International Monetary Fund

IMF Executive Board Concludes 2006 Regional Discussions with Eastern Caribbean Currency Union

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On January 17, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the 2006 Regional Discussions with the Eastern Caribbean Currency Union (ECCU).[1]

Background

Economic activity in the region is buoyant, despite high oil prices and the further erosion of European Union trade preferences. Growth is at its strongest rate in more than 15 years, at 5.6 percent in 2005, driven by tourism and construction ahead of the 2007 Cricket World Cup. Construction activity reflects significant expansions in hotel capacity—particularly in Antigua and Barbuda, and St. Lucia—grant-financed investments in cricket stadia, and supporting public infrastructure. The growth acceleration occurred despite high global oil prices—ECCU countries are among the world's most oil-import dependent economies—and further erosions of trade preferences that have impacted the economies with still large sugar and banana sectors. Inflation has picked up somewhat, reflecting the pass-through of global oil prices, but remains in the low single digits.

Despite the strong growth, there has been only a modest improvement in the overall fiscal and debt position. Tax revenues have strengthened with the uptick in economic activity, administrative efforts, and tax policy reforms—including the introduction of value-added taxes (VATs). Expenditure restraint has proven more difficult due to social priorities and enhanced public infrastructure ahead of the Cricket World Cup. As a result, public sector debt remains very high, averaging 107 percent of end-2005 GDP, despite restructuring in Dominica and Grenada and some debt relief in Antigua and Barbuda.

The fiscal benchmarks established by the Eastern Caribbean Central Bank's (ECCB) Monetary Council were modified in July 2006 with a focus on medium-term strategies to achieve the debt targets and increased emphasis on transparency. The target date for compliance has been moved from 2007 to 2020.

Monetary aggregates have been expanding rapidly, with a credit boom in the private sector. The financial system has been resilient, and progress continues to be made in strengthening financial sector supervision consistent with the 2004 Financial Sector Assessment Program recommendations. Capital markets have continued to develop, particularly the Regional Government Securities Market (RGSM) which has become a key regional market—all countries have at least one issue listed.

Stronger growth contributed to a widening of external current account deficits in 2005 and into 2006—to well over 20 percent of GDP—financed mostly by foreign direct investment and grants. Higher oil prices and construction activity spurred an increase in imports, while growth in travel receipts slowed due to one off-factors such as the impact of Hurricane Ivan in Grenada. Exports of agricultural products also declined as a result of preference erosion and hurricane damage. A dip in gross international reserves of the ECCB in 2005 was more than reversed by mid-2006, with the coverage of monetary demand liabilities at over 96 percent—well above the legally mandated floor of 60 percent.

The ECCU region joined the CARICOM Single Market (CSM) in June 2006. At the same time the framework for integration within the Organization of Eastern Caribbean States (OECS) is being revisited in the context of discussions on a revised OECS Economic Union Treaty.

Executive Board Assessment

Directors welcomed the resurgence in economic activity in recent years. They noted that the acceleration in growth had been driven by tourism, preparations for the Cricket World Cup and a pickup in private investment, and emphasized that the challenge will be to sustain the growth momentum in 2007 and beyond. While Directors considered that a soft landing can be achieved following the Cricket World Cup, they observed that the region continues to face significant obstacles, including elevated world energy prices, declining trade preferences, and a heavy public debt burden.

The quasi-currency board arrangement continues to serve the ECCU well. Directors observed that the exchange rate peg has fostered a long period of price stability and that the currency appears to remain competitive.

In light of the region's exchange rate peg, very high debt levels, vulnerability to natural disasters and other shocks, the key priority is to place fiscal positions on a sustainable path. Directors emphasized that it is critical that the present favorable cyclical circumstances be used to accelerate fiscal consolidation and to demonstrate a commitment to the new fiscal benchmarks through early and sustained reductions in debt ratios. In this context, they noted that fiscal pressures will intensify in the coming years as a result of population aging, and recommended prompt action to reform social security and public health systems. A few Directors noted their concern over the delay in the disbursement of donor grants to support adjustment to preference erosion and thereby help to smooth the transition process.

Directors welcomed the steps that have been taken to modernize tax systems throughout the region, and stressed the need for strengthened efforts to rationalize expenditure in order to ensure that the increased tax revenues translate into falling public debt ratios. They emphasized the importance of avoiding distortions in the tax system, including by strictly limiting exemptions to the VAT and by reining in tax concessions, which are costly and relatively ineffective in boosting investment. In this regard, a number of Directors considered that a regional approach to harmonizing and reducing tax concessions would help limit revenue losses and avoid counterproductive tax competition. They urged firm control over spending, including by limiting new expenditure commitments and by containing government wage bills in the context of civil service reforms.

Progress has been made in enhancing the regulatory framework for the banking system. Moving forward, Directors urged continued strengthening of the supervisory and regulatory framework for both banks and nonbanks, to contain emerging risks and to provide an environment that supports financial market development. They stressed the importance of ensuring the credibility of the new regulatory framework through effective enforcement, and of bolstering the supervision of the nonbank financial sector.

Further regulatory, administrative and legal reforms are needed to remove impediments to private business activity. In particular, Directors emphasized that liberalizing factor markets in the context of the Caribbean Single Market and Economy could play an important role in allowing the region to benefit more fully from globalization.

Directors stressed the importance of strengthening the quality, timeliness and dissemination of statistics, in support of more effective economic management and public transparency. While welcoming the greater use of public consultations on key issues, they observed that enhanced dissemination of relevant economic data will help foster social consensus for key policy decisions. Directors considered that CARTAC has played an effective role in assisting ECCU members and looked forward to continued donor support for technical assistance.

Eastern Caribbean Currency Union: Selected Economic Indicators

	2003	2004	2005	Proj. 2006	Proj. 2007

(Annual percentage change)					
Real sector 1/					
Real GDP	3.0	3.6	5.6	4.9	4.4
GDP deflator	1.2	2.1	2.5	2.3	2.9
Consumer prices, end of year	1.8	2.4	4.2	3.7	3.0
(In percent of GDP)					
Public finances 1/					
Central government overall balance	-5.6	-4.5	-3.8	-4.0	-2.3
Revenue and grants	29.4	29.0	30.1	31.1	29.7
Expenditure and net lending	34.9	33.5	33.9	35.1	32.0
Total public sector debt	113.5	117.1	106.6	104.5	99.7
(In percent of GDP, unless otherwise indicated)					
External sector					
Current account balance	-22.0	-16.4	-21.7	-22.9	-20.8
Trade balance	-38.0	-37.6	-40.0	-39.7	-38.7
Travel	27.5	28.7	26.2	25.8	26.5
Exports, f.o.b. (annual percentage change)	0.7	14.4	-7.6	4.6	4.4
Imports, f.o.b. (annual percentage change)	13.2	8.1	12.2	6.0	4.9
Stayover visitors (annual percentage change)	14.3	10.0	0.2	...	...
Terms of trade (12-month percentage change) 2/	0.0	0.2	-0.8	-0.1	-0.5
Real effective exchange rate (annual percentage change) 1/ 3/	-4.2	-3.6	-1.0	...	...
End-year gross foreign reserves of the ECCB					
In U.S. dollar million	539.9	632.4	600.8	651.7	711.3
In months of imports	4.4	4.7	4.0	4.1	4.3
In percent of broad money	19.8	20.5	17.9	17.7	17.6
External public debt (end-of-period)	69.2	69.7	57.9	56.4	53.8

	(Percentage change)			
Money and credit				
Net foreign assets 4/	8.7	6.8	1.4	0.3
				1.8
Net domestic assets 4/	0.8	6.4	7.1	9.5
				7.7
Broad money	9.5	13.2	8.4	9.8
				9.5

Sources: ECCU country authorities; and IMF staff estimates.

1/ Excludes Anguilla and Montserrat. ECCU aggregates are calculated as weighted averages of individual country data; ratios to GDP are then calculated by dividing this sum by the aggregated GDP of the region.

2/ Excludes Anguilla, Antigua and Barbuda, and Montserrat.

3/ End-of-period (depreciation -), 1990=100.

4/ In relation to broad money at the beginning of the period.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

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