while the treasury-bill rate has increased. The spread increased from 12.8 percent as at April 2015 to 13.1 percent at the end of April 2016. This came as the average 3–month deposit rate decreased from 1.3 percent at end-April 2015 to 0.9 percent at end-April 2016. At around the same time the T-bill rates have increased to 1.2 percent at the end of March 2016 (vs 0.6 percent in March 2015).

Private sector credit had a slight contraction of 0.24 percent for the period ended March 2016. Private sector credit contracted slightly and non-performing loans remained relatively high at 14.4 percent, down from 15.3 percent in 2013/14. Total provisions for non-performing loans increased to 58.5 percent at the end of 2015 from 51.2 percent in 2014 and 39 percent in 2013. The formation of the Resolve Corporation has contributed to the slight decline in the NPL portfolio.

The capital adequacy ratio (CAR)[2] remains high. The current ratio moved up to 30.9 percent or by 30 basis points. This is approximately 22 percent and 13 percent above the international and central bank targets respectively and indicates the adequate capitalization of the banking sector.

Conclusion

Growth is expected to be stable but low for the current period, as higher tourist air arrivals have not been sufficiently strong to compensate for other deficiencies within the sector. The uncertainty surrounding the Baha Mar project has negatively impacted the short-term growth prospects, however with the planned resumption of work in September, medium and long-term growth expectations are positive. The construction sector continues to receive an added boost from varied scaled foreign investment projects, especially within the Family Islands and Grand Bahama. International reserves have improved. Inflation remains low, driven by declining international oil prices. Increased short-term bridge financing to the public sector has contributed to a widening deficit, even as increased VAT collections continue to boost the consolidation program.

High-Frequency Macroeconomic Indicators				
	Last data	**Period**	**Prior data**	**Period**
Annual GDP growth (%)	-1.7	2015	-0.5	2014
Tourist arrivals	-0.5	2015	2.8	2014
Exports (12-month growth)	-1.7	2015	1.0	2014
Imports (12-month growth)	2.0	2015	0.0	2014
Private sector credit growth (%)	-0.2	Mar-16	-0.3	Mar-15
Inflation (% yoy change)	2.0	2015	0.2	2014
Exchange rate (end of period)	1.0	2015	1.0	2014
Unemployment rate (%)	13.4	2015	15	2014

[2] Financial Stability December 2015 report

Introduction

The United Kingdom's vote to leave the European Union (EU) has led to a downward revision of the global outlook. Driven by expectations of increased uncertainty, there have been several estimates of the post Brexit-era with scenarios showing the UK and the EU output negatively impacted. The IMF has estimated this impact by comparing the previous World Economic Outlook (WEO) report with the current. The results suggest that there will be a decline of 0.2 percent and 0.9 percent for 2016 and 2017, respectively, in the UK. Europe is projected to marginally grow in 2016 but decline by 0.2 percent the following year. The world economy is expected to decline by 0.1 percent for the two periods of 2016 and 2017. Nonetheless, the scale of the decline in output will probably heavily depend on the nature of the trade deal (FTA vs WTO scenario[3]) that the UK will be able to negotiate with the EU within the forthcoming period.

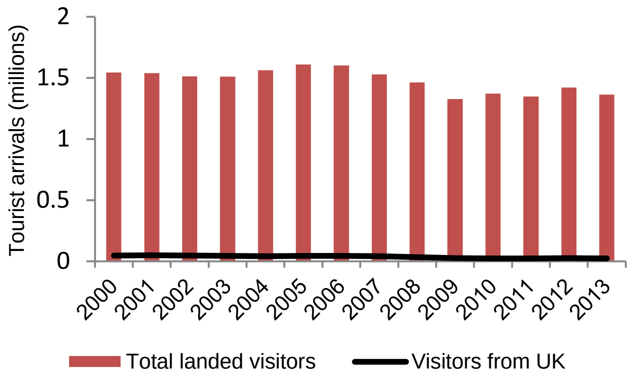
For the economies of the Caribbean, the expectation is that a Brexit vote will be similar to the global outlook. Foreign direct investments, trade, and financial markets are all expected to decline at least in the short term. Development finance and aid programs and remittances could also be impacted. One study estimates Brexit cost to developing countries at approximate US$3.8 billion.[4]

UK Linkages

In the case of The Bahamas, growth is expected to be stable, but low. The country continues to depend on growth in arrivals and tourism contribution, along with contributions from the financial services sector, private consumption and varied scale foreign investment. However, the uncertainty related to the Baha Mar project has stymied the growth outlook for the current term. Potential increased uncertainty of the Brexit vote leading to further revisions to the global outlook would add to the current state of weak economic performance.

The lower purchasing power of UK consumers and a depreciated currency will dampen air arrivals to several Caribbean economies including The Bahamas. Though not known as a popular destination for UK tourists (25,300 visitors or 2 percent of overall air arrivals), over the recent period, the Ministry of Tourism, has been increasing efforts recently to improve load capacity to the island and adding new connections and direct flights from continental Europe and the USA. With the current uncertainty from the Brexit vote, this effort could be hampered.

Figure 1: UK tourist arrivals vs Total landed visitors



Source: Bahamas Tourism Statistics

Rising financing costs and lower global growth outlook will gradually see investors move their investments, usually to stronger economies. The UK and other investors could eventually limit or withdraw from financing investment in Caribbean markets.This could be a concerning phenomenon as in the first three months of the current period, The Bahamas has been experiencing an increase in construction starts and permits for varied scale projects, granted within the Family Islands and Grand Bahama, as the government of The Bahamas (GoBH) increases its growth efforts. The movement of investments away to more robust economies, coupled with the depreciated pound, will certainly negatively impact many of the current private capital investment projects.

Lower tourism receipts and private foreign direct investments are all scenarios that could play out in a post-Brexit era for The Bahamas in the medium term. With the level of reserves now slightly improving, any significant negative change could expose the economy to external shocks and natural disaster risks, as tourist contribution and foreign direct investments are major components of the country's reserves.

For countries like Barbados (19.4 percent), Saint Lucia (16.7 percent) and Jamaica (12.5 percent), inward remittance from Caribbean migrants[5] in the UK contribute a significant level of foreign exchange reserves in the Caribbean and represents a lifeline to their family and friends. In The Bahamas, inward remittance is

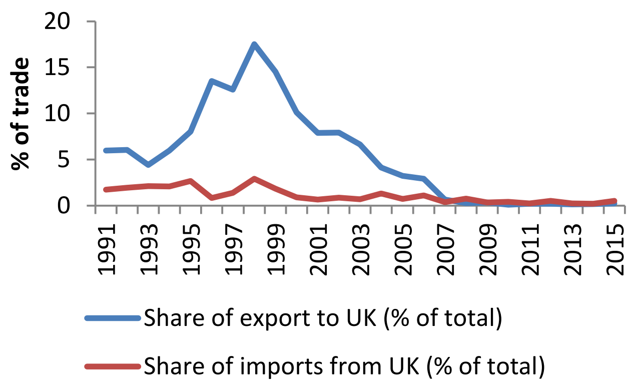
[3] Free Trade Agreement (FTA) implies keeping the UK closely integrated with the EU with expected impact benign, while a World Trade Organization (WTO) default rule indicates a significantly negative impact, as the UK will be no part of the EU custom union.
[4] Overseas Development Institute 2016 Report

[5] CCMF June 2016

minuscule as outward remittances are the predominant private transfer. Outward remittances rose from US$140M in 2012 to US$151M[6] in 2014, with transfers by migrant workers and the wages and salaries earned by non-resident workers comprising the major components. The expectation that the Brexit vote will impact the outlook through increased uncertainty is possible. The uncertainty dampens prospects of robust economic growth for the region, incuding The Bahamas, and by extension, limits levels of The Bahamas' outward remittances as economic conditions become tepid.

With the uncoupling of the UK from the EU, Caribbean economies, including The Bahamas, could no longer have favored trade agreements with the EU; it also implies the reduction of EU socioeconomic development grants to the region. The current level of The Bahamas' trade[7] with the UK in 2014 stood at $5M or approximately 0.7 percent of overall exports and $23M or 0.6% of imports. Though a small portion of the overall trade, a downcasted European outlook will further limit the island's ability to export to the UK. Juxtapose this with a stronger BS dollar, pegged to the stronger US dollar, it could contribute to widening trade balances between the two economies.

Figure 2: The Bahamas trade with the UK



Source: World Integrated Trade Solution database

With increased uncertainty impacting global outlook, The Bahamas could be affected. As investors face rising financing costs and regular UK citizens find their ability to purchase goods and services is negatively impacted, economic outlook throughout the archipelago could be further dampened. The impact on total arrivals from the dampening of a small share UK market is expected to be minimal, however, current efforts to expand connections in Europe and the USA might be impacted.

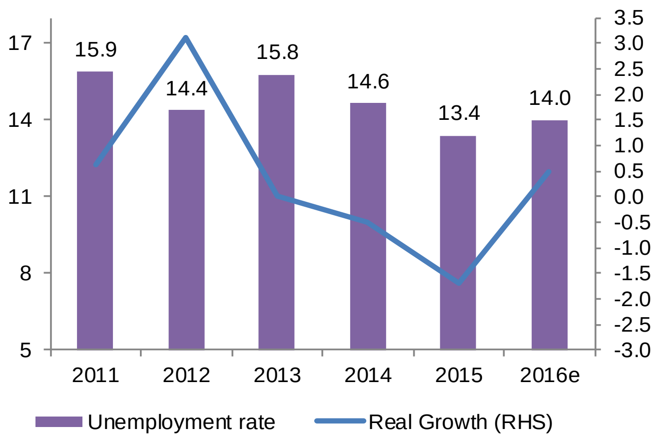
Conclusion

The full socioeconomic impact of the Brexit vote is difficult to quantify at this time. Negotiations on the future role of the UK in EU's customs union have only just begun. However, the current consensus is there will be a relatively small effect from the vote, concentrated in the UK, Europe and, to a lesser degree, the United States. Given weak direct linkages between The Bahamas and the UK, effects are thus expected to be muted (see also regional section for simulations on the effects).

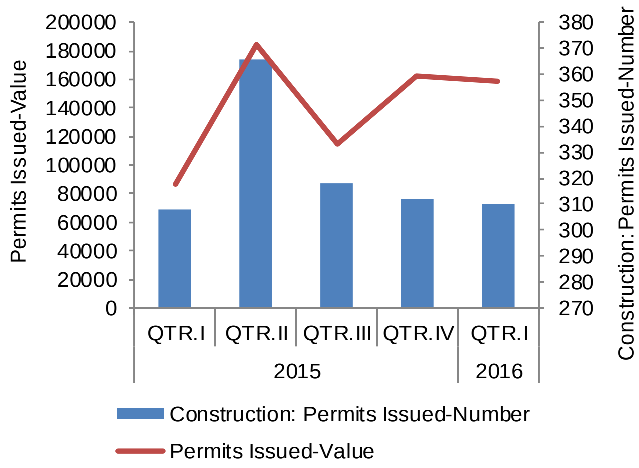
Caribbean economies should assure continued alliances with the EU and the United Kingdom. Forging the deepening of diplomatic links and improving efforts to support and enhance international competitiveness and financial markets are central for the development of small island states. Through these alliances, opportunities could arise in the region even within the context of the Brexit era.

[6] World Bank Bahamas Remittance Estimates
[7] Global Insights Report

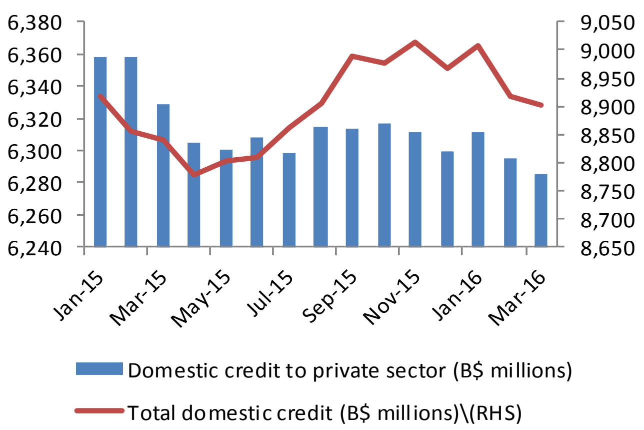
Growth outlook is stable but low, unemployment remains high



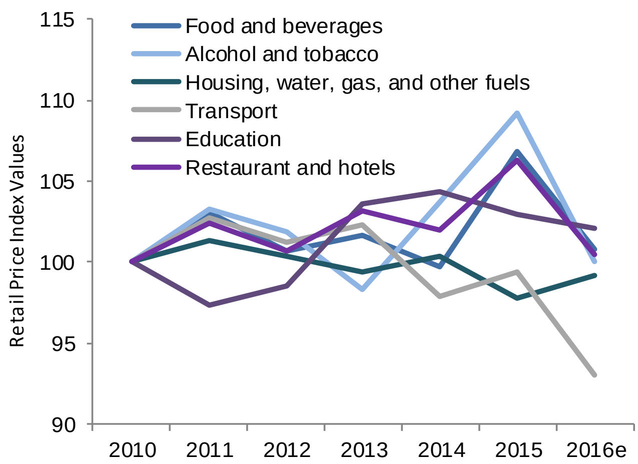
Construction Permits



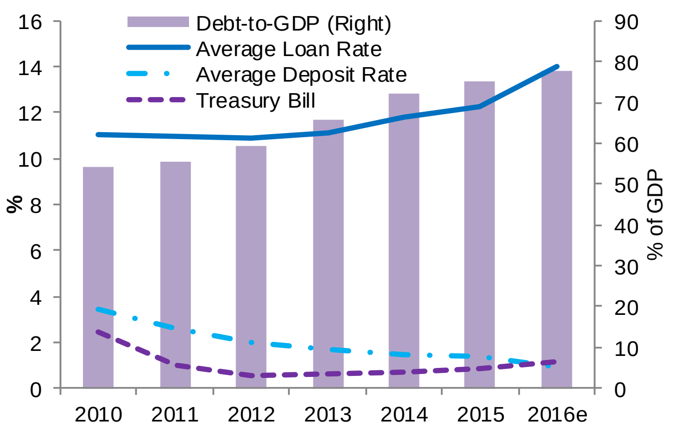
Private sector credit



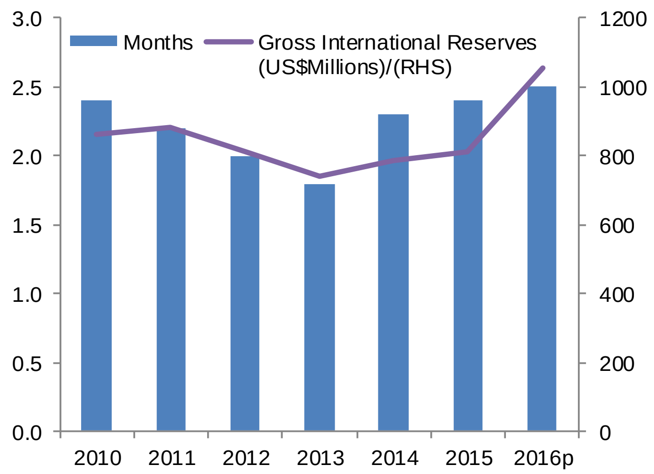
Inflation



Average Interest Rate Spread and Debt, 2010-2016e (% of GDP)



Gross International Reserves



Source: The Central Bank of The Bahamas and International Monetary Fund's World Economic Outlook

Selected Indicators for The Bahamas, 2011-2015

Social and Demographic Indicators (most recent year)			
GDP (US$ millions), 2015	8,854	Adult literacy	95.6
Per capita GDP (2015,US$)	23,903	Poverty rate (percent), 2013	12.8
Life expectancy at birth in years (2014)	75.4	Population (thousands), 2015	364
Rank in UNDP Development Index (2014)	55	Unemployment (2015)	13.4

Economic Indicators

	2011	2012	2013	2014	2015
(Annual percentage change, unless otherwise indicated)					
Real Sector					
Real GDP (% change)	0.6	3.1	0.0	-0.5	-1.7
Nominal GDP(% change)	-0.3	6.5	1.5	1.1	2.7
Inflation (end of period)	3.0	0.7	1.0	0.2	2.0
Unemployment	15.9	14.4	15.8	14.6	13.4
(In percent of GDP, unless otherwise stated)					
External Sector					
Exports of goods and services	42.2	43.8	42.6	41.5	38.8
Imports of goods and services	54.0	58.6	56.3	58.4	44.6
FDI	8.4	6.3	4.5	2.9	0.9
Current account	-15.1	-17.9	-17.5	-22.0	-15.3
Gross International Reserves (US$M)	884.9	810.2	741.6	787.7	811.9
In months of next year's imports	2.2	2.0	1.8	2.3	2.4
Central Government Operations 1/	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**
Revenue and grants	17.9	16.3	16.9	19.5	20.8
Total Expenditure	23.5	22.8	22.5	23.9	23.8
Overall balance	-5.6	-6.6	-5.6	-4.4	-3.0
Primary balance	-3.3	-4.2	-3.1	-1.7	-0.1
Memorandum items:					
National debt (in millions of $B)	4,362.8	4,995.7	5,587.0	6,231.8	6,637.6
In percent of GDP (including contingent liabilities)	55.3	60.7	66.3	73.2	76.3
Nominal GDP (in millions of B$)	7,890.0	8,399.0	8,522.0	8,618.0	8,854.0

Source: International Monetary Fund (IMF) Article IV 2016, The Central Bank of The Bahamas, and the Department of Statisti

1/ The data refer to fiscal years ending on June 30.

Contributors: Camilo Gomez Osorio and Kimberly Waithe

Recent Developments

Tourism activity and favorable external conditions continue to boost output. The uptick in tourist arrivals along with lower international oil prices contributed to improve Barbados's external position. Lower import prices and weak domestic demand contributed to deflation and the narrowing of the current account deficit by the end of June 2016. International reserves continue under pressure and greater fiscal effort is needed to stabilize the increasing public debt.

Barbados's economy grew by 1.3 percent at the end of June 2016. This outturn is favourable compared with the stagnation recorded a year earlier reflective of a gradual tourism recovery. Tourism value added grew by 3.6 percent at the end of June 2016. Long stay arrivals[1] grew by 5.3 percent to reach 320,000 visitors, but the length of stay declined with the change in the composition of tourists, from UK nationals to USA visitors. The growth in arrivals came from the United States (13 percent) and CARICOM (13.8 percent), while the performance of United Kingdom (3 percent) and Canada (0.7 percent) was modest. At the same time, Barbados' internal demand was weak and private consumption and investment declined. The national accounts are compiled on a quarterly basis by value added; there is no estimation of GDP on an expenditure basis, which makes it difficult to assess the contribution of private investment and consumption to growth.

The construction sector was more dynamic during the first half of 2016. Construction activity grew by 1.8 percent, when compared with the same period last year, and employment grew by 2.5 percent. The start of major tourism projects, such as Sandals and the Sam Lord's Castle hotels, and a pick-up in villa construction, are growth-positive. Other sectors that registered an increase were distribution (1.8 percent) and finance and other services (2.3 percent). This outturn led non-tradable sector growth to 1.4 percent.

Barbados's fiscal deficit widened by US$14.2 million to reach US$102 million at the end of April to June 2016.[2] The Budget for FY2016/17 aims for a deficit target of 7.8 percent of GDP (cash basis). Revenues fell by US$12.3 million (4.2 percent) on account of: lower fuel import excises, declines in personal income taxes with the reduction in the rate in 2015, and lower VAT collections. Total expenditure grew marginally by 0.5 percent to reach US$383.3 million, driven by higher domestic interest payments of US$8 million (10 percent). In contrast, grants to public institutions fell by 12.6 percent. Fiscal adjustment efforts remain insufficient to stabilize an increasing trend in public debt, which is estimated at 144.1 percent of GDP, including National Insurance Scheme (NIS) holdings as at end-June 2016.

Highlights

Real GDP grew by 1.3 percent at the end of June 2016.

Fiscal deficit widened by US$14.2 million to reach US$102 million by first quarter of FY2016/17.

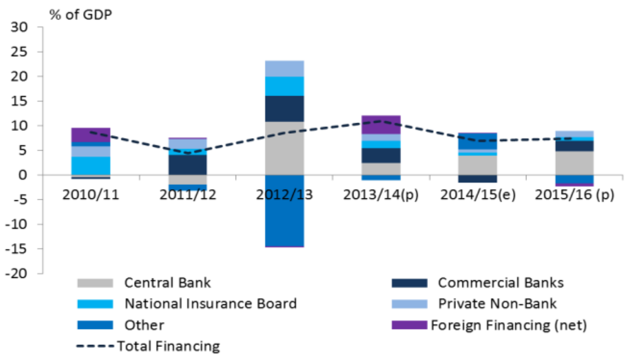
The Budget FY2016/17 aims for a deficit target of 7.8 percent of GDP (cash basis).

Reserves declined and stood at 2.6 months of imports or US$441.9 million.

Brexit poses downside risks to growth in the short term, with an unclear long-term impact.

The deficit continued to be domestically financed. The government decreased its reliance on the National Insurance Scheme (NIS) that by the end of FY2015/16 represented 10.8 percent of total financing; the Central Bank contributed 64 percent and became the main financier of the deficit. The Government aims to reduce its reliance on shorter term instruments, such as treasury bills, in favor of medium-term savings bonds. Over the past six months, around US$45million were raised through savings bonds. Four bonds were issued since the launch of the savings bonds program in 2015. On May 23, the Central Bank announced the latest issuance of US$5 million at an interest of 5.5 percent with a 5-year maturity.

Figure 1: Financing of the deficit



Source: Ministry of Finance and Central Bank of Barbados

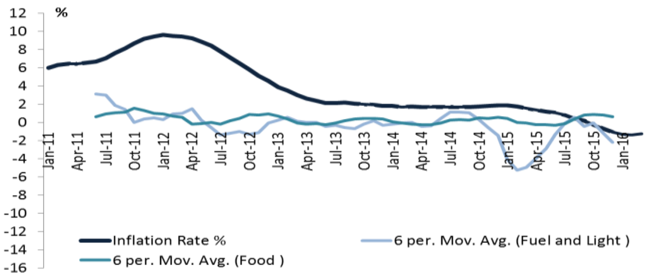
Prices continued their declining trend. Since October 2015, Barbados witnessed deflation (Figure 1). By the end of 2015, the CPI declined by 1.1 percent and prices

[1] Data on tourism arrivals and expenditure are sourced from the Barbados Statistical Service and the Caribbean Tourism Organization (CTO) on a monthly and quarterly basis. Tourism expenditure data is lagged one quarter.

[2] Data on fiscal outturns are obtained from the Ministry of Finance and the Central Bank of Barbados on a monthly and quarterly basis.

decreased by -1.4 percent at the end of March 2016, compared with a 1.0 percent rise a year earlier. A combination of forces at play drove these trends. The lower fuel prices contributed to a drop in electricity tariffs and transportation costs, while lower international commodity prices reduced the food import bill. At the same time, weak domestic demand, weak labor markets and lower disposable incomes, contained housing prices and consumption imports. Inflation averaged 4.7 percent during 2010-2014. Data on inflation is sourced from the Central Bank of Barbados and the Barbados Statistical Service and is publicly available on a monthly basis with a lag.

Figure 1. Monthly Inflation Rates, 2011-2016



Source: Central Bank of Barbados and Barbados Statistical Service

Unemployment declined to single-digits at the end of the first quarter 2016.[3] The unemployment rate fell to 9.3 percent, which represents a decrease of 2.5 percentage points from the 11.8 percent recorded a year earlier (Figure 2). The number of unemployed persons was 13,600. Tourism activity over the winter season led the job creation. However, these figures may be picking up a seasonal effect and need to be monitored closely for evidence of a declining trend. Employment figures are compiled by the Barbados Statistical Service on a quarterly basis and are publicly available.

Reserves stood at US$441.9 or 2.6 months of imports as at end-June 2016. This represents a decline when compared with US$484.2 in June 2015, due to external debt payments and lower tourism receipts when compared with the first quarter. Lower international oil prices, which led the 33 percent decline in fuel imports, and weaker domestic consumption, continue to restrain imports. Balance of payments data and reserves are obtained from the Central Bank of Barbados and are available on a monthly and quarterly basis.

The International Monetary Fund's (IMF) outlook for Barbados is cautiously optimistic. The 2016 Article IV reported that Barbados's economy appears to have "turned the corner". "The fiscal situation remains challenging despite ongoing government adjustment efforts. The FY2015/16 budget deficit was broadly unchanged… Revenue measures, though raising revenue by 1 percent of GDP, fell short of target due to implementation delays. On the expenditure side progress on reducing transfers to State Owned Enterprises was also slower than anticipated..." The financial system remains stable, and non-performing loans fell year-on-year. The Fund recommended additional fiscal adjustment of 3.5 percent of GDP cumulative over a three-year period.

On June 9th, Sandals Resorts International (SRI) broke ground on its US$180 million expansion project. The project is expected to contribute to room capacity with an additional 222 rooms and over its current 280-room property. The resort expects to nearly double its existing staff by adding 520 workers by November 2017. The construction phase could generate around 1,200 direct jobs at its peak.

Sagicor Financial Corporation (SFC) moved its headquarters from Barbados to Bermuda. On June 8th, 2016 shareholders approved the change of domicile for this company that had its head office in Barbados since 1840. Sagicor would remain a tax resident. The move is expected to take place before the end of 2016, and will not see any SFC subsidiary business relocated. The decision was made after Standard & Poor's downgraded Barbados's sovereign rating to 'BB-' from 'BB+', which had a direct impact on the company's credit ratings.

Outlook

Barbados's medium-term growth outlook is modest. The Central Bank projects 1.5 percent by the end of 2016, while the IMF projects 2.1 percent and 2.3 percent for 2017. The tourism recovery and gradual increase in arrivals and spending per tourist is growth positive. If projects, like the new Sandals hotel and the rehabilitation of Sam Lord's Castle continue on schedule, the construction sector would be more dynamic.

Fiscal adjustment efforts would likely continue. The budget aims for a fiscal deficit target of 3.5 percent of GDP (on an accrual basis). It is subject to reversing the declining trend in revenue collection and containing recurrent expenditure, particularly transfers & subsidies to state–owned companies.

High-Frequency Macroeconomic Indicators	Last Data	Period	Prior Data	Period
Annual GDP growth (%)	1.3	Jun-16	1.7	Mar-16
Tourism arrivals (annual % change)	5.3	Jun-16	7.2	Mar-16
Nonperforming loans (%)	10.4	2016 Q1	11.4	2015 Q1
Private sector credit growth(%)	-0.1	Mar-16	-0.5	Feb-16
Foreign Exchange Reserves cover,weeks	13.5	Jun-16	14.0	Mar-16
Inflation(%)	-1.4	Mar-16	-1.4	Feb-16
Unemployment rate (%)	9.3	2016 Q1	10.2	2015 Q4

Source: Central Bank of Barbados

[3] Data on unemployment is available quarterly from the Barbados Statistical Service and is lagged one quarter.

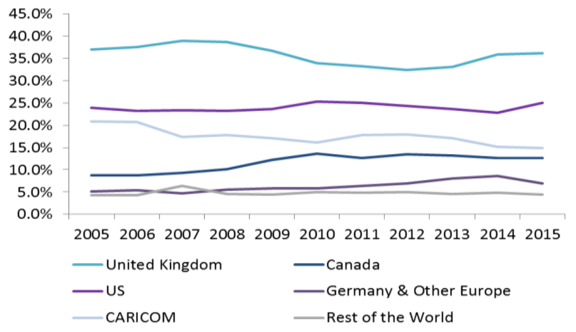
Introduction

Barbados is more integrated to the UK economy than other Caribbean islands and Brexit could bring challenges. Within the Caribbean countries of the Commonwealth, Barbados has the closest economic ties to the United Kingdom. Their partnership is both historical and economic through tourism, trade and investment. The uncertainty surrounding Brexit may bring challenges to growth prospects, but also comes with opportunities. It may be early to determine its long-term impact on Barbados's economy.

Direct effects from Brexit

A decline in tourist arrivals from the UK would have an adverse impact on output. A closer look at the composition of tourist arrivals shows its exposure to UK tourism. Over the last five years, 35 percent of total arrivals were British. Tourism, the motor of growth in Barbados, accounts directly for 12 percent of GDP, but over 40 percent of GDP when considering indirect spillovers into services, construction, real estate, and wholesale & retail. British visitors tend to stay longer than those from other countries, like the USA and Canada, spend more and contribute more to output. With the recent growth in arrivals of around 13 percent for 2015 driven by American and Canadian markets, the length of stay reduced and their impact on growth was more modest. Overall, the impact may change the composition of arrivals, but other markets would gradually compensate the decline. However, one may expect further reduction in the average length of stay as a result of Brexit (see Figure 1).

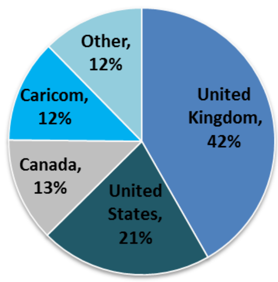
Figure 1. Tourism Arrivals by Market, 2005-2015



Source: Barbados Statistical Service and Caribbean Tourism Organization (CTO)

The depreciation of the sterling pound would make it more expensive for British tourists to visit Barbados, driving a decline in arrivals. Currently, 42 percent of all tourism expenditure comes from the United Kingdom, a share larger than the combined contribution from the USA and Canadian markets (see Figure 2). Going forward, if the weaker sterling sustained over the medium term, this contribution would decline. Following the Brexit vote on June 23rd, the value of the British pound fell by more than 10 percent against the US dollar and, with Barbados's currency pegged at US$1=BDS$2, undermined price competitiveness. Fortunately, Barbados tends to be an upmarket destination and demand may be less sensitive to price fluctuations than competing peers.

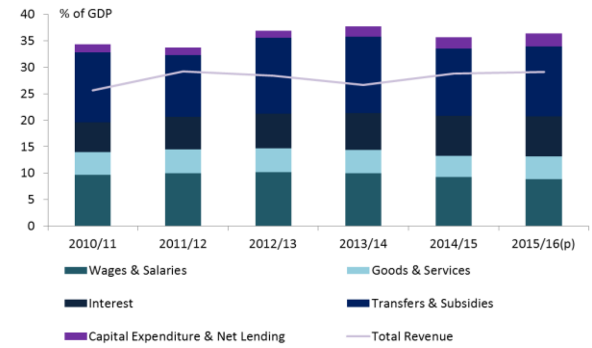
Figure 2. Tourism Expenditure by Market, 2011-2015



Source: Barbados Statistical Service and Caribbean Tourism Organization (CTO)

With fewer British tourists, and lower tourism receipts, revenues may take a hit. Over the last five years, revenue collection was affected by economic stagnation. A closer look at VAT collection from 2011 to 2015 showed a decline from 10.8 percent to 10.1 percent of GDP, while corporate tax receipts fell from 3.3 percent to 2.6 percent of GDP (see Figure 3). This was a combination of lower economic activity and an erosion of the revenue base through tax concessions, waivers, and reduced rates to stimulate private investment and growth. Revenues were unable to cover current expenditure. Therefore, any expected fall-off in economic activity from Brexit could widen the fiscal position at a time when authorities are making efforts to reduce the fiscal deficit.

Figure 3. Revenue and Expenditure, 2010-2015



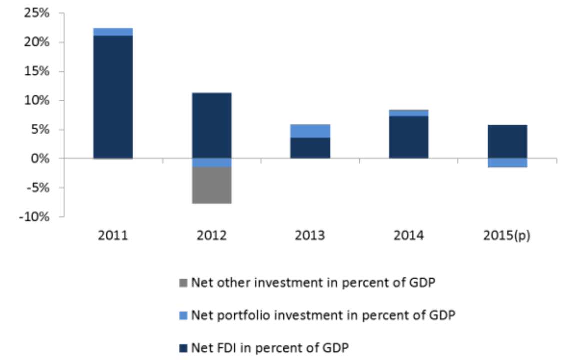
Source: Ministry of Finance and the Central Bank of Barbados

Barbados could see a decline in international reserves and increased pressure on the exchange rate peg. Before Brexit and by the end of the first six months of 2016, reserves fell by 9 percent to reach US$441.9 (or an estimated 2.6 months of imports) when compared with a year earlier, despite growth in tourist

arrivals and lower fuel imports. The renewed pressure on the exchange rate was the combination of external debt payments due and lower foreign direct investment (FDI) inflows. This tendency would be exacerbated by the uncertainty surrounding Brexit. The decline in British arrivals, tourism receipts, British FDI and private inflows, would add pressure to reserves to maintain the exchange rate peg. If the demand for US dollars rises as a result of the Brexit uncertainty, reserves would continue under pressure at a time when they are below the indicative minimum threshold of three months of import coverage.

Brexit could lead to lower investment. A closer look at the current account suggests financing has been mainly through long-term private sector investment, namely in FDI. FDI averaged around 10 percent of GDP and declined over the last five years, a trend that would likely sustain with the Brexit uncertainty (Figure 4). As a share of Barbados's total direct investment inflows, the UK represents around 9.5 percent. FDI inflows have focused on tourism and real estate through the construction and purchase of condominiums and villas. A weaker sterling would affect the demand for second homes and villas. In addition, the impact from remittances would be nuanced, as these represent less than 2 percent of GDP over the last five years, but would affect the income of those relying on UK pensions.

Figure 4. Financing of the Current account deficit, 2011-2015



Source: WEO April 2016

Barbados could see a decline in exports to the UK in the short term, while the long-term effect on trade would depend on the terms agreed under future trade arrangements. The UK is Barbados's main trading partner within the European Union. Exports of goods and services to the UK represented around 21 percent of total exports of goods and services[4] and 9 percent of GDP at the end of 2015. In the short term, the weaker sterling would impact Barbados's exports of goods and services, making them more expensive. However, over the medium term the impact is uncertain and dependent on the outcome of formal trade negotiations. Trade arrangements would be reviewed, since the Economic Partnership Agreement (EPA) signed between the EU and CARIFORUM, would not cover trade with Britain. The fact that Britain may be open to increase trade with non-EU markets over the medium term is an opportunity for Barbados and other Caribbean nations to step in and strengthen trade partnerships.

Indirect effects from Brexit

Barbados is vulnerable to external shocks. Its output moves closely with those of its main trading partners and the uncertainty surrounding Brexit would have indirect effects. The IDB estimates a total loss in UK GDP of about 1.7 percent over the next three years, implying a loss of 2.8 percent in Latin American and Caribbean GDP. So, with lower UK growth, Brexit may pose downside risks to Barbados's growth outlook.

Given the uncertainty in global markets, interest rates in the US are expected to remain low. With increased risks surrounding Brexit and uncertainty in global markets, the Federal Reserve may opt for a more gradual rate increase over time. The impact on Barbados' economy would be marginal as the country is not dependent on short-term private flows and has capital controls that would smooth the volatility of interest rate movements in the USA. The Central Bank would likely maintain domestic interest rates low because of the impact an increase may have on debt service. At the same time, uncertainty would take a toll on the demand for private credit, with individuals postponing their investment and consumption decisions. This too would contribute to a possible stance of maintaining low domestic lending rates.

Conclusion

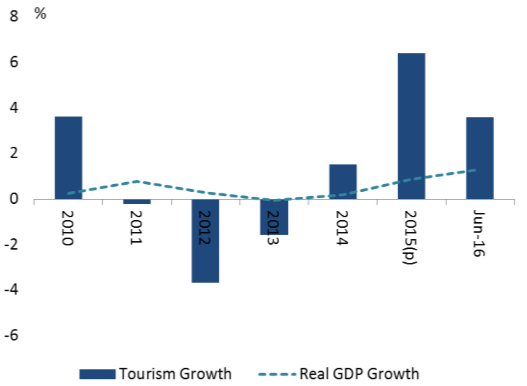
Brexit poses downside risks for Barbados in the short term, but the long-term impact is unclear at this time. The direct effect on tourist arrivals and price competitiveness may be felt in the short term, along with a response to trade flows. However, it may be too early to tell what the long-term effect would be. It comes with opportunities for Barbados as the UK would look to non-EU trading partners to strengthen trade relationships.

[4] Refers to *export of goods and tourism related services* only, excludes financial services.

Barbados's Economy at a Glance

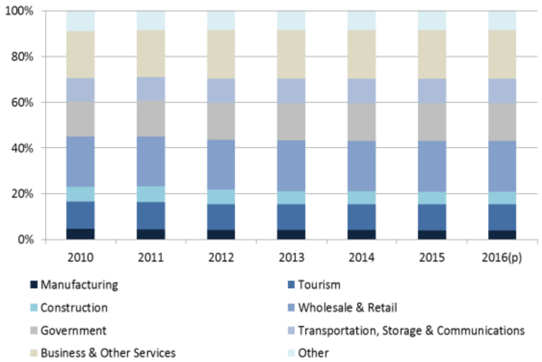
Gradual tourism recovery with weak domestic demand

Figure A. Real Growth and Tourism Growth



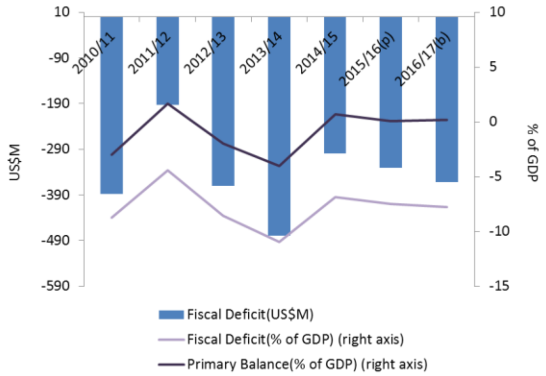
… which are the driver of growth.

Figure B. Contribution to GDP, (in % of GDP)



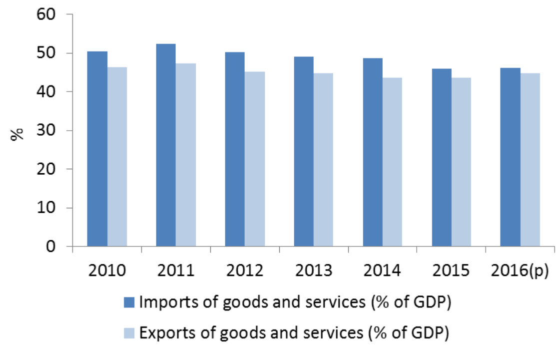
Fiscal consolidation reduce the deficit

Figure C. Revenues and Expenditures, (% of GDP)



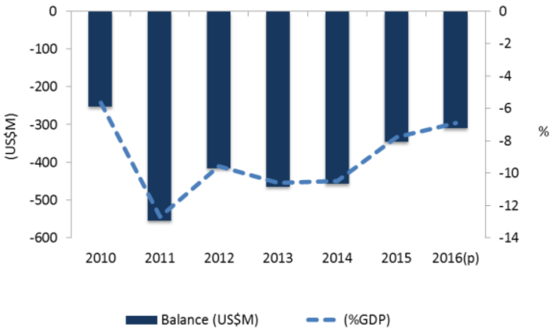
…lower oil and commodity prices contained imports

Figure D. Exports & Imports (% of GDP)



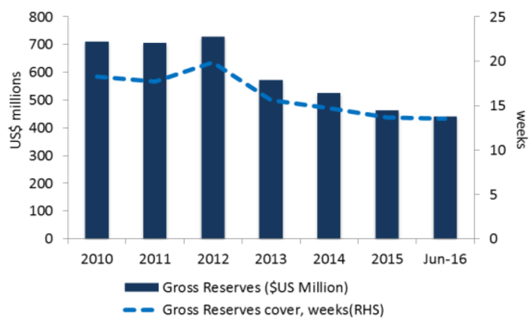
…improved the current account balance

Figure E. Current Account Balance (% of GDP)



…and stabilized reserves.

Figure F. Gross Reserves, (US$ mn)



Sources: Central Bank of Barbados; World Economic Outlook, IMF (April 2016); Ministry of Finance.
Note: (p) projected figures for 2015.

Barbados: Selected Indicators

	2011	2012	2013	2014	2015	2016(p)
(Annual percentage changes, unless otherwise indicated)						
Real sector						
Real GDP	0.8	0.3	-0.1	0.2	0.9	1.5
Nominal GDP	-2.0	-0.6	0.9	-0.4	1.6	1.3
Inflation (end of period)	9.4	4.5	1.8	1.9	-1.1	-0.2
Unemployment	11.2	11.5	11.6	12.3	11.3	11.5
External sector						
Exports of goods and services (% change)	0.4	-5.3	0.2	-3.2	1.7	4.0
Imports of goods and services (% change)	1.9	-4.8	-1.2	-1.5	-3.9	1.6
Current account (percent of GDP)	-12.7	-9.6	-10.6	-10.5	-7.8	-6.8*
International reserves (US$millions)	707.4	728.9	572.1	526.1	463.4	441.9*
International reserves cover (months)	3.7	4.0	3.2	3.0	2.7	2.6*
(In percentage of GDP, unless otherwise indicated, on a fiscal year basis)						
Public sector						
Total revenue	29.3	28.4	26.7	28.8	25.7	28.5[+]
Total expenditure	33.7	36.9	37.7	35.7	33.6	36.4[+]
Central government primary balance	1.6	-2.0	-4.0	0.7	-0.2	0.2[+]
Central government overall balance	-4.4	-8.5	-11.0	-6.9	-7.4**	-7.8[+]
Debt indicators						
General government debt	78.0	83.5	94.4	100.1	104.9	107.7*
General government debt (inclusive of NIS holdings)	105.3	113.6	127.3	134.5	140.4	144.1*
Central government debt over revenues	266.7	294.5	353.4	347.8	382.8	364.6*
External debt service as percentage of exports of goods and services	6.9	7.3	6.9	7.6	12.1	n.a

Sources: Central Bank of Barbados; World Economic Outlook, IMF (April 2016); Ministry of Finance (MOF).
Note: (p) projected figures for 2016.
n.a. not available
* Data as end of June 2016
**Source: Central Bank of Barbados (June 2016 economic review). The MOF reports a lower deficit that is not comparable on a cash basis.
[+] Budgeted figures for FY2016/17

GUYANA GROWTH BUOYED BY RESURGENT GOLD

Contributors: Mark D. Wenner and Dillon Clarke

Highlights

Gold production continues to shoulder economic growth while other sectors stutter.

On 1st July 2016, the World Bank reclassified Guyana as upper middle-income with a Gross National Income (GNI) per capita of over US$4,036.

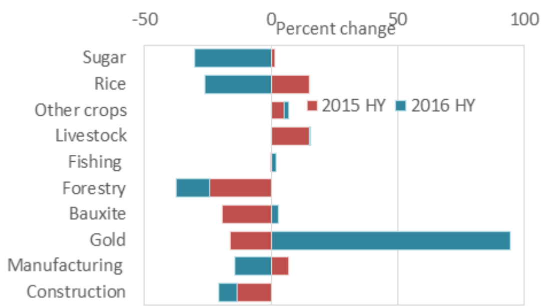
Overview

The economy remains tethered to gold which has supported both real GDP growth and contributed to improvements in the external current account, along with low oil prices. Fiscal stimulus is heavy on transfer payments while severe challenges remain in implementing the public sector investment program (PSIP). The financial sector remains sound despite mounting non-performing loan performance.

Outlook

Gold props up economic growth. Economic activity expanded by 2.0 percent for the first half of the year, compared to 0.9 percent over the same period 2015 due to a 94.3 percent increase in gold production according to the government's mid-year report. The stellar performance for the gold industry reflects the operations of two large-scale gold mines and the impact of the UK vote to leave the European Union, which triggered a price rebound. On the other hand, weak performances, which were largely attributed to inclement weather, low prices, and the prevalence of structural challenges, especially for rice and sugar, were visible across all the other sectors (see Figure 1). Gold production at the end of 2016 is projected to propel growth to 4.0 percent, but this figure may be subject to revision. Over the medium term, restructuring ailing sectors and promoting greater diversification are needed to ensure that growth is broad-based and resilient to negative shocks to the primary commodity sectors.

Figure 1. Sectoral mid-year performance



Notes: HY - Half Year
Source: Ministry of Finance

Inflation

Inflation remains subdued. Price levels rose a tepid 1.1 percent for the first six months of 2016 following a year in which the economy experienced deflation of -1.8 percent. Low inflation continues to reflect low oil prices and 20 percent electricity tariff reductions. However, current yearly indices are applicable only to the Greater Georgetown metro area and do not capture the sharp differences in urban-rural differences in the cost of living. Inflation statistics are now being published quarterly. Authorities project a price level rise of 2.1 percent in 2016.

External Developments

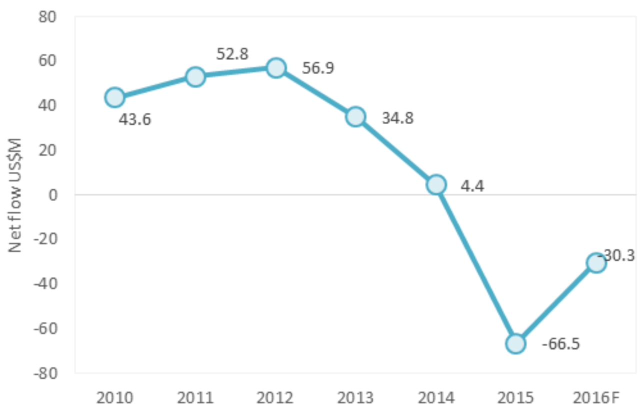
Strong gold earnings and low oil prices supported a reversal of Guyana's current account deficit. The current account recorded a first half surplus of US$40.9 million from a deficit of US$135.7 million in the corresponding period 2015. The turnaround is due to the combination of continued low oil import prices, higher gold prices, and an increased gold production. The strong gold sector performance compensated for the weak performances in all other traditional export sectors

During the first half of 2016, Oil import bill declined 24.5 percent, which saw total import shrink by 10.1 percent. Exports grew by 29.1 percent due to a 107.5 percent rise in gold earnings. Meanwhile, lower production due to inclement weather and structural challenges saw rice and sugar export earnings slump by 29.8 percent and 31.8 percent, respectively. Authorities expect gold to continue to support export growth while oil prices are expected to remain depressed during 2016. The current account is projected to remain in surplus in 2016 at approximately 2.2 percent of GDP, from a deficit of -3.2 percent of GDP in 2015.

Fiscal and Monetary Policy Developments

Expansionary fiscal policy is being pursued with marked increases in transfer payments and capital expenditures. The primary surplus declined by 46 percent to G$9 billion (approx. 2 percent of GDP) at end June 2016. Current expenditures grew by 31.6 percent during the first six months of 2016 largely due to an 88.1 percent increase in transfer payments primarily to support loss-making public enterprises and increased subsidies to vulnerable groups. Wages and salaries, and goods and services grew by 4.3 percent and 3.5 percent, respectively. Meanwhile, capital expenditure increased by 84 percent, compared to a paralyzed fiscal cycle during 2015. However, the expansion in capital expenditures for the first 6 months of 2016 is primarily due to government-financed projects linked to urban road upgrades and the 50th Independence celebrations. Foreign financing for ongoing capital projects have slowed due to underlying procurement, contracting, and execution issues (see Figure 2).

Figure 2. Net official flows to the Non Financial Public Sector (NFPS)



Source: IMF, Ministry of Finance.

Fiscal revenues increased by 9.7 percent, primarily supported by 16.1 percent and 18.5 percent growth in income tax and trade tax revenue. Authorities expect an overall fiscal deficit of approximately 4.1 percent of GDP by the end of 2016. Total public debt is expected to rise to 52.3 percent of GDP in 2016 from 48.6 percent of GDP in 2015, a result of increased domestic debt financing.

Monetary policy remains accommodative in 2016. Money aggregate, broad money (M2), grew by 1.8 percent, at end of June 2016. Narrow money (M1) marginally increased by 0.17 percent. The exchange rate closed at GY$206.5 in June 2016, unchanged from December 2015. Monetary authorities attempt to manage inflationary expectations by anchoring the exchange rate through frequent sterilization exercises.

Financial Markets

Private sector credit decelerated in the first half of 2016. During the first half of the year, credit to the private sector expanded by 3.9 percent due to growth in personal credit and home mortgages, and distribution continues to drive expansion while mining and agriculture declined. Symptomatically, as a result of weak performances in the agriculture and small miners sectors, non-performing loans rose to 11.7 percent in March 2016 from 11.5 percent in December 2015. However, commercial banks remain well capitalized with an industry average capital adequacy ratio of 25.3 percent, well above a prudential benchmark of 8 percent. The capital adequacy ratio (CAR) measures a bank's ability to absorb losses without jeopardizing depositors. Authorities indicate measures to increase loss provisioning and implement the new Basel III core principles.

Other Developments

Telecoms liberalization bill passed. On 18th July, Parliament passed legislation that effectively liberalized the telecommunication sector. The Bill, first introduced in 2011 and revised in 2013, is expected to add new service providers and result in greater choice, improved quality, and lower prices for customers. It also addresses the expansion of networks and services into unserved and under-served areas through the institution of new universal access/service programs.

Guyana is now classified as an upper middle-income economy. In 2015, Guyana's gross national income (GNI) per capita rose to US$4,090 and into the upper middle-income threshold according to the World Bank Atlas method that informs lending eligibility. The main reason cited was the announced ExxonMobil discovery of approximately 1.4 billion recoverable barrels of high-quality oil. Higher income classifications could reduce concessional resources overtime. Guyana's GNI per capita rose 41 percent over 2010-2015, during the boom cycle for gold and rice.

Guyana moves one step closer to establishing a Public Procurement Commission (PUC). On August 9th, The National Assembly voted to accept nominees selected by the bipartisan Public Accounts Commission (PAC). The nominee selection required a two-thirds majority. The authorities cite the creation of the PUC will improve transparency, accountability and competitiveness in the tendering process.

High-Frequency Macroeconomic Indicators

	Last	Period	Prior	Period
Annual GDP growth (%)	3.0	2015	3.0	2014
Exports (12-month growth)	0.2	2015	-15.1	2014
Imports (12-month growth)	-17.7	2015	-5.1	2014
Private sector credit growth (%)	6.2	2015	9.1	2014
Inflation	-1.8	2015	1.2	2014
Exchange rate (e.o.p)	206.5	2015	206.5	2014

Source: Central Bank of Guyana

BREXIT AND GUYANA

Introduction

On Tuesday, June 23rd, the citizens of the United Kingdom (UK) voted 52 to 48 percent in favor of leaving the European Union. A separation agreement will take approximately two years unless reversed by Parliament or a new referendum, during which time the EU rules will still apply. As a result of this development, Guyana will experience both direct and indirect effects.

Below are some of the direct and indirect effects.[1]

Direct Channels:

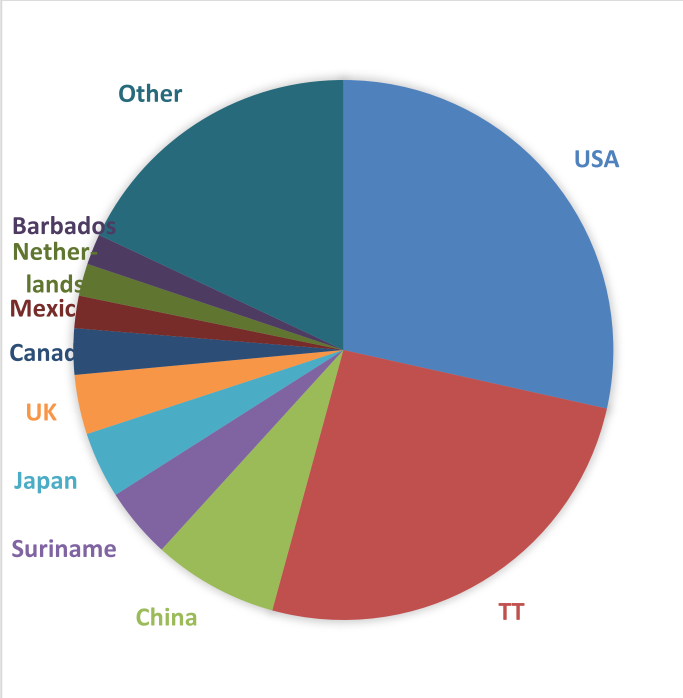
The most important and immediate channel of BREXIT effects will be the exchange rate: The British Pound Sterling has depreciated in value vis a vis other major currencies since the BREXIT vote, which will make British exports more price competitive from the perspective of Guyanese importers. On the other hand, the weaker Pound Sterling will tend to reduce import demand for Guyanese products and reduce the purchasing power of UK tourists abroad, including those who may want to visit Guyana.

Trade: Guyanese exports have low export sophistication (13.1 on a scale of 100 as of 2008), with mostly raw, unprocessed agricultural commodities, and face elastic demand. Therefore, in order to maintain its market share for any particular product,Guyana will have to become more cost competitive than other producers of the same product entering the UK market.. Structural deficiencies that undermine Guyanese competitiveness will likely manifest and could lead to erosion in export shares.

As can be seen in the following two figures, Guyana does not have a significant amount of trade with the UK. In trade data for the period January to May 2016, British imports amounted to 3.6 percent of total imports, falling in sixth place (see Figure 3). The countries that placed ahead of the UK in rank order were United States 28.5% share), Trinidad and Tobago (25.8% share), China (7.5% share), Suriname (4.2% share), and Japan (4%share). With a weaker Pound, British exporters stand a chance to gain a larger share.

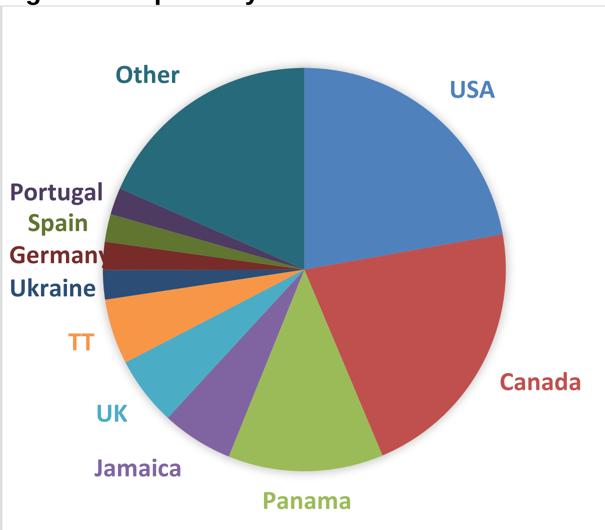
During the period January to June 2016, 5.5 percent of Guyana's total exports is to the UK (Figure 4). The major export markets for Guyana are the US (22.2 percent share), Canada (21.5 percent share), Panama (12.5 percent share), and CARICOM neighbors. Guyana scored 3.56 out of 7 on the World Economic Forum, index of Export Competitiveness in 2015-2016, signaling that it may face challenges after EU trade preferences end in 2017 and a lower UK import demand becomes manifest two years hence.

Figure 3: Imports by origin country



Source: United Nations Trade Database

Figure 4: Exports by Destination



Source: United Nations Trade Database

Tourism: With a devalued Pound Sterling, UK tourists will have less purchasing power and may be less inclined to travel, especially to a distant and high-cost location such as Guyana. According to Caribbean Tourism Organization 2010 report, approximately 6 percent of

[1] See also regional contribution for simulations and a comparative assessment for the region.

international arrivals in Guyana are European passport holders. Due to lack of disaggregation and low periodicity of publication of data, it is presumed that the majority of those arrivals would be British citizens, native born and expatriate Guyanese. Pre- BREXIT, the UK tourist source market had been targeted by the Government of Guyana with regular Travel Fairs being held. Post BREXIT, it is likely that naturalized Guyanese citizens may continue to visit family and friends in Guyana due to strong ties but the high-end British Ecotourist may be less inclined due to the weaker Pound Sterling.

***Foreign Assistance*:** Historically, the amount of foreign assistance that the UK has granted to Guyana has been relatively low compared to other former British colonies in the Caribbean. A low level inertia in the amount of allocation seems to have set in. With an expected lower growth scenario for the UK post-BREXIT and likely fiscal challenges, the arguments for increased foreign aid may be difficult to justify, therefore less aid should be expected. At present, the UK government has earmarked but not officially approved or disbursed £52 million (equivalent to US$67 million) for the construction of a new bridge across the Demerara river as part of a Caribbean-wide aid initiative. It is likely that this project will go forward, but the future of other flows of bilateral foreign assistance is uncertain.

***Debt and FDI*:** Guyana has no bilateral debt with the UK and no known FDI. Most of Guyana's inward flows of direct foreign investment originated from Canada, China, Brazil, Russia, India, and the United States and are primarily associated with extractive industries (mining, forestry, hydrocarbons).

Remittances: For the latest bilateral matrix of remittances available (2011), Guyana received US$21 million from the UK, which is five percent of the total remittances received in that year (US$ 410 million). The United States and Canada are much more significant sending countries, accounting for more than 80 percent of annual remittances flows to Guyana. Therefore, with lower income growth expected in the UK, the limited amount of remittances received from the UK may fall even further, but should not make a significant difference to the already small amount.

Indirect Channels:

***Commodity Prices**: The UK is the fifth largest economy in the world and a prolonged slowdown in growth would impact commodity prices which in turn will affect a commodity exporter like Guyana. In general, less growth in a major importing partner will translate into less demand for Guyana's exporters. However, due to the uncertainty aroused in financial markets about what will transpire after the separation of the UK from the EU, some investors have turned to gold and have driven up its price, benefiting Guyana and other gold-exporting countries. On the day of the vote, the spot price was US$1,256 per ounce. On August, 16th, the spot price was $1,349, a 7.4 percent increase. This rebound in price, combined with an uptick in production by large gold mines in Guyana, has contributed to positive growth in Guyana in the first half of 2016. Gold prices forecasted over 2017-2018 indicate a rising trend but increased volatility,

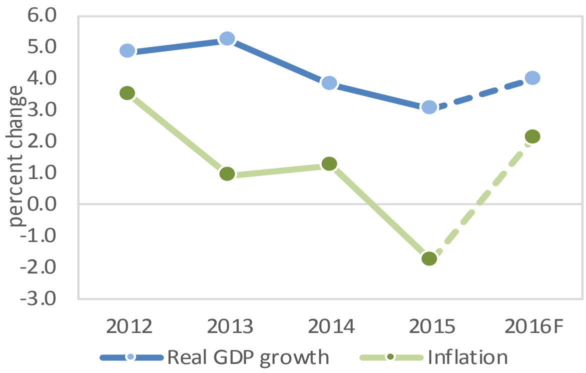
Interest Rates: Guyana as a concessional country pays negative real interest rates on its foreign debt. In the aftermath of BREXIT, the Bank of England is likely to engage in accommodative monetary policy in order to lower interest rates and thereby stimulate the economy. As a result, the LIBOR rate is likely to become more volatile, depending on the financial market's reaction to the issuance of UK debt instruments. Since Guyana has no access to international commercial credit markets, these interest rate developments would not have direct effects but are likely to have indirect effects, because the premier financier of the country, the IDB, uses the LIBOR rate as a reference in calculating interest rates charged on ordinary capital loans. Guyana receives a blending of concessional and ordinary capital resources in some of its loans from the IDB.

Conclusion

In conclusion, although Guyana has generally weak economic ties to the UK when compared to the US, Canada, and China, the uncertainty surrounding BREXIT has served to immediately benefit Guyana through higher gold prices. This positive effect may diminish in the future as more details are worked out in the separation agreement or if the decision to leave is reversed. The other expected economic effects are of small orders of magnitude. The largest potential negative effect is the loss of export market share after the separation agreement is finalized and EU trade preferences expire. The lack of product sophistication and export cost competitiveness vis-à-vis other exporters of the same product could become manifest in 2018 to 2019 if new reciprocal preferential trade agreements are not obtained.

Real GDP growth strengthens while low price environment contains inflation

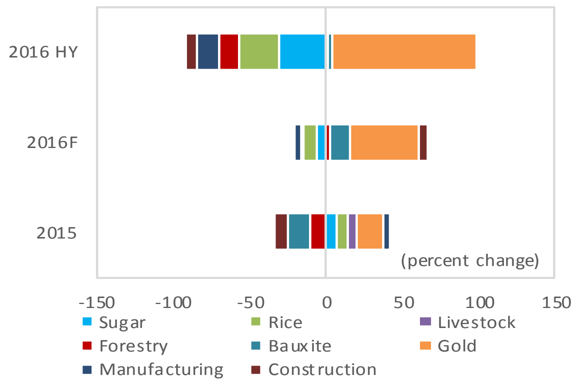
Figure A. Real GDP growth and inflation



Source: IMF, Ministry of Finance

However, growth is narrow and remains tethered to gold mining.

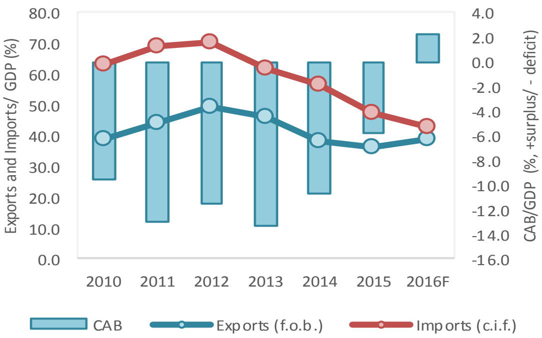
Figure B. Core commodity performances



Source: IMF, Ministry of Finance

Strong gold earnings and low oil prices supported a reversal of Guyana's current account deficit.

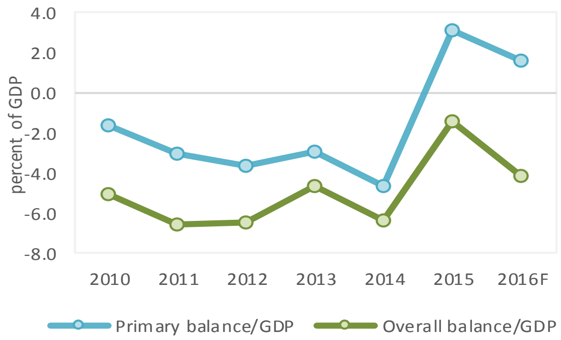
Figure C. External current account



Source: IMF, Bank of Guyana

Expansionary fiscal policy erodes fiscal balances…

Figure D. Primary and fiscal balances



Source: Ministry of Finance

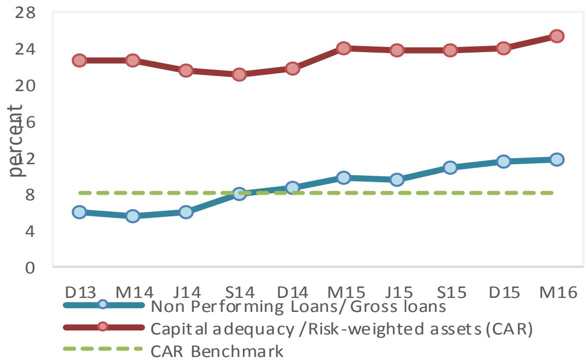
…However, expenditures are skewed towards transfer payments

Figure E. Current expenditure

Source: IMF, Ministry of Finance

Meanwhile, banking system's ability to absorb loss remains strong despite deteriorating credit

Figure F. Capital adequacy Ratio and NPLs



Source: Bank of Guyana

Guyana: Selected Indicators

	2012	2013	2014	2015	2016F
(Annual percentage changes, unless otherwise indicated)					
Real Sector					
Real GDP	4.8	5.2	3.8	3.0	4.0
Nominal GDP (GYD millions)	582656	614100.0	635300	653300	692100.0
Inflation (end of period)	3.5	0.9	1.2	-1.8	2.1
External Sector					
Exports of goods	25.4	-2.8	-15.1	-1.4	13.0
Imports of goods	12.8	-7.5	-5.9	-14.2	-4.6
Current account (percentage of GDP)	-11.6	-13.3	-10.8	-5.7	2.2
Remittances (percentage of GDP)	14.7	11.8	14.9	13.1	13.0
FDI (percentage of GDP)	10.3	7.2	8.3	4.0	2.6
Gross official reserves in months of imports	4.1458	4	3.5	3.6	3.8
(In percentage of GDP, unless otherwise indicated, on a fiscal year basis)					
Central Government					
Revenue and grants	23.6	23.4	23.0	24.9	26.0
Current expenditure	19.5	19.7	21.1	22.6	24.7
Capital expenditure and net lending	10.7	8.6	8.2	4.7	7.1
Overall balance	-6.5	-4.7	-6.4	-1.4	-4.1
Debt Indicators					
Public sector debt	63.7	57.9	51.9	48.6	52.3
External public sector debt	47.7	41.8	39.5	36.1	36.0
Domestic debt	16.0	16.1	12.4	12.5	16.3
Three-month T-bill rate (e.o.p, in percent)	1.45	1.5	1.7	...	...

Note: FDI= foreign direct investment; (F) Forecasts numbers for 2016.

Source: Central Bank of Guyana, International Monetary Fund World Economic Outlook, April 2016.

THE NEW DARLING OF BOND MARKETS?

Contributor: Juan Pedro Schmid

Highlights

IMF Board approved 13th review of the Extended Fund Facility on 19th September, 2016, on a time lapse basis.The IMF program will end in March 2017 but expectations are for a follow-up program.

Jamaica re-opened the 2039 global bond to retire short-term external debt.

Overview

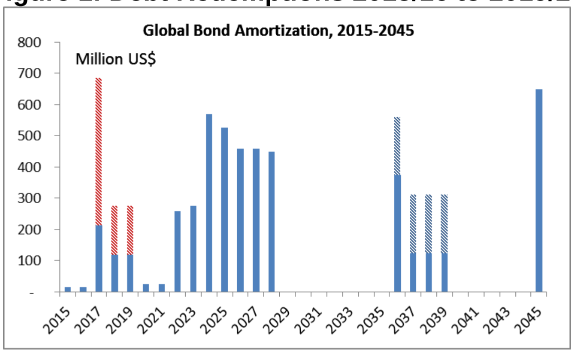
Jamaica's economy remains stable with a positive outlook. The change of government introduced some uncertainty early in the year but expectations point to a continuation of the successful strategy of fiscal prudence while trying to accelerate economic growth. The IMF-supported Extended Fund Faculty will end in March 2017 however a follow up program is anticipated.

Recent Developments

Jamaica successfully accessed international bond markets in August 2016. The authorities re-opened the 8 percent coupon global bond that matures in 2039. Demand was strong and the transaction settled above par for US$846.4 million (US$743.2 million at the price of US$114.1), yielding 6.75 percent. The proceeds are being used to retire 2017 and 2019 bonds. External repayments in 2017-2019 will be reduced as a result of the transaction, reducing the rollover risk (Figure 1).

The bond placement has several advantages for Jamaica. Besides the reduction in the rollover risk over the next three years, the replacement of the 2017 and 2019 bonds with the longer-dated, lower-interest rate instrument also reduces the interest rate burden. In addition, the demand for Jamaican debt at this interest rate also underscores the confidence of investors in Jamaica's successful stabilization.

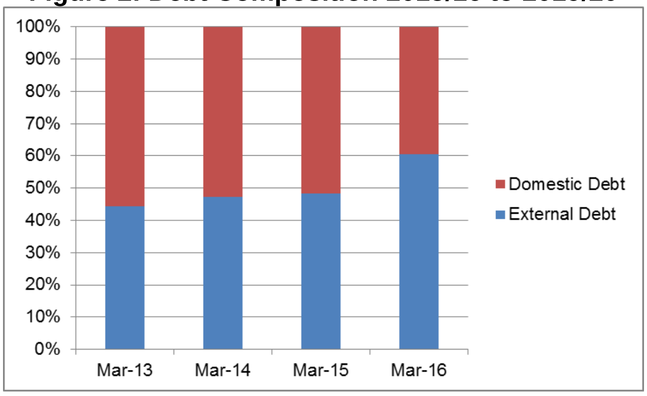
Figure 1: Debt Redemptions 2015/16 to 2019/20



Source: Own calculations based on Ministry of Finance and the Public Service.
Notes: Patterned red, bond that have been redeemed, patterened blue, August 2016 issuance.

The bond issuance reinforces the shift to external debt begun in 2014. Jamaica accessed international bond markets in July 2014 (US$800 million), July 2015 (US$2 billion) and August 2016 (US$846.4 million), each occurrence at a historically lower yield. At the same time, the authorities tapped the domestic market in February 2016 for the first time in three years for a comparatively low amount (JM$15 billion, equivalent to around US$120 million). The decline in international bond yields in addition to the decrease in the risk premium due to the EFF implementation contributed to the falling yields, making external issuances attractive. At the same time, access to domestic bond financing remained restricted by low demand from the domestic financial sector following the debt exchanges in 2010 and 2013.

Figure 2: Debt Composition 2015/16 to 2019/20



Source: Own calculations based on Ministry of Finance and the Public Service

The IMF Board approved the 13th review of the EFF on September 19, 2016, on a time lapse basis, following an IMF mission which concluded in August.

Growth is projected to recover. Growth is estimated at 0.8 percent for the 2015/16 fiscal year, below the initial projection of 1.9 percent but an improvement over the 0.2 percent of growth recorded in fiscal year 2014/15. Projections for FY2016/17 currently stand at 1.4 percent, driven by tourism, business process outsourcing and agriculture as well as increased private investment.

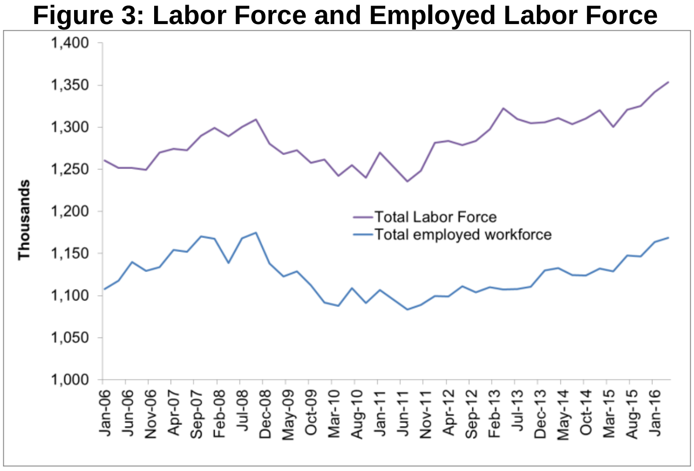
Inflation remained subdued. As of June 2016, year over year inflation was 2.5 percent, well below the inflation target of 4.5-6.5 percent. As the effect from the year over year decline in oil prices fades, inflation is expected to move back into the target range.

International reserves remain above prudent levels. At the end of August 2016, net international reserves were US$2.5 billion while gross international reserves amounted to US$2.9 billion, which is equivalent to 20 weeks of imports of goods and services.

Treasury bill and repo rates continue to decline and credit growth is improving. The 180 day T-bill rate has been below 6 percent since early 2016 compared to 6.25 percent in October 2015. In addition, the repo rate was reduced to 5.25 percent in October 2015 from 5.50 percent in July 2015. Credit growth has accelerated with nominal credit growth 9.6 percent in 2015. However, consumer credit remains the dominant form of private credit.

Employment growth has increased but so have jobseekers. The unemployment rate at end-April 2016 was 13.7 percent, an increase from 13.2 percent one year earlier. However, the increase in the unemployment rate occurred as jobseekers increased. Employment actually increased by 3.5 percent year over year and is now close to the record 1.174 million recorded in October 2008 (blue line in Figure 3). The increase in the numbers of jobseekers has contributed to the continued high unemployment rate.

Figure 3: Labor Force and Employed Labor Force



Source: Own calculations based on Statistical Institute of Jamaica.

Jamaica has been affected by the Zika virus. As the island is home to the main carrier of the virus, the Aedes Aegyptus mosquito, the authorities have been taking actions to suppress the outbreak. Zika infections are often asymptomatic but as of August 26, close to 5000 cases were classified as 'suspected Zika'. In addition, out of 470 suspected Zika virus infections in pregnant women, 31 tested positive. In terms of the neurological complication of Guillain Barré (paralysis) Syndrome, out of 20 cases that fit the case definition, three were Zika positive. Jamaica is expected to participate in a Zika vaccine trial that has been approved for humans.

Conclusion

Jamaica's economic performance over the last three years has been disappointing. Further efforts are needed to engrain the advances that have been made on macrostability to achieve higher growth. The authorities have been conducting informal discussions on a follow up to the EFF program that expires in early 2017. A successor program would strengthen the credibility of the medium-term macroeconomic framework once the EFF expires.

After twelve successful EFF reviews, challenges in employment generation and economic growth remain significant. The slight easing of the required primary surplus opened up a small amount of space for capital expenditure, however more concerted efforts are needed to show concrete returns for the population.

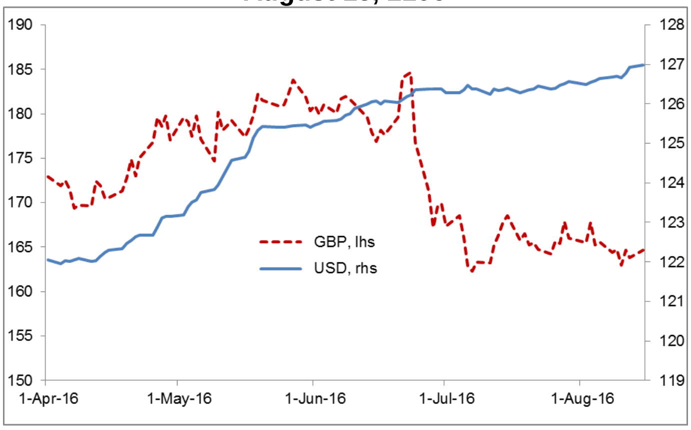
High Frequency Macroeconomic Indicators	Last data	Period	Prior data	Period
Real GDP Growth (y/y)	0.8	2016 Q1	0.7	2015 Q4
Inflation (y/y)	2.2	Jul-16	2.9	Mar-16
Net international Reserves (US bil)	2.5	Aug-16	2.3	Apr-16
Exchange Rate (end of period)	127.6	Aug-16	123.6	Apr-16
Unemployment Rate (%)	13.7	Apr-16	13.3	Jan-16

Sources: Bank of Jamaica and Statistical Institute of Jamaica

Introduction

Like other English speaking countries in the Caribbean, Jamaica is part of the Commonwealth of Countries and has historical, cultural and economic ties to the United Kingdom. The United Kingdom is Jamaica's 5th merchandise export destination, second in remittances and is the main tourist market for Jamaica within Europe. Nevertheless, as discussed below, Jamaica is particularly dependent on the United States, which cushions the country to a great extent from the anticipated decline in UK demand. The situation would change, however, should Brexit generate effects on the world economy beyond direct ones spurred by lower UK GDP and import demand. The impact would also depend on the extent of post-Brexit adjustments in the UK. Current forecasts range from a benign decline in UK growth of less than half percentage point to several percentage points over an extended period of time. Given the importance of the GBP exchange rate for remittances and external demand, the final equilibrium exchange rate will also be an important determinant for the strength of the post-Brexit adjustment in Jamaica.

Figure 1: JM$ to GBP and USD, April 1, 2016 to August 15, 2106

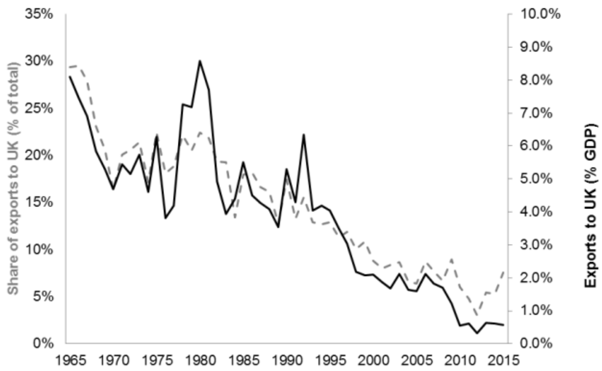


Source: Own calculations based on Bank of Jamaica

UK Jamaican linkages

The importance of the UK for Jamaica's merchandise exports has been declining steadily (Figure 2). In 2015, the UK was the fifth goods export market for Jamaica, behind the USA, Canada, the Russian Federation and Iceland. In 2015, Jamaica's goods exports amounted to US$80.9 million, equivalent to 0.58 percent of GDP. As such, lower UK demand should only have a negligible impact on Jamaica's already weak export performance.

Figure 2: Jamaica-UK Trade, share of total and share of GDP, 1965-2015

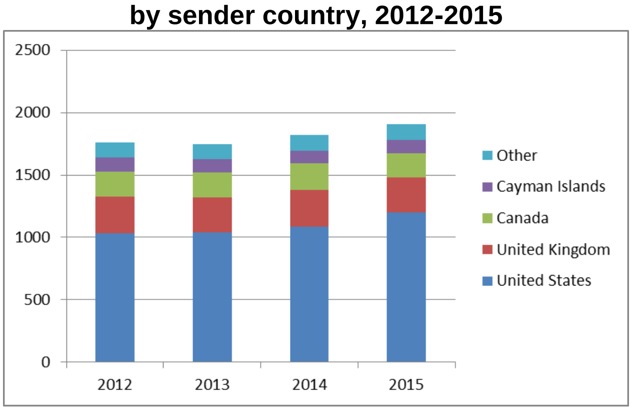


Source: United Nations Trade Database

Lower remittances are likely as the GBP weakened against the JM$ since the vote to leave the EU. Depreciation of the British pound against major currencies was reflected in the JM$/GBP exchange rate. From a high of JM$ 184.7 the day of the vote, the exchange rate declined to below JM$170 per GBP. The pound continued its weakness and is currently trading at around JM$164 (Figure 1). This decline of over 10 percent is likely to be reflected in remittances, should they remain the same in GBP. In addition, hiring has slowed in the UK since the Brexit vote and employment could decline, which could impact the ability of Jamaicans in the UK to send remittances home.

The UK is the second most important source of remittances to Jamaica. UK remittances in 2015 amounted to US$331 million, equivalent to 2.5 percent of GDP or 15 percent of total remittances (Figure 3). A decline in proportion to the 10 percent change in the GBP strength would decrease Jamaicans' spending power by 0.14 percent of GDP.

Figure 3: Remittances through remittance companies by sender country, 2012-2015

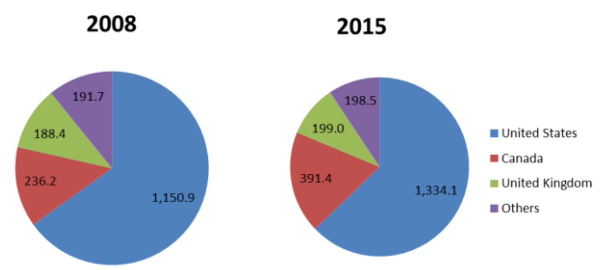


Source: Own calculations based on Bank of Jamaica

The economic slowdown in the UK and the weaker exchange rate are also likely to decrease tourism demand from the UK. Just under 10 percent of all visitors to Jamaica in 2015 were from the UK, which is the third country in importance for tourism after the United States (63 percent of total) and Canada (18 percent of total). However, UK tourism might be more important than their share suggests as, on average, they stay on longer (15 days compared to 7.4 days for US tourists) and thus have higher tourism expenditures ($1,165 per UK tourist compared to US$1021 for US and US$1026 for Canada).[1]

UK tourism to Jamaica is sensitive to the exchange rate and UK economic activity as the last few years have shown. Up to 2008, arrivals of UK citizens to Jamaica was growing, but started to stagnate in 2008. In 2012, tourist arrivals from the UK had declined to 145 thousand compared to 188 thousand in 2008. Arrivals recovered since 2012, with especially strong growth in 2015, attaining 199 thousand by that year. The period of decline was marked by a depreciating pound, weak economic performance following the world financial crisis and the steep increase of the air passenger duty. Conversely, the subsequent recovery in the UK and the lowering of the air passenger duty contributed to increased UK tourist arrivals. The sense of safety in the Caribbean compared to other typical European tourist destinations also supported the increase in 2015. While arrival numbers are small compared to the United States, growth in UK tourism has contributed to the strong performance of the sector over the last two years. Simulations indicate that the effects on GDP from lower UK tourism arrivals and spending could cut GDP by another 0.04 percent.[2]

Figure 4: Stop-over visitor arrivals by country of origin, 2008 and 2015



Source: Own calculations based on Bank of Jamaica

[1] 2014 Tourism expenditure survey, JTB.
[2] See regional section for simulations.

Cultural and historical linkages are also reflected in UK's direct support to Jamaica. Through the Department for International Development (DFID), Jamaica can access regional programs for the Caribbean, and also receives direct support to promote economic growth and reduce crime.[3] Even without any change in the allocation, the weaker pound will lead to lower support in real JM$ terms.

Indirect effects

Challenges from Brexit could come from spillovers. The leave vote happened at a time when the world economy was still in a fragile state. Depending on the final resolution of the EU – UK separation, several scenarios for the adverse effects on world economic growth are possible (see regional section for possible scenarios). Observers expect a negative growth effect from Brexit for the European Union, the United States and other countries that have strong links to Jamaica through both a potential slowdown of trade and financial sectors, and uncertainty about the resolution of the separation. Turmoil from heightened uncertainty would have a disproportionate impact on Jamaica, which is highly dependent on external economic circumstances.

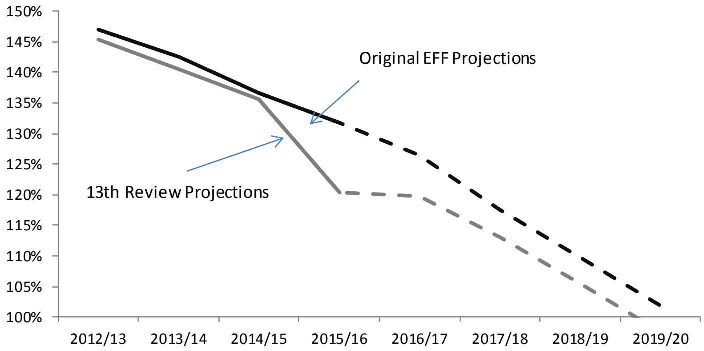
Conclusions and Policy Implications

So far Brexit has only been a scare for Jamaica. In spite of cultural and historical closeness, Jamaica's linkages to the UK are not comparable to those to the United States. As such, Jamaica has so far been isolated from strong, direct effects. However, a negative impact is nevertheless possible. Keeping in mind that Jamaica only grew by 0.8 percent in the last fiscal year and that the country is still in a fragile recovery, even small declines in tourism demand and remittances can be significant. In the event the Brexit vote leads to slower economic activity in countries with strong linkages to Jamaica, such as the European Union, the United States and Canada, the effects could be multiplied.

[3] In total, DFID allocated £75 million for the Caribbean from 2011 to 2015. This includes direct support for Jamaica, as well as programs that benefit the whole region.

Petrocaribe deal supports reaching the debt target …

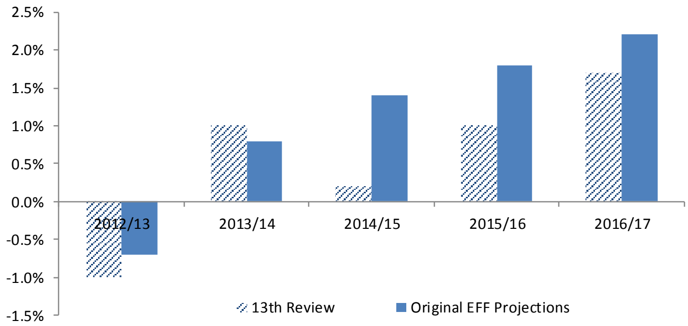
Figure A. Debt-to GDP 2011/12 - 2019/20



Source: International Monetary Fund

despite dissapointing growth figures

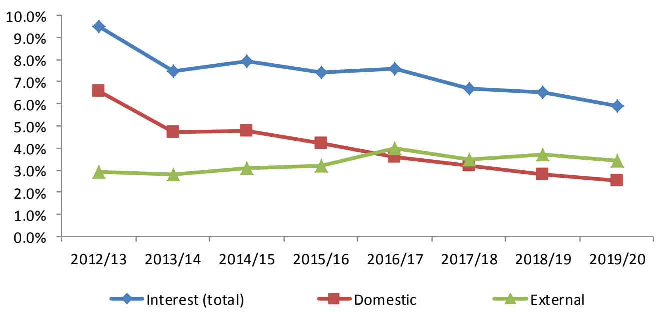
Figure B. Annual GDP growth rate



Source: Statistical Institute of Jamaica

Interest Payments are on a downward path…

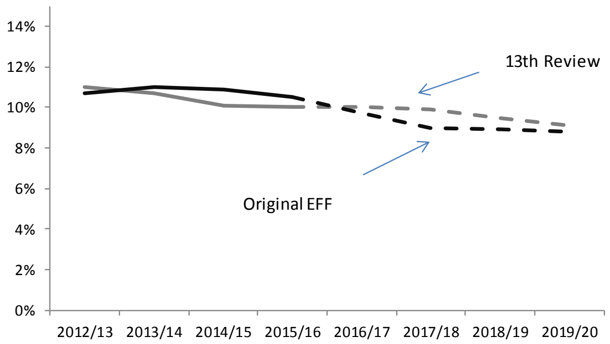
Figure C. Interest payments on Government Debt (% of GDP)



Source: International Monetary Fund.

while public sector salaries remain above target

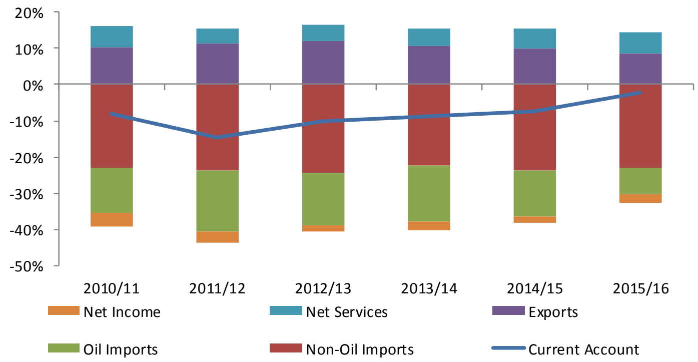
Figure D: Public wages and salarias (% of GDP)



Source: International Monetary Fund.

The Current Account has benefitted from low oil prices

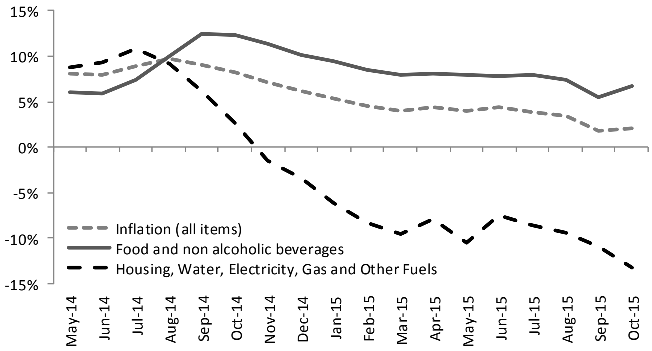
Figure E. Contributors to current account deficit (% of GDP)



Source: Bank of Jamaica

…which has helped to keep inflation under control

Figure F. Inflation and its Main Components (y/y % change)



Source: Bank of Jamaica

Jamaica: Selected Indicators

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16 (P)
(Annual percentage changes, unless otherwise indicated)						
Real Sector						
Real GDP	-0.6	0.9	-0.7	0.9	0.2	1.0
Nominal GDP	7.8	7.5	6.1	8.9	6.9	7.5
Inflation (end of period)	7.8	7.3	9.1	8.3	4.0	3.0
Exchange rate (end of period)	85.7	87.3	98.9	109.6	115.0	122.0
External Sector						
Exports of goods and services (yoy, %)	0.8	13.0	3.5	3.5	-5.0	0.3
Tourism receipts (yoy, %)	2.0	1.1	1.4	1.8	10.0	5.9
Imports of goods and services (yoy, %)	6.8	13.5	0.4	0.4	-7.3	-9.7
Current account (percentage of GDP)	-9.0	-14.9	-11.5	-8.4	-6.6	-2.2
Treasury bill rate (percent, end of period)	6.5	6.2	5.8	8.0	7.0	5.8
(In percentage of GDP, unless otherwise indicated, on a calendar year basis)						
Central Government						
Revenue and grants	26.8	25.6	25.8	27.2	26.3	27.0
Budgetary expenditure	33.2	32.0	29.9	27.1	26.8	27.3
Primary balance	4.5	3.2	5.4	7.7	7.5	7.1
Budget balance	-6.3	-6.4	-4.1	0.1	-0.5	-0.3
Public sector balance	-6.9	-6.4	-4.2	0.1	0.4	1.8
Debt Indicators						
Public sector debt	141.3	143.7	146.4	141.6	124.8	120.3
Public sector debt over revenues	536.1	563.7	n.a.	516.4	491.6	445.6
Foreign currency public debt (end of period)	83.3	81.4	76.0	76.4	49.9	70.0
International Reserves						
Net international reserves (USD Mill)	2553	1777	884	1303	2294	2415
Gross international reserves (weeks of good and services imports)	23.4	17.8	<12	14.4	19.4	23.3

Source: International Monetary Fund and country authorities

Contributor: Chrystol Thomas

Highlights

Gold and oil prices trended upwards, suggesting positive returns for government revenues and foreign reserve.

The IMF is conducting its first review under its Stand-by Arrangement with the Surinamese Authorities.

The Government has indicated its commitment to improve the quality and dissemination of economic data

Brexit should have a minimal impact on Suriname's economy.

Overview

The government is implementing its macroeconomic stabilization and reform agenda, with contribution from the IMF and multilaterals. The external situation has improved somewhat given efforts to control imports and increases in commodity prices, with the volatility in exchange rate movements between the official and parallel markets decreasing.

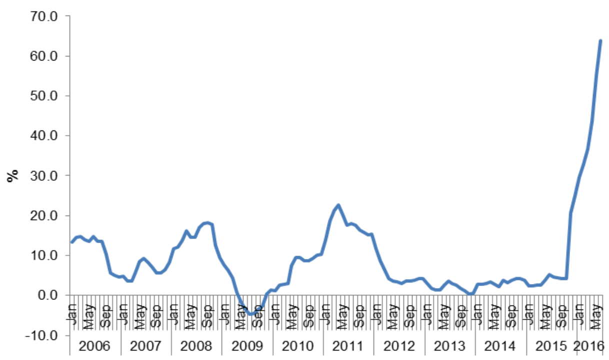
Recent Macroeconomic Developments

Suriname's growth prospects should improve with the rise in commodity prices. Commodity prices have trended upwards for the first half of 2016. Crude oil prices rose 37 percent in the second quarter and averaged $45/bbl. Oil prices climbed for five straight months and have traded within the band of $40-49/bbl. since April.[1] Gold prices increased by 6.7 percent in Q2 of 2016 compared to Q1. At the end of June 2016, the gold price was $1276/toz, slightly higher than the average price for 2014 ($1266/toz). The rise in oil and gold prices suggests positive macroeconomic gains for the Surinamese economy this year. This should help offset the negative economic impact from the cessation of the bauxite industry and the contractionary impact from the fiscal consolidation program.[2] The impact of the rise in commodity prices on the economy is not yet measured as there is no recent official data on GDP and Government accounts.

Consumer prices continue to increase owing partially to exchange rate devaluation. Monthly annualized inflation increased from 36.6 percent in March 2016 to 63.8 percent in June (Figure 1). For the first 6 months of the year, inflation averaged 44.7 percent compared with the same period in 2015 (3.2 percent) and 2014 (2.9 percent). Much of the inflation spikes are attributed to higher cost for utilities and the depreciation in the exchange rate. Average inflation is projected by the IMF to remain in the double digits in 2016, at 36.8 percent, but should decline in the medium term to an average of 6.7 percent.[3]

The external indicators have improved over the previous year. The current account balance improved by US$93.2 million in the first quarter of 2016 (or 5.8 percent of GDP) mainly on account of lower imports on goods and services (US$270.5 million). Exports on goods and services fell in Q1 2016 by US$185.4 million and US$22 million, respectively, when compared with Q1 2015 (see Figure 2). The falloff in exports is partially attributed to the closure of the bauxite industry. Gross international reserves increased by 46 percent at the end of June 2016 to US$404.3 million, estimated at 2.5 months of import cover, over the level recorded at end-March 2016. The reserve position was boosted by the IMF's first disbursement of its SBA (US$81 million) and from the financial support to the SBA by the Caribbean Development Bank (US$50 million) and the IDB (US$70 million).[4] Under the IMF's SBA, international reserves at the end of 2016 are projected at US$538 million (equivalent to 2.8 months of import cover). Moreover, the current account balance is expected to improve in 2016 to −8.7 percent of GDP, compared with −15.6 percent in the previous year.

Figure 1. Inflation (Annualized)



Sources: Bureau of Statistics, and CBvS.

Exchange rate volatility tapered but there is still some disequilibrium in the market. The flexible exchange rate

[1] World Bank. 2016. Commodity Markets Outlook. http://pubdocs.worldbank.org/en/328921469543025388/CMO-July-2016-Full-Report.pdf.

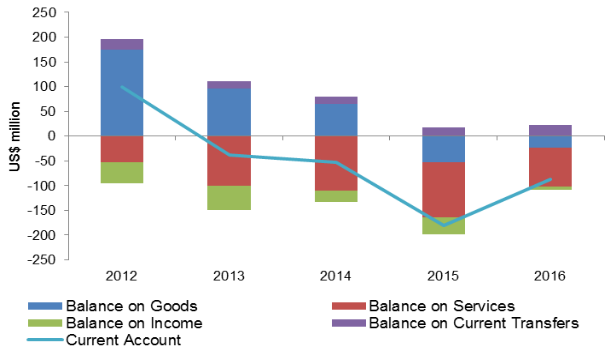
[2] The oil and gold sector represented about 60% of Suriname's total export in 2015.

[3] WEO, April 2016.

[4] The IDB and the Caribbean Development Bank provided budgetary support to Suriname through the energy sector.

system, which was fully adopted in May, 2016, has helped smooth out the large fluctuations between the official and parallel exchange rate markets. Since mid-June, the US dollar to the SRD dollar was exchanged between SRD$7 and SRD$8.[5] An adequate reserve position and stabilization of the macro economy is important for a country to achieve equilibrium in the foreign exchange market.

Figure 2. Current Account Balance (First Quarter)



Sources: IMF, Central Bank of Suriname, and IDB.

The debt stock increased. Suriname's total debt stock to GDP was 38.2 percent of GDP at the end of April 2016, an increase of 2.8 percent of GDP compared with the previous month. Foreign debt to GDP grew by 2.1 percentage points while domestic debt to GDP increased slightly by 0.8 percentage points. Suriname's available debt space for foreign and domestic debt remains 13.1 percent and 8.6 percent of GDP, respectively, with its national debt thresholds for external and domestic debt.[6] The debt position is expected to increase further at the end of the year (the IMF projects debt at 46.2 percent of GDP) with additional borrowing under the SBA and other investment projects from both bilateral and multilaterals.

The IMF Stand-by Arrangement (SBA) is underway and the Fund team indicated a mixed performance after the first three months. To date, Suriname has received program support of US$81 million from the IMF. Additionally, the government received budget support from two multilateral organizations of US$120 million (US$ 70 million from the IDB and US$50 million from the CDB). An IMF team visited Suriname in August 2016 to review the country's performance under the program. The IMF's press statement[7] made reference to the progress made in containing spending and implementing a number of planned reforms, both contributing to the fiscal deficit remaining close to the programed path. However, the Fund noted that significant additional increases in fuel taxes and electricity tariffs, as planned in the program to improve the fiscal situation and make space for better-targeted social spending, are still outstanding. The IMF will continue discussions with the Surinamese authorities after further progress on the program outcomes.

Government revenue is expected to increase from higher fuel prices at the pump and increased custom duties. Under pressure from rising exchange rates, the government announced an increase in fuel taxes per liter of SRD$0.22 for diesel, SRD$0.21 for gasoline without additives, and SRD$0.21 for gasoline with additives, effective August 11, 2016. The increase in fuel taxes is projected by the IMF to have a net positive impact of 0.9 percent of GDP. Customs duties are also adjusted in accordance with market exchange rates which will now reflect the increase from SRD$4.04 to SRD$7.28 per US dollar. This will also generate additional revenue for the government.

The Surinamese Authorities will be working with the IMF and other development partners to improve the quality and dissemination of economic data. Suriname has made progress in collecting and disseminating quality statistics in the monetary, financial, and balance of payments sectors. The government has acknowledged that timeliness of data availability remains an issue, and the need for improvements in data quality for GDP, CPI, and labor statistics. They have indicated their commitment to publishing social indicators to support social policy design for inclusive growth, including the most recent household survey.[8]

Conclusion

Suriname was hit hard by the fall in commodity prices, leading to large fiscal and external imbalances. However, stabilization has begun under an IMF-supported SBA and the economic outlook for 2017 is promising.

High Frequency Macroeconomic Indicators

	Lastest data	Period	Prior data	Period
Real GDP growth (y/y)	0.1	2015	1.5	2014
Inflation (end of period)	55.0	May. 16	36.6	Mar. 16
Net international reserves (US$M)	404.3	Jun. 16	212.5	May. 16
Exchange rate (to US$)	7.1	Jul. 16	4.0	Dec. 15
Unemployment rate (%)	8.7*	2016	8.7	2015

Sources: Central Bank van Suriname; General Bureau of Statistics; World Economic Outlook (April 2016).
* data is estimated

[5] For more on exchange rate movements, see previous Caribbean Region Quarterly Bulletin 2016: Vol 5, Issues 1 and 2.
[6] The external and domestic debt thresholds are 35% and 25% of GDP, respectively.
[7] http://www.imf.org/en/News/Articles/2016/08/19/PR16378-Suriname-IMF-Mission-Visits-Suriname-for-First-Review-of-Stand-By-Arrangement
[8] https://www.imf.org/external/pubs/ft/scr/2016/cr16141.pdf

Introduction

The implications of Brexit for Suriname are likely to be marginal, given Suriname's minimal relation with the United Kingdom. Suriname is the only country in the Caribbean Country Department (CCB) of the IDB that was not colonized by the UK. Instead, the country's history is with the Netherlands, gaining its independence in 1975. Historically, Suriname has been oriented toward bilateral support, of which the Netherlands played an important role. Suriname maintains close ties with the Netherlands, with a large diaspora community of more than 340,000 Surinamese (about 60 percent of its population)[9] where most of the country's remittances originates.[10] Apart from the Netherlands, Suriname also has close trade relations with North America, its main trading partner for both exports and imports. Moreover, domestic transactions are undertaken in the US dollar and the Euro.

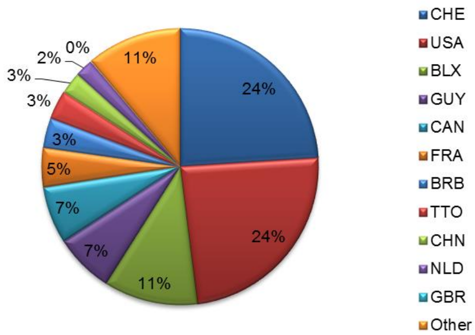
The UK's exit from the European Union (EU) should have a meaningful but not large impact on the USA, particularly export growth.[11] [12] There is uncertainty about the shape of relations between the UK and EU after Brexit, which is expected to dampen investor confidence. One possible implication of Brexit is the possible disharmony that can be created in the EU which could distract attention from other pressing problems.[13]

There is little presence of the British in Suriname.[14] Support from the UK to Suriname came from the UK being a major donor and member of the EU. For example, Suriname benefits from special commodity arrangements with the EU under the Lome Convention and Cotonu Agreement. Suriname works with the EU in many areas such as transport infrastructure[15] and agriculture.

Implications for the External Sector

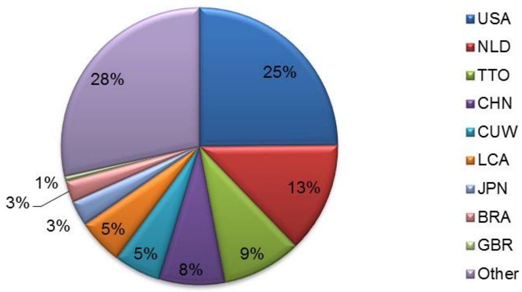
The USA is Suriname's main trading partner for both exports and imports. Suriname's export basket is dominated by gold, crude oil, and alumina: these three commodities generate around 90 percent of foreign exchange earnings and attract high inflows of foreign direct investment (FDI).[16] The top export destinations of Suriname are the USA and Switzerland (CHE), both representing about 24 percent of total export[17] (see Figure 3). The United States is also the top source of imports in Suriname (about 25 percent). Other significant import origins include the Netherlands, Trinidad and Tobago, China and Curacao (see Figure 4). Suriname trades very little with the UK, the share of total exports to the UK is 0.03 percent while the share of total imports from the UK is 1 percent.

Figure 3: Export Destinations (2014)



Sources: CBvS, OEC and IDB.

Figure 4: Origins of Imports (2014)



Sources: CBvS, OEC and IDB.

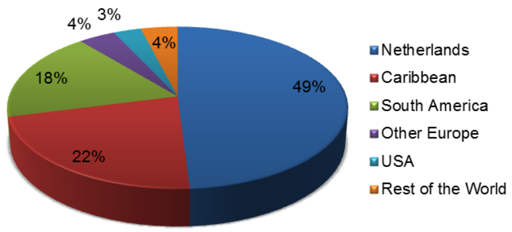
Foreign direct investment should not be affected by Brexit. Most FDI in Suriname is in the mineral sector and tends to correlate strongly with commodity prices. Consequently, foreign investments in the mining sector tend to fall when commodity prices are low as expected revenues and profitability decrease. International firms that invest in Suriname's mining sector are mainly from the USA and Canada. There is no known large British

[9] International Organization for Migration (2015).
[10] Suriname currently receives family remittances equal to about 3 percent of GDP. The recipient families mostly use them for everyday consumption, followed by medical expenses and education (IOM 2015).
[11] Fitch Rating Global Perspectives. 2016. Brexit Negotiations Have Already Started. 7 July 2016. www.fitchratings.com.
[12] See discussion in Regional section.
[13] FitchConnect 2016. Fitch: Direct Brexit Impact on U.S. Limited; Financial and EU Spillovers Matter More. 28 June 2016. https://app.fitchconnect.com/research/press-release/PR_1008114.
[14] The UK government does not have any permanent representation in Suriname.
[15] The policy framework and the Transport Master Plan are being updated with the support of the EU.
[16] At the end of November 2015 Suriname's bauxite industry ceased production. A resolution of the industry is still pending and being discussed by the government and interested stakeholders.
[17] Switzerland's main import goods from Suriname is gold (99.8% or US$431.1 million) while the USA imports refined petroleum (37% or US$158.7 million), aluminum oxide (35% or US$150.2 million), and gold (11% or US$47.2 million).

company in Suriname. Given these trade relations, Suriname's external balance is more likely to be affected by developments in the USA, Switzerland, and the Netherlands, which suggests that implications for the UK resulting from Brexit should not have a noteworthy contagious impact on the Surinamese economy.

Brexit should not impact the tourism sector in Suriname. Unlike other countries in the Caricom region, the tourism sector plays a minor role in Suriname's economy. The sector's direct contribution to national income was about 3 percent in 2015.[18] Moreover, tourist arrivals are mainly from the Netherlands (49 percent) and the Caribbean (22 percent).

Figure 5: Tourist Arrivals by Main Markets (2010)



Source: Caribbean Tourism Organization (CTO).

Suriname's Vulnerability to International Markets

Suriname will remain vulnerable to international commodity price movements unless the structure of its economy is transformed. The main contributors to GDP growth are mining and quarrying, manufacturing, and trade. Commodity price swings affect the macroeconomic framework—particularly GDP, the current account, and revenues. Projected declines in gold and oil prices could dampen the outlook for growth and adversely affect the fiscal and external positions. GDP growth and the fiscal and external balances could weaken by 1 to 2 percentage points under current forecasts. The impact on international reserves could also be large (a loss of 1.5 months of import cover).

Suriname's growth outlook may be further affected by a protracted period of slower growth in advanced and emerging markets. Exports to the USA and Canada account for over 40 percent of total exports, and growth in both of these countries would boost demand for Surinamese products. This is also true for countries in the European area such as Belgium, France, and the Netherlands[19]. Export volumes would also be affected by lower growth rates in CARICOM and China. The recent depreciation of the pound sterling against the US dollar could imply lower tourism and remittance flows for countries highly dependent on the UK's economy such as Barbados. As a result, negative spill-offs from Brexit to these countries and international commodity prices could imply a decline in Suriname's export volumes and values. Slower world growth rates would put downward pressure on commodity prices and depress foreign direct investment.

Conclusion

There is uncertainty on the impact of Brexit on the EU and other important trading partners of Suriname. Uncertainty surrounds Brexit given that negotiations are still very preliminary and that the magnitude of the shock depends on its negotiated terms.

The dependence on imports and just a few mineral and energy exports leaves Suriname highly vulnerable to external shocks. International price volatility not only complicates equilibrium in the balance of payments, but also in the government's budget. Suriname's macroeconomic framework has weakened as a result of the recent fall in commodity prices. The longer the uncertainties of Brexit persist, the greater the cumulative negative economic implications on the world economy. Moreover, unfavorable exit terms and larger macroeconomic shocks would have a much greater impact on economies affected by Brexit. Suriname's minimal relation with the UK is likely to reduce any adverse impact from the exit such as the depreciation of the pound sterling. Nevertheless, private sector development and trade and export promotion would be important to mitigate external shocks and encourage sustainable growth and development.

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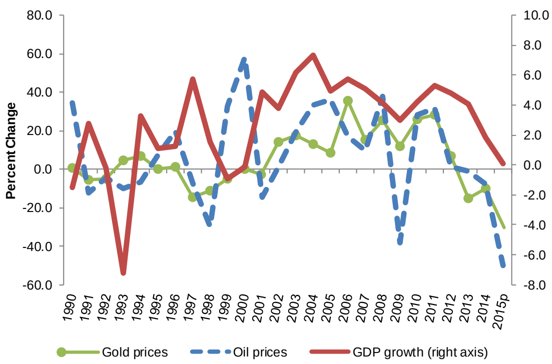
[18] In 2012, 240,000 international tourists visited Suriname (a 131% increase over eight years). Visitors stay an average of 12 days and spend most of their time in the interior in eco-tourism activities.

[19] These countries absorb 22 percent of Suriname's total exports.

Suriname's Macroeconomic Snapshot

Low commodity prices restricted economic growth...

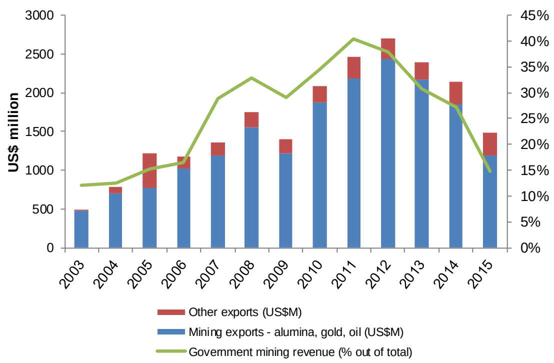
Figure A. Real GDP, and Commodity Prices



Sources: Central Bank of Suriname, and World Economic Outlook (April 2016).

… and reduced government revenue and export contributions from the mining and oil sectors.

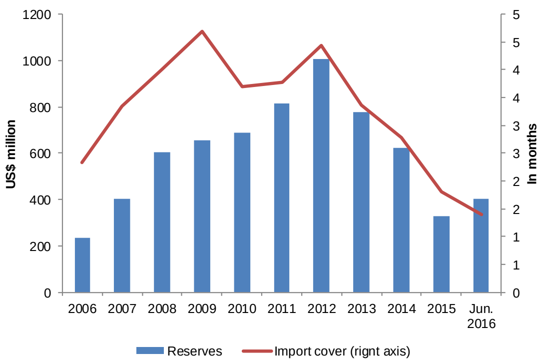
Figure B. Mining Dependence



Source: World Economic Outlook (April 2016) .

The international reserve position imporoved with financing support of the IMF and multilaterals.

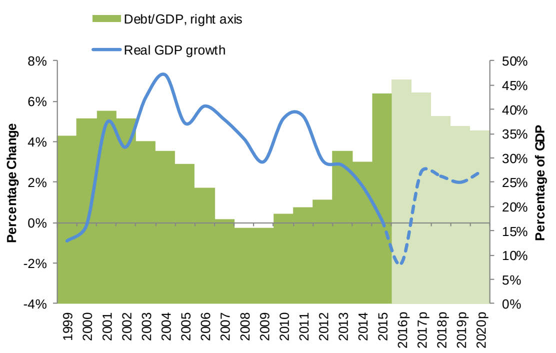
Figure C. International Reserves



Source: Central Bank of Suriname.

The stock of debt should increase.

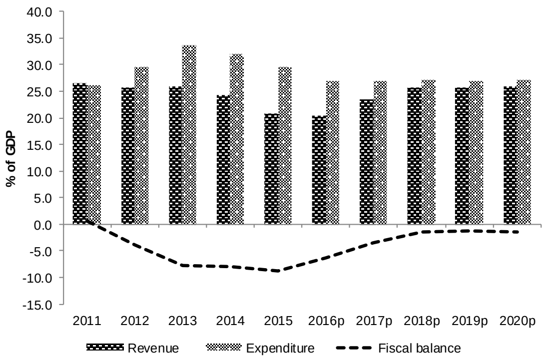
Figure D. Debt Evolution



Sources: Central Bank of Suriname, and World Economic Outlook (April 2016).

Investments in the mineral sectors should stabilize economic growth and return fiscal balances to pre-2012 levels …

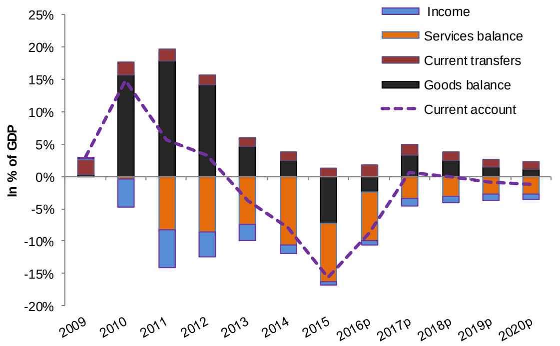
Figure E. Fiscal Performance



Source: Central Bank of Suriname, and World Economic Outlook (April 2016).

… and the current account balance should improve to more sustainable position in the medium term.

Figure F. Current Account Balance



Source: Central Bank of Suriname, and World Economic Outlook (April 2016).

Suriname: Selected Indicators

	2011	2012	2013	2014	2015 (p)	2016(e)
(Annual percentage changes, unless otherwise indicated)						
Real sector						
Real GDP	5.3	3.1	2.8	1.8	0.1	-2.0
Nominal GDP	20.5	13.7	3.0	1.5	2.3	29.6
Inflation (end of period)	17.0	4.4	0.6	3.9	25.0	63.8**
Unemployment	7.5	8.1	6.6	6.9	8.7	8.7
Exchange rates (end of period)	3.3	3.3	3.3	3.3	3.4	7.29*
(In percent of GDP, unless otherwise indicated, on a calendar year basis)						
External sector						
Exports of goods and services	60.3	57.7	50.6	45.2	35.8	40.7
Imports of goods and services	50.7	52.0	53.1	53.2	52.0	50.4
Current account	5.7	3.3	-3.8	-8.0	-15.6	-8.0
Gross international reserves (US$ millions)	816.9	1008.4	775.4	621.8	330.2	404.3**
Central government						
Revenue and grants	26.7	25.7	25.9	24.2	21.0	20.6
Commodity-related revenues	10.8	10.1	9.0	7.0	3.1	2.0
Total expenditure	26.1	29.6	33.6	32.1	29.7	27.0
Primary balance	1.5	-2.9	-6.4	-7.0	-7.4	-4.4
Overall balance	0.5	-3.9	-7.7	-7.9	-8.8	-6.4
Debt indicators* **						
Total government debt	19.9	21.4	31.4	29.2	43.3	45.4
Government debt over revenues	74.8	83.1	121.4	120.3	206.7	215.0
External debt	10.5	11.3	14.7	16.0	21.5	30.2
Domestic debt	9.4	10.1	16.8	13.1	21.8	15.2
External debt as percent of exports of goods and services	17.4	19.6	29.0	35.4	60.1	74.2

Sources: Central Bank of Suriname; General Bureau of Statistics; World Economic Outlook, IMF (April 2016); IDB.

Notes: (p) denotes provisional figures. (e) denotes estimated figures.

* Data as at August 15, 2016. On March 22, 2016, Suriname adopted a flexible exchange rate regime.

** Data as at the end of June 2016.

Contributor: Juan Pradelli

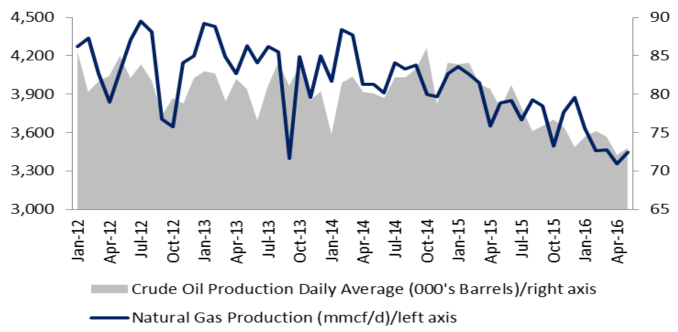
Overview

Economic recession continues in 2016 and a mild recovery could start in 2017. Output is expected to decline by 1.5 percent in 2016, but some forecasts point to a deeper contraction of 2.5 percent. Adverse price and production conditions facing the energy sector explain most of the continued recession. Spill-over effects—which operate through shrinking foreign-trade activity, lower government revenue and capital expenditure, and waning business confidence—constrain the performance of non-energy sectors and prolong their stagnation. Going forward, domestic energy production will probably normalize in 2017 as fewer plant shutdowns are planned and four new gas fields come on stream. Stimuli to non-energy sectors are likely to be limited insomuch as positive spill-over effects are partly offset by the fiscal tightening expected to guide the FY2016/17 Budget. A mild recovery is anticipated to commence in 2017, although output losses incurred in 2015-2016 will not be fully reclaimed.

Recent Developments

Energy output contracts for both structural and temporary factors (Figure 1). Depressed prices in global markets for oil and gas are compounded by country-specific adversities, most notably the gradual maturation of fields and temporary plant shutdowns for maintenance and infrastructure upgrading. Energy-sector output decreased by 4.9 percent in 2015 and could drop another 6-7 percent in 2016. Current volumes of natural gas and oil are 10 percent below the average daily output observed in 2010-2014.

Figure 1. Energy Sector Output



Source: Central Bank of Trinidad and Tobago.

Economic stagnation is taking a toll on employment. Job creation has come to a halt and unemployment is on a rising path. According to the Central Statistical Office, by December 2015 there were 7,100 fewer employees compared to December 2014; in addition, the unemployment rate rose slightly to 3.5 percent in late 2015 from 3.3 percent one year earlier. Outright job losses are hitting the petroleum, manufacturing, transport, and construction sectors.

> **Highlights**
>
> *Economic recession continues in 2016 but a recovery is expected for 2017.*
>
> *Job losses and unemployment are on the rise, while inflationary pressures remain contained.*
>
> *Austerity is likely to shape the FY2016/17 Budget, which will signal the fiscal strategy going forward.*
>
> *A successful sovereign bond issuance coexists with mounting pressures in the foreign exchange market.*

Inflation is subdued in 2016 as the domestic economy undergoes a recession, although price adjustments resulted from fiscal measures. Headline inflation, measured using the Index of Retail Prices, was 3.4 percent (y-o-y) in June 2016 against 5.6 percent (y-o-y) in June 2015. Some price adjustments followed the recent VAT reform and the rise in fuel prices. Despite discrete policy-driven adjustments, the economic recession and weak demand contain price pressures and keep inflation at low levels.

Fiscal policy is progressively geared toward austerity. Facing significant energy revenue shortfalls, the Government formulated compensatory measures, including expenditure cuts, initiatives to enhance non-energy revenues, and an exhaustive review of capital projects. The fiscal deficit in FY2015/16 is targeted at 4 percent of GDP according to the Mid-Year Budget Review Statement, but it could even exceed 6-7 percent of GDP according to credit rating agencies and the June 2016 IMF Article IV Report. Further austerity is expected to guide fiscal policy embedded into the FY2016/17 Budget to be tabled in the Parliament by late September 2016.

The Heritage and Stabilization Fund (HSF) now helps fund the budget deficit. In late 2015, the Government proposed to introduce legislation to formally separate the HSF into a savings fund and a stabilization fund. Eventually, in June 2016 an amount of US$375 million was withdrawn to settle salary arrears in public agencies, and it was indicated that an additional US$300 million could be accessed before the end of FY2015/16. At present, the HSF holds a portfolio invested in foreign assets, with an estimated size of US$5 billion (equivalent to one-fifth of the nominal GDP and almost half of the total public debt).

External debt is also used to meet financing needs. A US$1 billion sovereign bond has been placed among local and international investors in late July 2016. Proceeds will be used for financing capital expenses in 2016 and 2017. The 10-year bond was more than three times oversubscribed and carries a 4.5 percent coupon rate. The financing terms are fairly similar to the last international bond issued in 2013, when the economy was performing better and credit ratings were slightly higher. This successful issuance suggests there is market confidence in the country's solvency and capacity to handle the current adverse circumstances. Public sector debt is projected to exceed 50 percent of GDP in 2016.

Foreign trade and external imbalances deteriorated in a context of depressed commodity prices and reduced export volumes.[1] Merchandise exports declined to US$10.8 billion in 2015 from an annual average of US$15.4 billion in 2012-2014. Energy producers lose an estimated US$4 billion in export receipts and ostensibly reduced dividend payments to parent firms. Lower commodity prices for energy products purchased abroad impacted on merchandise imports, which fell to US$9.5 billion against a historical average of US$11.9 billion. The trade account in goods and services recorded a surplus of 2.2 percent of GDP, a sharp contraction relative to the average surplus of 15.5 percent of GDP achieved during the commodity boom in 2010-2014. The current account also reversed its long-standing surpluses and recorded a small deficit of US$0.1 billion. The overall BOP deficit was funded with international reserves, which declined by US$1.5 billion and stood at US$9.8 billion at end-2015.[2]

Monetary policy follows a cautious approach. As domestic economic conditions weaken, inflationary pressures ease, and the US Federal Reserve maintains its policy stance, the Central Bank of Trinidad and Tobago has adopted a cautious approach and ended the tightening cycle pursued in 2014-2015. Thus, the Monetary Policy Committee decided to keep the policy (repo) rate unchanged at 4.75 percent in its four meetings held in 2016. However, lagged effects of the earlier monetary tightening are now being felt, e.g., increases in the repo rate in 2014-2015 are pushing market interest rates upwards. With higher interest rates and a depressed economic activity, bank credit to the private sector is gradually slowing down. Businesses are reportedly more cautious in their demand for working-capital financing. Lending to the private sector by the consolidated financial system increased by 6.2 percent (y-o-y) in March 2016 compared to 6.7 percent growth (y-o-y) in October 2015.

Commercial banks continue to perform well despite the adverse economic conditions. According to the Financial Stability Report 2015, the banking system remains well capitalized, liquid, and profitable. The regulatory capital-to-risk weighted assets ratio currently exceeds 20 per cent and above the 8 percent statutory minimum. Just a few institutions are experiencing rising non-performing business loans. The liquid assets-to-short term liabilities ratio remains above 30 percent. Banks' profitability is healthy as the returns on assets and equity in 2015, respectively 2.9 percent and 18.1 percent, were higher than one year earlier.

Conclusion

Trinidad and Tobago should adopt new policies to thrive facing a new reality. With lower oil and gas prices in global markets, the past life standards and levels of aggregate (private and public) expenditure cannot be afforded going forward. New macroeconomic policies and structural reforms are necessary to bring income and expenditure back into balance, as well as to revive growth impetus. Buffers can attenuate the re-balancing but should not postpone it. Adjusting to the new reality is the key policy challenge for the country right now.

High-Frequency Macroeconomic Indicators

	Latest data	Period	Prior data	Period
Real GDP Growth (%, y-o-y)	-2.3	Q4 2015	-2.0	Q3 2015
Exports (12-month growth, %)	-23.4	Q3 2015	-20.1	Q2 2015
Imports (12-month growth, %)	-17.4	Q3 2015	-19.6	Q2 2015
Private sector credit (12-month growth, %)	6.2	Q1 2016	6.1	Q4 2015
Inflation (headline, % yoy change)	3.4	Jun.2016	3.4	May.2016
Exchange rate TT$/US$ (end of period)	6.70	Jul.2016	6.66	Jun.2016
Unemployment rate (%)	3.4	Q3 2015	3.2	Q2 2015

Source: Central Bank of Trinidad and Tobago.

[1] Trade and BOP data for 2011-2015 are currently being revised by the Central Statistical Office and the Central Bank of Trinidad and Tobago.
[2] The external imbalance continues in 2016. In January-May 2016, the export volumes of LNG and crude oil declined, respectively, by 15 percent and 9 percent relative to the same period one year earlier. In addition, the Henry Hub natural gas price and the WTI crude oil price, often used as price references in export contracts, were slightly lower than their average level in 2015.

Introduction: "It is the Global Economy and Energy Prices (not the UK), Stupid!"

The UK's withdrawal from the European Union ("Brexit") will impact Trinidad and Tobago through global channels, as opposed to country-specific linkages with the UK. Despite the strong historical and cultural ties between Trinidad and Tobago and the UK, and with the exception of British companies operating in the oil and gas industry, the economic linkages between the two countries are fairly limited. Hence, Trinidad and Tobago is barely exposed to Brexit through *direct channels* such as exports to the UK, or tourism and remittances from the UK. Energy companies, most notably BP T&T and Shell-British Gas T&T, are global players, and the recent performance of their stock prices suggests investors are confident that they can withstand Brexit. On the other hand, the Trinidadian economy is deeply integrated into international trade and finance, and therefore Brexit can have an impact through *global channels*, such as the effects on global growth, international interest rates and commodity prices, and investor confidence.

Global Channels

Further slowdown of the global economy, but additional easing of monetary policy in the UK and the EU. An update to the IMF World Economic Outlook released in July 2016 forecasts deterioration in 2016-2017 global growth as a result of uncertainty in the aftermath of the UK referendum. The IMF estimated Brexit could reduce global growth by 0.1 percent in the near term as uncertainty takes a toll on confidence and investment. Revisions to the growth outlook are concentrated in advanced European economies, with a relatively muted impact in the United States, China, and Asian countries—which are major destinations of Trinidadian exports. As concrete details and implications of the exit process emerge, this uncertainty will be gradually reduced. The IMF is confident the UK and the EU will do their best to avoid large increases in economic barriers, disruptions in global financial markets, and political destabilization in Europe. In this regard, the Bank of England and the European Central Bank have referred to Brexit as a factor that warrants maintaining their expansionary monetary stance and reinforcing policy efforts to sustain the recovery of European economies, including creating jobs and reducing unemployment.

Depressed energy prices are largely more worrisome for British companies operating in Trinidad and Tobago than the fallout from the UK referendum. Energy companies of British and European ownership—most notably, BP T&T and Shell-British Gas T&T—are global players with diversified markets and sources of financing. Thus, they are likely to withstand Brexit without major disruptions. At any rate, their decisions on investment and production are currently much more affected by the depressed world prices of hydrocarbons than by Brexit. For instance, driven by the abrupt drop in oil prices, the BP plc ADR price declined by 40 percent from mid-2014 to end-2015, while it has remained in the range of US$30-35 since then without any significant change after the UK referendum. Investors, therefore, reveal serious concerns about the companies' prospects and profits in a new era of cheap oil and gas, and not so much worry about the possibility of the UK and the EU breaking apart.

Direct Channels

Tourism and remittances from the UK are of minor importance in Trinidad and Tobago. Right after the UK referendum, the British pound depreciated by nearly 14 percent and its value reached an historic low vis-à-vis other international currencies. A weaker currency may enhance the UK's competitiveness and boost growth potential of tradable sectors in the medium term, but in the short term it certainly reduces the purchasing power of pound-earning individuals and companies on imported goods and services, and on other international currencies. This is a concern for Caribbean countries receiving significant flows of British tourists and remittances from nationals living in the UK. Trinidad and Tobago, however, is not among those countries: tourism is a small sector (arguably, underdeveloped) in the local economy, and UK tourists were just 12 percent of total arrivals in 2015, while the US, Canada, and other Caribbean countries accounted for more than 70 percent; in addition, the total remittances received from nationals living abroad in 2014 were less than 1 percent of GDP, with most of the flows coming from the US. Besides, the country's international reserves and HSF portfolio are largely composed of US dollar-denominated assets, and a weaker pound implies a larger purchasing power on the UK's production and currency.

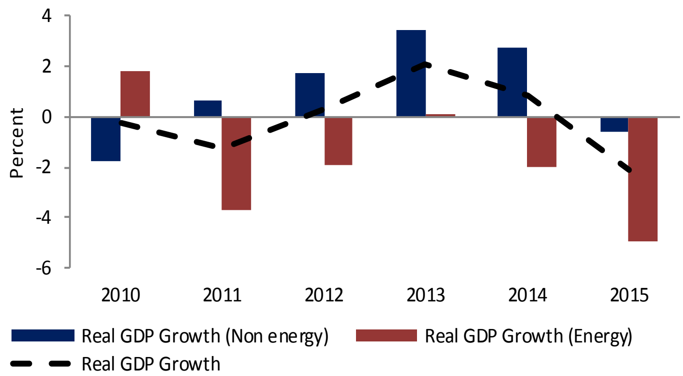
An exit from the EU bloc is an unprecedented event, and thus there is uncertainty about implementation details and future trade arrangements between the UK and the EU. Article 50 of the Lisbon Treaty allows for two years of negotiations of exit conditions. Predicting how the exit will play out is difficult, not least because there is no historical precedent on this matter. However, during the timeline for negotiations, the existing trade agreements with the UK as part of the EU will stand. This means that the existing trade agreements between the EU, the UK, and CARICOM are likely to continue as well, while new trade arrangements can be reached in the next two years.

CARIFORUM (CARICOM plus the Dominican Republic) may have to negotiate with the UK along the lines of the Economic Partnership Agreement (EPA) with the EU. Since 2013, the EPA facilitates trade between CARICOM countries and the EU through duty- and quota-free access to EU markets for all products, trade-related aid, and gradual reciprocity for EU exports to the Caribbean region. After Brexit, CARIFORUM will have to negotiate a separate trade deal with the UK outside of the EPA, seeking a waiver from the World Trade Organization (WTO). Dealing with the UK may be easier if the former colonial power were to seek stronger bonds with its Commonwealth and non-EU trading partners.

A Lesson from History for the Caribbean Integration?

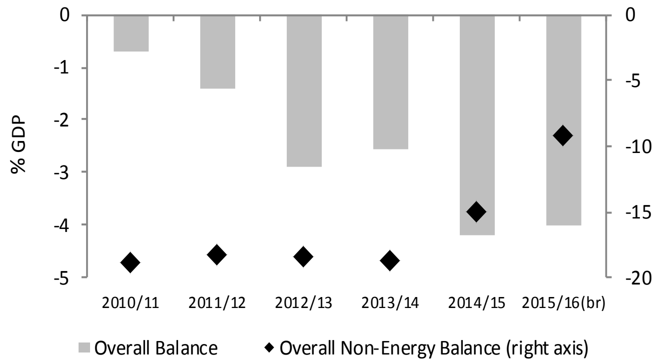
Demonstration effects can be detrimental to Caribbean integration. The EU is arguably the most highly developed and respected international integration experience in modern history. Economic, political, and social trends in the UK, as well as tensions within the EU, led unsatisfied voters to opt for a break-up in a bold move. For other regional integration initiatives around the world, there may be deleterious demonstration effects. The key lesson to be learned is that country-specific trends and tensions within country members should be managed carefully and decisively before the exit option starts winning advocates and supporters. In this regard, the uncertainty and tensions within CARICOM member countries could escalate, and there is a risk that countries may start questioning their membership. Jamaica, for example, has already set up a commission to review the benefits of its association with CARICOM. Policy efforts should be made to protect the regional integration initiative and avoid following the example of the UK breaking up with the EU.

The economy entered in a recession in 2015 ...

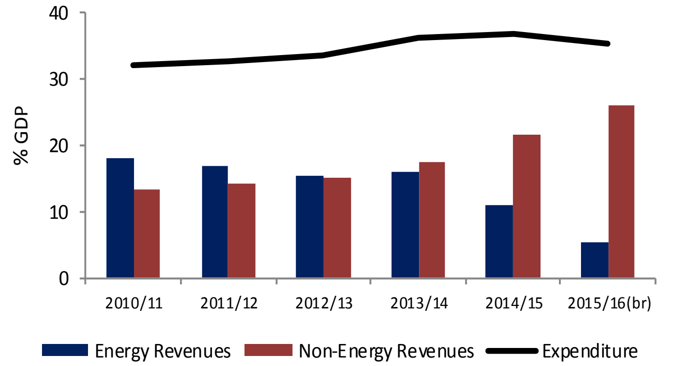


... and the labour market no longer creates jobs.

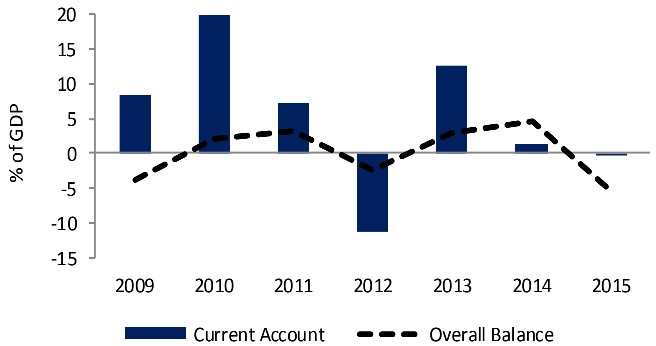
Government's fiscal policy gears towards consolidation ...



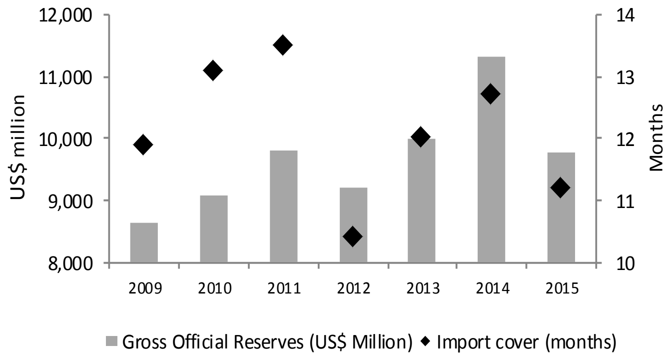
...with initiatives to boost non-energy revenue and cut expenditure.



External position deteriorates due to lower energy exports ...



... and further tightens the foreign exchange market.



Source: Central Bank of Trinidad and Tobago

Notes: Figures in FY2015/16 refer to Mid-Year Budget Review

Trinidad and Tobago: Selected Indicators

	2010	2011	2012	2013	2014	2015
	(Annual percentage changes, unless otherwise specified)					
Real Sector and Prices						
Real GDP /1	-0.2	-1.3	0.3	2.1	0.8	-2.1
Real GDP - Energy /1	1.8	-3.7	-1.9	0.1	-1.9	-4.9
Real GDP - Non-energy /1	-1.8	0.6	1.8	3.4	2.8	-0.6
Headline Inflation	10.5	5.1	9.3	5.2	5.7	4.7
	(In percentage of GDP, unless otherwise specified)					
External Sector						
Exports (merchandise)	53.4	61.2	52.5	68.8	50.4	39.0
o.w. Energy Exports	44.8	51.6	39.8	55.7	41.9	30.4
Imports (merchandise)	30.9	38.9	47.4	46.3	39.1	34.2
o.w. Energy Imports	12.7	17.6	22.7	26.2	19.3	11.9
Trade Balance (merchandise)	22.5	22.3	5.2	22.4	11.4	4.8
Services Balance	2.3	-2.6	-2.7	-1.6	-1.6	-2.7
Income Balance	-5.1	-12.6	-13.8	-8.3	-8.4	-2.3
Current Transfers (net)	0.1	0.1	0.1	0.1	-0.1	-0.2
Current Account	19.8	7.3	-11.1	12.5	1.3	-0.4
Capital and Financial Account	-17.8	-4.2	8.6	-9.7	3.3	-5.2
Overall Balance	2.0	3.1	-2.5	2.9	4.6	-5.5
Variation in Int'l Reserves (US$ billion)	0.4	0.8	-0.6	0.8	1.3	-1.5
	(In percentage of FY GDP)					
Central Government (on a FY basis) /2						
Revenue and Grants	34.0	31.5	31.3	30.8	33.6	32.7
o.w. Energy Revenues	17.6	18.1	16.9	15.5	16.2	10.9
Current Expenditure	28.9	27.6	28.2	28.8	31.3	31.9
o.w. Transfers and Subsidies	17.4	16.6	17.3	17.6	20.0	18.8
Capital Expenditure and Net Lending	5.0	4.6	4.4	4.9	4.9	5.0
Primary Balance	2.3	1.2	0.5	-1.3	-0.8	-2.4
Overall Balance	0.1	-0.7	-1.4	-2.9	-2.6	-4.2
Debt Indicators (on a FY basis) /2						
Net Public Sector Debt	35.3	31.2	39.4	39.1	40.9	45.4
CG External Debt	7.7	7.2	5.9	8.2	7.9	8.2
CG External Debt Service	1.1	1.0	1.3	0.8	1.1	1.3

Source: Central Bank of Trinidad and Tobago

Notes: 1/ CBTT estimates using QGDP Index

2/ E.g., the figures reported in 2015 correspond to FY2014/15

Contributors: Camilo Gomez Osorio and Onoh-Obasi Okey

Highlights

Tourism recovery is underway across the OECS.

Private sector credit contracted by 5.5 percent.

Prime Minister Allan Chastanet of the United Workers Party (UWP) won the elections in St. Lucia.

Moody´s upgraded St. Vincent and the Grenadines' outlook from negative to stable.

Antigua and St. Lucia have closer economic ties to the UK and are more exposed to the uncertainty of Brexit.

Recent Developments[1]

A gradual tourism recovery is underway in most OECS countries. Over the first five months of 2016, Antigua, Grenada and St. Vincent saw dynamic growth in tourist arrivals, while St. Lucia reported contraction (Table 1). Long-stay arrivals increased by over 8 percent in Antigua and St. Vincent. Grenada led the recovery in the cruise passenger segment with growth of 33 percent according to the Caribbean Tourism Organization (CTO). The exception was St. Lucia, where long-stay figures declined by 1.5 percent and cruise passengers by 17.4 percent. St. Lucia saw fewer visitors from Canada and Europe, a 15.2 and 9.1 percent drop, respectively, and fewer cruise stops when compared to the first four months of 2015. The ECCB publishes tourism data on a monthly basis with a six-month lag. The most current figures to date are at March 2016. Another source of tourism data for the OECS is the CTO, covering up to the first six months of 2016, but it excludes Dominica and St. Kitts and Nevis.

Table 1: Tourist Arrivals in 2016

	Long-Stay Visitors by Air		Cruise Ship Passengers		Total Visitor Expenditure
	2015	Jan-May 2016	2015	Jan-May 2016	2015
Antigua	0.5	9.2	22.4	-2.0	-2.2
Dominica	-2.9	n.a.	-7.6	-4.6+	0.3
Grenada	4.4	7.8	3.6	32.7	5.9
St.Kitts	4.4	n.a.	30.9	n.a.	7.4
St.Lucia	2.0	-1.5**	5.6	-17.4**	1.7
St.Vincent	6.6	8.2*	-3.6	6.5*	3.6

Source: Eastern Caribbean Central Bank and CTO.
*Data up to March 2016; ** Data up to April 2016; + Data up to June 2016.

Fiscal consolidation continued in four countries in the union by end-March 2016. St. Lucia's fiscal deficit fell to US$0.98 million at the end of the first three months of 2016 from US$13.7 million recorded a year earlier. St. Vincent and the Grenadines' deficit declined to US$3.8 million from US$3.9 million a year earlier. Antigua and Barbuda recorded an overall fiscal surplus, which stood at US$9.9 million for 2016 compared with US$7.7 million in 2015. Similarly, Grenada recorded a fiscal surplus of US$4.9 million compared with a deficit of US$4 million recorded a year earlier. In contrast, Dominica's fiscal position deteriorated on account of higher current spending of 11 percent with an increased fiscal deficit of US$4.2 million compared with US$2.9 million at end-March 2015. Reconstruction efforts and repairs pressured expenditures. St. Kitts and Nevis sustained it fiscal surplus, but at US$24.6 million for 2016, which was lower than the US$38.2 million for March 2015. The ECCB publishes fiscal data on a monthly basis and with a six-month lag.

The domestic financial sector is challenged by the regional trend of de-risking and loss corresponding banking relationships. The risk associated with conducting offshore banking and due diligence to ensure compliance with anti-money laundering regulations has led to the loss of corresponding banking services for domestic financial institutions. This is having an adverse impact on the profitability of domestic banks, taking a toll on remittances and the ease of paying for education and healthcare services across the Caribbean. To discuss a mitigation strategy, the Ministers of Finance of the ECCU met in Antigua on July 22, 2016. Antigua has the largest financial services sector in the union.

Private sector credit remains subdued across the OECS. Although banks have excess liquidity, private credit contracted by 5.5 percent (y-o-y) at the end of March 2016. Antigua and Barbuda saw the deepest drop of 11 percent, while St. Lucia, Dominica, and Grenada reported declines of 5, 0.1, and 0.7 percent, respectively. In contrast, St. Kitts and St. Vincent witnessed growth of 3.8 and 2.6 percent, respectively. With high non-performing loans, at 18.8 percent for the ECCU, banks have become more risk averse, while at the same time the demand for credit has been low. Small businesses

[1] This bulletin focuses on developments in the independent countries of the OECS: Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Vincent and the Grenadines, and St. Lucia. Figures exclude territories that are members of the OECS. ECCU: Eastern Caribbean Currency Union

are facing limited access to financing and high lending rates. The Chair of the Monetary Council of the ECCU, Prime Minister Ralph Gonsalves, announced a reduction in the requirement ratio from 2 percent to 3 percent effective May 1, 2016, in an attempt to spur credit growth and bring down interest rates. ECCB reports data on financial indicators on a monthly basis with a six-month lag.

St. Vincent and the Grenadines is seeing a gradual recovery. The IMF's Article IV 2016, which concluded on July 13, 2016, estimated growth at 2.2 percent. Public debt increased to 74 percent of GDP at the end of 2015, but St. Vincent remains committed to the ECCU target of 60 percent by 2030. Lower oil prices have contributed to low inflation and a reduction in the current account deficit. The fund emphasized the need to strengthen the macroeconomic policy framework and pursue structural fiscal reforms to send debt levels on a downward trajectory and broaden the tax base. The soundness of the banking sector in St. Vincent was noted, but increased monitoring of the offshore financial sector was recommended.

Moody's sovereign credit rating for St. Vincent and the Grenadines remained stable at B3/NP' and B3, but with an improved outlook (from negative to stable). The rating agency noted the higher economic growth. It reported that "while debt will likely continue to rise in the next two years, the increase will be moderate and debt affordability will continue to be supported by low-interest funding from multilateral and bilateral creditors." Further, debt is expected to reach 72 percent of GDP in 2016 and rise moderately over the next two years while maintaining debt sustainability through low-interest funding.

Dominica is projected to grow at 1.3 percent in 2016. The IMF's Article IV 2016, which concluded on July 13, 2016, attributed growth to external capital grants and the normalization of tourism. Other sectors such as agriculture and manufacturing will need more time to recover from the effects of tropical storm Erica. Government revenue is expected to outweigh expenditure by 0.8 percent of GDP, following the collection of tax arrears, the higher economic citizenship program (ECP) revenues, and lower capital expenditure. International oil prices kept inflation low but are not expected to affect the trade deficit significantly as a result of low exports in the tourism and agriculture sectors. Further, the economy is reporting high non-performing loans and contraction of private sector credit.

Dominica's Douglas Charles International Airport fully recovered from tropical storm Erica. It has been a year since the storm devastated the island, causing damage to its airport. The construction repairs began in December 2015 and were scheduled to conclude by the hurricane season starting in March. Given the heavy rains, works continued until June 2016. Its re-opening is another positive step toward normalizing tourism activities.

The current Prime Minister, Allan Chastanet, of the United Workers Party (UWP), won the elections in St. Lucia held on June 6, 2016. The former Prime Minister, Kenny Anthony, of St. Lucia's Labour Party (SLU), was defeated and will not hold the post of Opposition Leader. The UWP won 11 constituencies, while SLU won six. Mr. Anthony would remain Parliamentary Representative for Vieux-Fort South.

Outlook

The growth outlook for the OECS is positive. The IMF projects positive growth across all OECS countries in 2016. Strong tourist arrivals would support output in Antigua that is projected to grow by 2 percent, Grenada by 3 percent, St. Kitts by 3.5 percent, St. Lucia by 1.4 percent, and St. Vincent by 2.2 percent by end-2016. Dominica's forecast of 1.3 percent is in contrast to the 3.9 percent decline reported a year earlier and supported by reconstruction efforts following tropical storm Erica. Growth figures are published annually by the Eastern Caribbean Central Bank (ECCB) and are currently available until the end of 2015.

Table 2: Real GDP Growth in the OECS (2015-2016)

	2015 (E)	2016 (P)
Antigua and Barbuda	2.2	2.0
Dominica	-3.9	1.3
Grenada	4.6	3.0
St.Kitts and Nevis	5	3.5
St.Lucia	1.6	1.4
St.Vincent and the Grenadines	1.6	2.2

Source: IMF, World Economic Outlook Database, April 2016; 2015-2016.

High-Frequency Marcoeconomic Indicators

	Last Data	Period	Last Data	Period
Annual GDP growth (%)	1.9	Dec-15	3.4	Dec-14
Tourism arrivals (annual % change)	5.3	Mar-16	2.5	Dec-15
Inflation (end of period)	-0.10	Feb-16	-0.41	Jan-16

Direct effects from Brexit

Within the OECS, the exposure to the UK market varies across countries. While all OECS islands are members of the Commonwealth, Antigua and Barbuda and St Lucia have the closest economic ties to the UK in terms of tourism arrivals, FDI, remittances, and trade flows, making them more exposed. The Brexit effects on St Kitts and Nevis may be more nuanced, as the islands relies more heavily on the U.S. and Canadian tourism markets. St. Vincent and Dominica rely less on tourism services and have important contributions to output from agriculture.

Tourism has been an important driver of economic output in the union over the last decade. In Antigua and Barbuda and St. Lucia, the World Travel and Tourism Council reports the direct contribution of tourism to GDP in 2015 at 15.1 and 14.5 percent, respectively, but at around 57.1 percent of GDP and 41.5 percent when considering the indirect contribution to other sectors.

Table 1. Contribution of Tourism to GDP and Employment, 2015

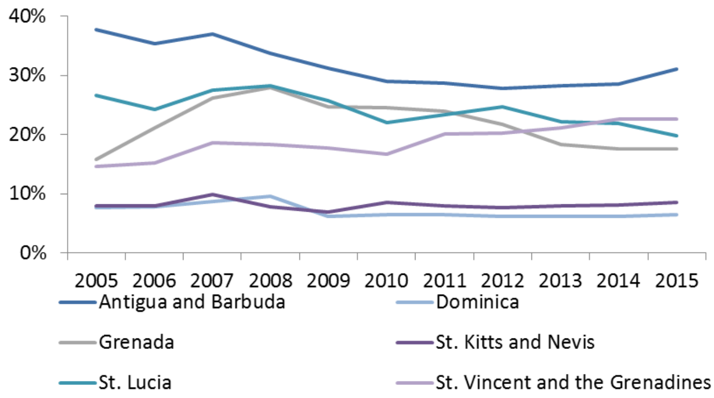
	Contribution to GDP		Contribution to Employment	
	Direct Contribution to GDP	Contribution to GDP	Direct Contribution	Total Contribution
Antigua and Barbuda	15.1	57.1	15.6	51.6
Dominica	12.9	39	11.7	35.6
Grenada	7.5	25.5	6.9	23.3
St. Kitts and Nevis	7	28.1	6.9	26.7
St. Lucia	14.5	41.5	21.5	46.3
St. Vincent and the Grenadines	6.6	23.2	6.1	21.3

Source: World Travel and Tourism Council-Economic Impact 2016.

The devaluation of the British pound could affect tourism performance. The weaker sterling made traveling to the Caribbean more expensive in an environment of a fixed East Caribbean dollar. The depreciation following the Brexit vote could affect tourist expenditure in the short term. Antigua and St. Lucia are more reliant on the British market. In Antigua, 27 percent of long-stay arrivals are from the UK, followed by St. Vincent with 23 percent, St. Lucia with 18 percent, and Grenada with a 16 percent UK market share. In contrast, tourism figures in St. Kitts would be less affected, as it relies more on arrivals from the United States and Canada. The St. Vincent and Dominican economies also have large agriculture sectors.

It may be too early to assess the overall impact on trade as a result of Brexit. In the short term, there may be a trade response with the weakening of the sterling. Imports from the UK would become cheaper, and the union is heavily dependent on imported food and inputs. At the same time, exports of goods and services from the OECS would be relatively more expensive, particularly tourism services, which may see a modest decline.[2] British merchandise imports represented 43 percent of total imports for St. Lucia in 2014 and 39 percent in Antigua and Barbuda in 2015, while exports of goods accounted for 26 and 11 percent, respectively. In contrast, exports to the UK in Dominica, St. Kitts and Nevis, and St. Vincent and the Grenadines are marginal, averaging about 1 percent.

Figure 1. UK Tourists as a Percent of Total Long-stay Arrivals



Source: Eastern Caribbean Central Bank.

Brexit could pressure the union's external position. During 2011-2015, the OECS sustained high current account deficits averaging around 16.3 percent of GDP; these ranged from 11.5 percent of GDP in St. Lucia to 28.4 percent in St. Vincent. Over the last five years, imports of goods and services accounted for an average of 54 percent of GDP, while exports of goods and services stood at around 36 percent of GDP. The moderation of oil and commodity prices and higher tourism receipts improved the union's external position in 2015. However, the current account balance may widen in Antigua and St. Lucia, where Brexit could bring lower tourism receipts and higher UK imports.

Trade agreements between the EU and the OECS may be re-examined. In the long run, the impact on trade flows to the UK and the EU would depend on the outcome of the trade negotiations, and it may be too early to tell. This also presents opportunities and could open the door for greater access to exports from the union. If banana or other agriculture exports, which had lost preferential access to the EU and the UK, enter the trade discussions, Dominica and St. Vincent would benefit

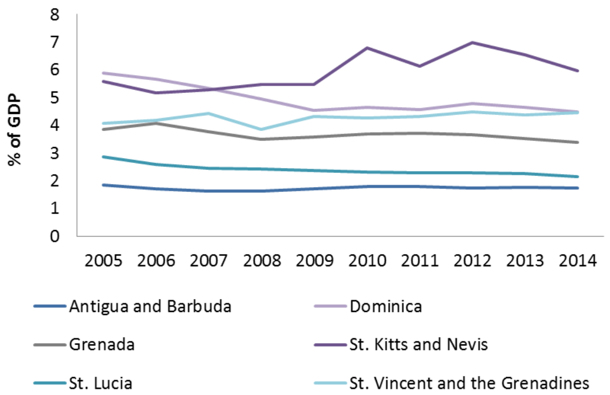
[2] The Eastern Caribbean dollar is fixed to the US at a rate of US$1 to EC$2.70.

greatly. Brexit could open the door to deepen trade flows with the UK and Commonwealth states.

The OECS could see a fall in foreign direct investment (FDI) inflows as a result of Brexit. FDI plays a significant role in the OECS. Over the past five years, FDI was highest in St. Vincent and Grenadines and averaged 15 percent of GDP, followed by St. Kitts and Nevis, with 13 percent of GDP. These FDI inflows have concentrated on tourism and real estate. With the devaluation of the pound, these inflows may be affected in the short term. The British demand for real estate would ease as a result of the higher cost of purchasing a second home.

The weaker pound would have are more nuanced impact on remittances. For many households in the OECS remittances are an important source of income. In St. Kitts and Nevis remittances were as high as 7% of GDP in 2012. A weaker pound would affect the amount of remittances and pensions households receive in the OECS. However, for the islands more exposed to the UK, remittances are amongst the lowest in the unions. In St. Lucia total remittances represent less than 2% of GDP and in Antigua an even smaller share. On a larger scale, reductions in foreign exchange inflows through reduced foreign direct investment, remittances and tourist expenditure, could pressure the levels of international reserves.

Figure 2. Remittances as a Percent of GDP



Source: World Development Indicators.

Indirect effects from Brexit

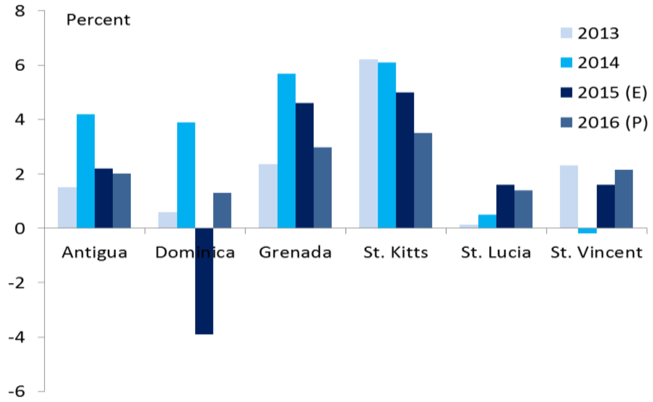
Brexit does not represent a significant risk to the union's growth outlook. The OECS is comprised of small open economies which are vulnerable to external shocks in international markets. Changes in tourism demand or policy changes abroad tend to hit home with greater impact. While over the medium term Brexit represents a downside risk worth monitoring, the OECS is on track to reach 3 percent average real growth in 2016. Antigua and St. Lucia may be more exposed in terms of variations in tourism receipts, remittances, trade flows and FDI, but other domestic developments could help balance the Brexit effect.

International interest rates may remain low in the short to medium term. While a more gradual increase of international interest rates could be expected after Brexit, the OECS countries are less connected to international capital markets. Few islands in the OECS have a credit rating. [3] They tend to have limited access to capital markets. Sovereign bonds trade in the smaller regional market and governments tend to finance their deficits domestically. The increased uncertainty in the international market would keep investor demand low.

[3] Only St. Vincent and the Grenadines has an international credit rating. While two islands, Dominica and St. Lucia have regional credit ratings.

Growth is recovering in the OECS

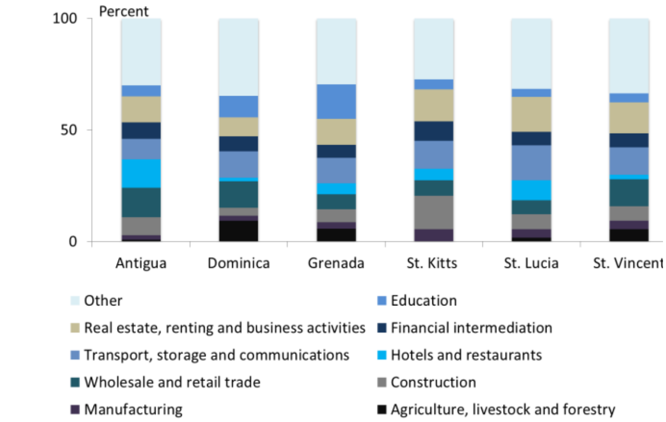
Figure 1: Real GDP Growth



Source: World Economic Outlook, April 2016

…with tourism, construction, and agriculture leading the way.

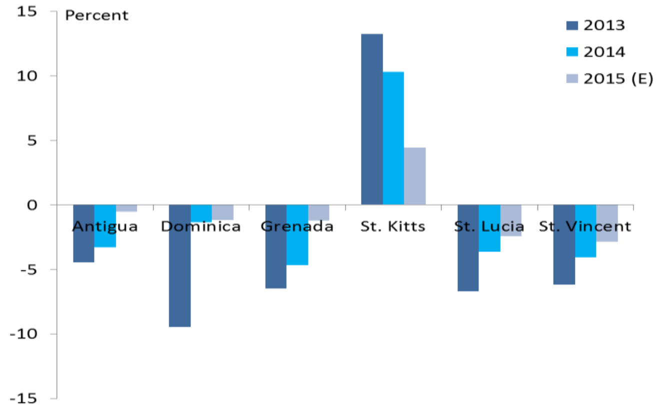
Figure 2: Contribution to GDP, 2015



Source: ECCB

Fiscal deficits are declining…

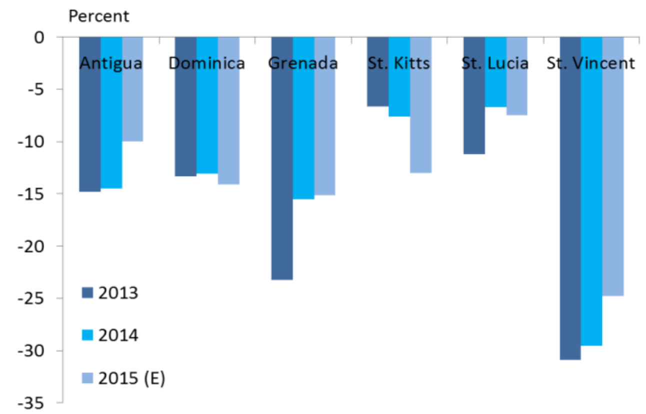
Figure 3: Fiscal Deficit (% of GDP)



Source: ECCB

... current account deficits remain high…

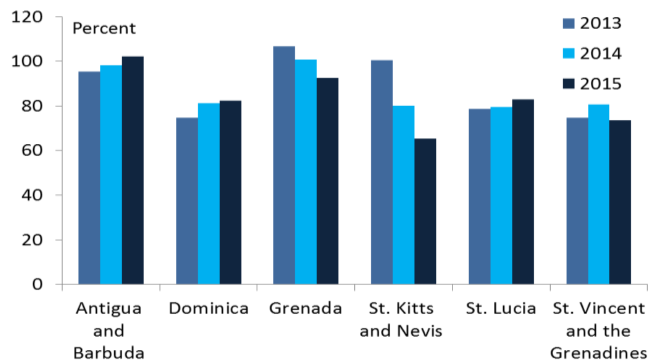
Figure 4: Current Account Balance (% of GDP)



Source: World Economic Outlook, April 2016

…and debt continues to accumulate…

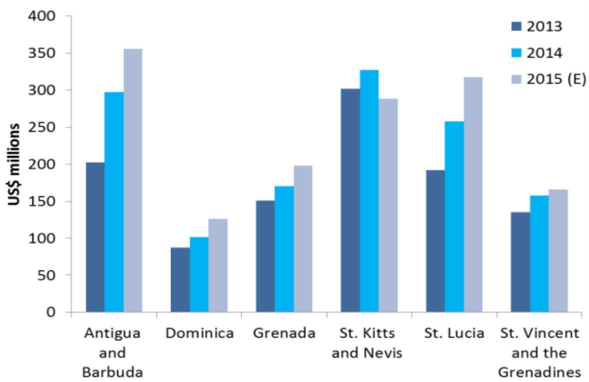
Figure 5: Central Government Debt (% of GDP)



Source: World Economic Outlook, April 2016

…but reserves have improved over time.

Figure 6: Gross International Reserves (US$ millions)



Source: ECCB and WDI

Selected Indicators

	Antigua and Barbuda				Dominica				Grenada			
	2012	2013	2014	2015 (E)	2012	2013	2014	2015 (E)	2012	2013	2014	2015 (E)
Real Sector												
Real GDP (% change)	3.6	1.5	4.2	2.2	(1.3)	0.6	3.9	(3.9)	(1.2)	2.4	5.7	4.6
Nominal GDP (% change)	6.6	(1.6)	5.3	3.1	(3.3)	4.4	3.4	(5.1)	2.8	5.3	8.2	4.6
Inflation (end of period)	1.8	1.1	1.3	0.9	1.2	(0.4)	0.5	(0.1)	1.8	(1.2)	(0.6)	(1.2)
External Sector												
Exports of goods and services (% change)	(0.2)	-	(0.1)	2.3	(15.9)	14.1	3.3	9.2	(7.4)	(4.0)	15.3	5.3
Imports of goods and services (% change)	17.2	(7.5)	2.2	2.3	(5.0)	(1.2)	4.7	15.1	2.4	23.9	(0.4)	1.5
Current account (% of GDP)	(14.6)	(14.8)	(14.5)	(10.0)	(18.8)	(13.3)	(13.1)	(14.1)	(21.1)	(23.2)	(15.5)	(15.1)
International reserves (USD millions)	162.0	202.6	297.0	355.7	94.6	87.1	101.7	126.2	119.5	150.6	169.9	198.0
International reserves cover (months)	2.6	3.4	4.9	6.1	4.1	4.3	4.9	6.0	3.3	4.3	5.1	6.0
Public Sector												
Total revenue (% of GDP)	19.9	18.5	20.6	23.1	27.7	28.0	32.1	31.0	20.7	20.6	24.5	24.9
Current expenditure (% of GDP)	20.6	21.6	21.8	20.5	24.1	25.8	24.8	26.3	21.2	20.3	20.0	17.7
Capital expenditure (% of GDP)	0.6	1.3	1.7	1.5	12.9	11.7	8.6	5.9	5.0	6.8	9.2	8.5
Central government primary balance (% of GDP)	1.1	(2.4)	(0.2)	3.0	(7.6)	(7.4)	0.4	0.4	(2.1)	(3.4)	(1.2)	2.2
Central government overall balance (% of GDP)	(1.3)	(4.5)	(2.8)	0.1	(9.2)	(9.5)	(1.3)	(1.2)	(5.5)	(6.5)	(4.7)	(1.2)
Debt Indicators												
General government debt (% of GDP)	87.1	95.5	98.2	102.1	72.6	74.7	81.1	82.4	103.3	106.8	100.8	92.7

Notes:
(E) - denotes estimated figures
Source: Eastern Caribbean Central Bank; World Economic Outlook, April 2016

	St. Kitts and Nevis				St. Lucia				St. Vincent and the Grenadines			
	2012	**2013**	**2014**	**2015 (E)**	**2012**	**2013**	**2014**	**2015 (E)**	**2012**	**2013**	**2014**	**2015 (E)**
Real Sector												
Real GDP (% change)	(0.9)	6.2	6.1	5.0	(1.1)	0.1	0.5	1.6	1.3	2.3	(0.2)	1.6
Nominal GDP (% change)	0.5	7.6	8.2	5.1	1.6	1.8	5.2	0.8	2.5	4.0	1.2	3.8
Inflation (end of period)	0.1	1.0	(0.6)	(2.9)	5.0	(0.7)	3.7	(2.1)	1.0	-	0.1	(1.7)
External Sector												
Exports of goods and services (% change)	-	-	12.1	3.1	(3.9)	(0.7)	3.2	8.8	1.4	(1.1)	4.6	6.6
Imports of goods and services (% change)	(3.8)	7.7	17.8	6.8	(8.5)	(0.7)	2.4	13.2	7.1	6.6	1.3	12.0
Current account (% of GDP)	(9.8)	(6.6)	(7.6)	(13.0)	(13.5)	(11.2)	(6.7)	(7.5)	(27.6)	(30.9)	(29.6)	(24.8)
International reserves (USD millions)/1	263.5	302.0	327.3	288.4	232.0	192.2	257.7	317.5	111.0	135.1	157.4	166.0
International reserves cover (months)/1	8.4	9.4	9.4	8.2	3.4	3.1	4.4	5.3	3.2	3.9	4.6	5.0
Public Sector												
Total revenue (% of GDP)	42.6	46.3	42.5	37.9	23.7	24.5	25.3	26.1	27.0	26.9	28.1	27.3
Current expenditure (% of GDP)	27.7	26.4	26.6	26.6	23.3	23.5	23.3	22.9	26.1	25.2	25.8	25.2
Capital expenditure (% of GDP)	3.7	6.6	5.5	5.7	6.8	7.7	5.7	5.6	2.9	7.8	6.4	4.9
Central government primary balance (% of GDP)	17.2	17.1	13.7	6.3	(3.0)	(2.9)	0.2	1.4	0.3	(3.7)	(1.8)	(0.6)
Central government overall balance (% of GDP)	11.2	13.2	10.3	4.5	(6.5)	(6.7)	(3.6)	(2.4)	(2.1)	(6.2)	(4.1)	(2.8)
Debt Indicators												
General government debt (% of GDP)	137.4	100.4	80.2	65.5	73.7	78.6	79.7	83.0	72.0	74.7	80.6	73.6

Notes:
(E) - denotes estimated figures
Source: Eastern Caribbean Central Bank; World Economic Outlook, April 20166

The Caribbean Region Quarterly Bulletin was prepared by the Caribbean Economics Lab, Inter-American Development Bank.

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