INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/179

ST. LUCIA

June 2018

2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ST. LUCIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2017 Article IV consultation with St. Lucia, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Director as expressed during its June 13, 2018 consideration of the staff report that concluded the Article IV consultation with St. Lucia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 13, 2018, following discussions that ended on May 4, 2018 with the officials of St. Lucia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 31, 2018.
- An **Informational Annex** prepared by the IMF Staff.
- A Statement by the **Executive Director** for St. Lucia.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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June 20, 2018

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700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2018 Article IV Consultation with St. Lucia

On June 13, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with St. Lucia.

GDP growth reached 3 percent in 2017, sustained by robust activity in several sectors. Favorable external conditions, coupled with hotel expansions and the addition of new flights, generated a strong recovery in tourism, with **s**tay-over arrivals rising by 11 percent, the fastest growth in the Caribbean. Continued strong FDI and public investment supported activity in construction and other sectors, including wholesale and retail trade, but agriculture suffered the lingering effects of Hurricane Matthew. Backed by strong tourism inflows, the current account balance strengthened. Unemployment declined from 21.3 percent in 2016 to 20.2 percent in 2017, but youth unemployment remains high at 38.5 percent and labor force participation has fallen. Inflation turned positive again after two years of oil-price related deflation.

Based on preliminary data, the fiscal stance deteriorated slightly in FY2017/18, reflecting additional spending. As a result, the overall fiscal deficit and public debt continued to rise. To upgrade ailing infrastructure and reduce the high cost of servicing public debt, the authorities have secured concessional financing from a bilateral creditor, the terms of which are yet to be finalized. Banks continued to underperform while the non-bank sector expanded further. Nonperforming loans are still hovering at 12.5 percent of total loans, contributing to low profitability and contracting credit to the private sector since 2013. Credit unions continued their expansion, with assets growing respectively by 42 percent since 2014. Indigenous banks managed to maintain their corresponding bank relationships, although at higher costs.

The short-term outlook is favorable, but prospects beyond that are sobering. GDP growth is expected to remain buoyant in the near term, supported by large infrastructure investment, tourism-related FDI, and continued tourist inflows driven by the global recovery and increased capacity. Downside risks are prevalent. Over the medium term, growth will decline gradually as pipeline projects are completed. In the absence of corrective fiscal measures, public sector wage

[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.

negotiations and rising interest rates will add to expenditure pressures and government debt. Structural bottlenecks will continue to limit growth.

Executive Board Assessment[2]

Executive Directors welcomed St. Lucia's continued sustained growth and improved short-term outlook, supported by strong inflows of tourism and foreign direct investment. Directors noted, however, that there are significant risks, including those associated with rising public debt and recurrent natural disasters. They underlined the importance of fiscal consolidation and structural reforms to remove impediments to longer-term growth, enhance productivity, and reduce high production costs.

Directors noted that, while the rapid increase in infrastructure investment is necessary to address constraints to growth, the ensuing increase in public debt and the risks associated with its repayment heighten fiscal vulnerabilities. In this regard, they stressed the need for an adjustment aimed at attaining the ECCU debt target of 60 percent of GDP by 2030. The adjustment could focus on streamlining tax exemptions, controlling the government wage bill, and improving financing terms. Consideration of a fiscal rule, together with targeted social assistance, could support the fiscal effort while protecting the most vulnerable. Directors supported the authorities' plans to strengthen public financial management based on the Public Expenditure and Financial Accountability assessment, including revising the PFM Act and reviving the Public-Sector Investment Plan.

Noting the high exposure of St. Lucia's economy to climate change and natural disasters, Directors welcomed the Climate Change Policy Assessment pilot. They agreed that building resilience through appropriate mitigation and adaptation policies, which should be fully integrated in the macroeconomic framework, would enhance growth prospects and strengthen the fiscal position. They noted that donor support, primarily through grants, as well as private investment, would be important to assist these efforts.

Directors noted that, despite some progress, indigenous banks remain weighed down by non-performing loans, low profitability, and low capitalization relative to regional peers. They recommended a swift completion of new legislation on foreclosure and insolvency, as well as the operationalization of the Eastern Caribbean Asset Management Company. They concurred that the rapid growth of credit unions and microfinance companies calls for stronger supervision and regulation of these entities. Directors also underscored the importance of strengthening the AML/CFT regime, reinforcing due diligence procedures under the Citizenship-by-Investment program, and addressing gaps in compliance with international tax rules.

Directors agreed that comprehensive structural reforms would improve growth prospects and reduce external vulnerability. Addressing high structural unemployment requires enhancing education and professional training while attenuating labor market rigidities. Reducing other costs of doing business, including of energy and international trade, is necessary to improve

[2] 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. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

competitiveness. Strengthening tourism's backward linkages and developing sectors where scale economies are less important would help diversify the economy.

It is expected that the next Article IV consultation with St. Lucia will be held on the standard 12-month cycle.

St. Lucia: Selected Economic and Financial Indicators 2014–19						
				Est.	Projections	
	2014	2015	2016	2017	2018	2019
Output and prices (percent change)						
Real GDP (at market prices)	3.6	-0.9	3.4	3.0	3.5	3.7
Real GDP (at factor cost)	0.5	1.8	1.7	2.5	3.2	3.7
Consumer prices, end of period	3.7	-2.6	-3.0	2.2	1.4	1.5
Central government (percent of GDP) 1/						
Revenue	23.3	23.6	24.3	24.3	24.9	24.8
Expenditure	26.7	26.3	26.0	27.1	28.8	29.9
Primary balance	0.2	0.8	1.8	0.6	-0.4	-1.5
Overall balance	-3.4	-2.8	-1.7	-2.8	-3.9	-5.1
Money and credit (percent change)						
Broad money (M2)	1.2	5.8	2.3	0.2	4.8	5.3
Credit to private sector (real)	-9.9	-5.8	-4.8	-2.0	-1.5	-1.6
Credit to private sector (nominal)	-6.7	-6.8	-7.8	-1.9	0.0	0.0
Balance of payments (percent of GDP)						
Current account balance, *o/w:*	3.4	6.9	-1.9	1.3	-1.5	-2.5
Exports of goods and services	65.0	64.1	59.4	63.6	62.9	62.8
Imports of goods and services	-55.9	-51.3	-54.5	-55.8	-58.1	-59.1
Capital and financial account balance	1.3	-2.3	2.8	0.7	3.6	1.2
FDI	1.3	4.6	7.1	8.4	10.1	7.2
Capital grants	1.4	0.9	0.5	0.9	1.5	1.5
Other (incl. errors and omissions)	-1.4	-7.8	-4.8	-8.6	-8.0	-7.5
Overall balance	-0.4	-0.9	-1.7	0.0	0.0	0.0
Memorandum items:						
Nominal GDP (EC$ millions)	4,095	4,381	4,436	4,553	4,771	5,024
Net imputed international reserves						
Months of imports of goods and services	3.3	4.3	3.9	3.8	3.9	4.1
Percentage of demand liabilities	89.2	91.4	90.7	91.1	91.4	91.6
Central government debt stock ($EC millions)	2,946	2,980	3,091	3,258	3,488	3,789
(In percent of GDP)	70.7	67.8	69.2	70.7	72.2	74.6

Sources: St. Lucia authorities; ECCB; and Fund staff estimates and projections.

1/ Fiscal year (April–March) basis.

INTERNATIONAL MONETARY FUND

ST. LUCIA

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

May 31, 2018

KEY ISSUES

Context. Robust growth is supported by strong tourism, FDI inflows, and infrastructure investment, but the medium-term outlook presents significant challenges. Reflecting increased spending, the fiscal position has weakened, and public debt remains well above the ECCU target and continues to rise. The financial sector continues to be impaired by high nonperforming loans, and structural bottlenecks, including high costs of energy, limit growth prospects

Reaching fiscal sustainability and resilience to climate change. Attaining the ECCU debt target requires an ambitious fiscal effort, possibly supported by a fiscal rule. Appropriate mitigation and adaptation policies, described in the Climate Change Policy Assessment (CCPA) pilot, will help build resilience to natural disasters and generate a growth dividend that would contribute to fiscal consolidation.

Financial recovery and strengthening. Prompt action is needed to remove remaining obstacles to the resolution of bank non-performing loans (NPLs). Rapid growth of the non-bank financial sector calls for strengthened regulation and supervision.

Boosting sustainable growth, diversifying the economy, and reducing structural unemployment. Reforms are needed to address tourism infrastructure and linkages to the rest of the economy, labor market weaknesses, renewable energies, and the business climate.

Approved By
Krishna Srinivasan (WHD) and Mary Goodman (SPR)

Discussions for the 2018 consultation took place in Castries on April 23 - May 4, 2018. The team comprised Messrs. Bonato (head), Salinas, Vargas (all WHD), Ms. Sola (SEC), and Ms. Wickham (local IMF economist). Messrs. Srinivasan (WHD) and Williams (OED) joined the final policy discussions. The mission met with the Honorable Prime Minister Chastanet, the Honorable Minister in the Department of Finance Raymond, Director of Finance Thomas and other senior government officials, representatives of the opposition, the private sector, and labor unions. Ms. Tibung and Ms. El Kawkabi and Messrs. Brito and Vasquez assisted in the preparation of the staff report.

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RECENT DEVELOPMENTS AND OUTLOOK

A. Context

1. St. Lucia faces challenges common to many small states. Its economy has become increasingly dependent on tourism after the erosion of EU trade preferences led to downsizing banana production in the 1990s. Its narrow economic base, shallow financial system, and almost complete reliance on imported fossil fuel make it particularly vulnerable to external shocks while low productivity, weak institutional capacity, and natural disasters limit its growth potential. Tourism is limited by capacity constraints, including an inadequate road network and an outdated international airport. The Global Financial Crisis (GFC) dealt a severe blow to the economy, reflected in a protracted period of low or negative growth, rising public debt as the government increased the size of the public sector partly to cushion the impact of the crisis, and banks still dealing with legacy NPLs.

2. A particularly important vulnerability arises from the consequences of climate change. As underscored in the CCPA pilot, St. Lucia is one of the countries most exposed to natural disasters, with average annual damages exceeding 1 percent of GDP. More frequent and severe natural disasters would substantially harm long-term growth and fiscal sustainability. In a high CO_2 emissions scenario, the average impact of natural disasters would increase from 3½ percent of GDP or more to at least 5 percent of GDP.[1] Tax revenues would be negatively affected, and additional expenditure would be needed for immediate relief, social support, infrastructure rehabilitation, and reconstruction.

3. The authorities are taking measures to address these challenges. The government is trying to boost growth and restore fiscal sustainability by enhancing the potential of tourism with stronger marketing and new international hotel operators; reducing some taxes (VAT) while increasing others that the authorities deem more growth friendly (aviation taxes, road fuel tax); fostering revenues through the Citizenship-by-Investment Program (CIP); and improving the efficiency of the public sector. St. Lucia is a regional leader in climate change preparedness, with a balanced mitigation strategy backed by investment plans that have been costed, and a qualitative adaptation strategy with identified priorities. Staff advice has had some traction (Annex I).

B. Current Trends

4. Economic activity remained strong. Real GDP grew by 3 percent in 2017, driven by tourism, construction, and wholesale and retail trade (Figure 1). Stay-over arrivals grew by 11 percent, the fastest in the Caribbean, while the cruise ship segment rebounded from its decline in 2016. Several hotel expansions increased the room stock by about 10 percent and the addition of new flights increased airlift capacity by 5 percent. Conversely, agriculture experienced a contraction owing to the lingering effects of tropical storm Matthew. Backed by strong tourism inflows, the

[1] According to staff simulations in the CCPA pilot for St. Lucia (SM/18/131), based on the Representative Concentration Pathways scenario RCP8.5 of the 2014 report of the Intergovernmental Panel on Climate Change.

current account balance moved from a deficit of 1.9 percent of GDP in 2016 to an estimated surplus of 1.3 percent of GDP in 2017. Unemployment declined from 21.3 percent in 2016 to 20.2 percent in 2017, but youth unemployment remains high at 38.5 percent and labor force participation has fallen (Figure 5, Table 6). Inflation turned positive again after two years of oil-price related deflation.

5. Based on preliminary data, the fiscal stance deteriorated slightly in FY2017/18, reflecting additional spending. The primary surplus declined, owing to increases in current and capital spending that were only partially offset by higher revenues from airport taxes, road fuel tax, and CIP.[2] As a result, the overall fiscal deficit and public debt continued to rise. The authorities have raised fuel prices, which were capped and limited revenues, and outlined intentions that would help strengthen the fiscal position, including that of a new residency program and tax reforms, but no policy decisions have been taken yet. A system of targeted social assistance, expected to be in place by year end, should help protect low-income households when some of the measures are enacted. The authorities have secured concessional financing from Taiwan, Province of China, the terms of which are yet to be finalized, aimed at revamping the airport (US$100 million) and the road network (US$50 million).[3]

St. Lucia: Banking Sector Soundness Indicators' Map 1/ 2/

St. Lucia	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4
Overall Banking Sector Rating	M	M	M	M	M	L	L	M	L	L	L	M	M	M	L	L
Credit cycle	L	L	L	L	L	L	L	L	L	L	L	L	L	L	L	L
Change in credit / GDP ratio (pp, annual)	(3.1)	(2.6)	(8.3)	(11.0)	(14.5)	(17.1)	(13.8)	(9.9)	(5.4)	(4.4)	(3.6)	(7.4)	(8.6)	(6.7)	(6.7)	(3.1)
Growth of credit / GDP (%, annual)	(3.0)	(2.5)	(8.0)	(10.9)	(14.5)	(17.2)	(14.5)	(11.0)	(6.2)	(5.4)	(4.4)	(9.3)	(10.7)	(8.6)	(8.6)	(4.2)
Balance Sheet Soundness	M	M	M	M	M	L	L	M	L	L	L	M	M	M	L	L
Balance Sheet Structural Risk	L	L	L	L	L	L	L	L	L	L	L	L	L	L	L	L
Deposit-to-loan ratio	87.3	86.7	87.7	91.7	97.7	102.3	102.6	103.6	107.2	111.3	108.7	110.9	121.0	121.0	117.5	119.8
FX liabilities % (of total liabilities)	17.0	19.1	18.8	17.6	17.7	16.1	16.6	16.5	16.3	16.0	15.7	15.2	15.8	15.9	14.6	14.7
FX loans % (of total loans)	16.2	15.6	14.7	13.4	13.2	10.7	10.3	10.5	10.3	9.8	9.9	10.1	10.1	9.7	9.8	10.0
Balance Sheet Buffers	H	H	M	M	M	L	L	M	L	L	L	M	M	M	L	L
Leverage	M	M	M	M	M	M	M	M	M	M	M	M	M	M	M	M
Leverage ratio (%)	4.7	4.0	4.1	3.8	3.6	3.7	3.9	3.5	3.6	3.5	4.1	3.4	3.9	4.5	4.8	5.0
Profitability	H	H	H	H	H	L	L	L	L	L	L	H	H	H	L	L
ROA	(0.0)	(0.5)	(0.4)	(0.1)	(0.2)	0.3	0.3	0.3	0.6	0.8	0.5	(0.3)	(0.2)	(0.2)	0.2	1.2
ROE	(0.8)	(10.5)	(9.2)	(1.5)	(5.9)	7.0	6.7	8.9	17.0	22.4	12.7	(7.0)	(4.3)	(4.3)	3.7	27.1
Asset quality	H	H	L	L	L	L	L	M	L	L	L	L	L	L	L	L
NPL ratio	20.9	20.6	19.6	17.6	18.7	18.9	18.8	18.2	18.1	16.9	16.4	13.1	13.2	13.3	14.1	12.5
NPL ratio change (%, annual)	15.3	17.2	(10.2)	(14.9)	(10.5)	(8.5)	(4.3)	3.6	(3.2)	(10.3)	(12.8)	(27.9)	(27.0)	(21.5)	(13.9)	(4.7)
Memo items 3/:																
Regulatory capital to risk-weighted assets (CAR)	14.9	13.8	14.3	13.3	13.4	13.4	13.8	12.9	13.4	12.0	14.0	11.8	15.5	17.2	17.6	18.2
Regulatory Tier 1 capital to risk-weighted assets	13.5	12.1	12.2	11.9	11.9	12.1	12.2	12.0	12.0	10.0	12.1	7.8	9.8	11.1	11.1	11.4

Source: ECCB and IMF staff calculations.

1/ Red, orange and green cells represent high, medium and low risks, respectively.

2/ The indicators do not reflect the forthcoming prudential regulations or the introduction of IFRS9 and thus the map can potentially understate the provisioning needs and related risks.

3/ Corresponds to indigenous banks only.

[2] The government increased the airport tax on non-CARICOM travel from US$25 to US$63 and introduced an airport development tax of US$35, effective January 2018. The airport tax was then reduced to US$53 in January 2018. The excise tax on gasoline and diesel for road use was increased by EC$1.5 per gallon, but its revenue impact was limited by the imposition of a ceiling on fuel prices at EC$12.75, which by March 12, 2018 restricted the tax increase to EC$0.7 per gallon for gasoline and to EC$1.1 per gallon for diesel.

[3] Public debt will increase only by the amount of the road network loan. The airport loan will be contracted by SLASPA (the port and airport authority), a non-financial public corporation, and repaid with the proceeds of the Airport Development Tax of US$35 per departing visitor levied as of January 1st, 2018. The road network loan will be contracted by a private non-resident Special Purpose Vehicle, which the government will repay with part of the proceeds of the road fuel tax. As the owner of the road network, the central government will be ultimately responsible for this obligation.

6. Banks continued to underperform while the non-bank sector expanded further. NPLs are still hovering at 12.5 percent of total loans, contributing to low profitability and contracting credit to the private sector since 2013 (Figure 2). The Eastern Caribbean Asset Management Company (ECAMC), which is part of the regional strategy to help banks clean their balance sheet, started operating last year, but faces capacity challenges. New insolvency and foreclosure laws, which would help simplify the resolution of NPLs, are still under preparation. Indigenous banks managed to maintain their corresponding bank relationships (CBRs), although at higher costs. Credit unions continued their expansion, with assets and membership growing respectively by 42 and 20 percent since 2014. Total assets of credit unions represented about 15 percent of total assets of banks in 2017.

C. Outlook and Risks

7. The short-term outlook is favorable, but prospects beyond that are sobering. GDP growth is expected to remain buoyant in the near term, supported by large infrastructure investment, tourism-related FDI, and continued tourist inflows driven by the global recovery and increased capacity**.** However, weaknesses in the banking sector will continue to be a drag on growth. Reflecting the increase in capital spending, the fiscal and external positions will deteriorate. Over the medium term, growth will decline gradually as pipeline projects are completed, and the current account deficit will narrow. In the absence of corrective fiscal measures, public sector wage negotiations and rising interest rates will add to expenditure pressures and government debt.

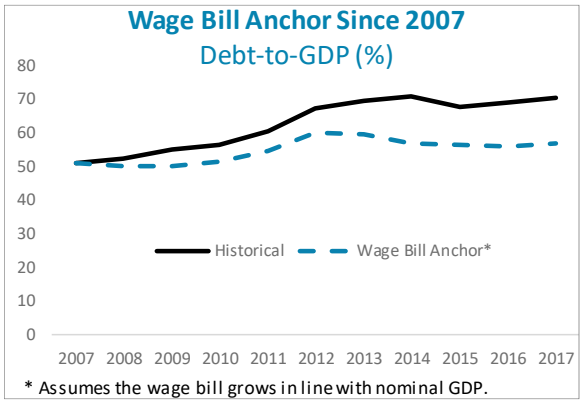
8. Downside risks dominate (Annex II). Policy uncertainty in major advanced economies and tighter global financing conditions could be a drag on global growth and tourism demand. Tax erosion may occur from concessions to tourism and other sectors and tax revenues earmarked for the repayment of infrastructure loans may fall short, further weakening the fiscal position and increasing the risk of an abrupt fiscal adjustment. Risks related to the assessment of compliance with international tax rules, slow progress in addressing bank weaknesses, and a growing non-bank financial sector could undermine financial stability and growth. Over the medium term, high production costs, low productivity, and a difficult business environment will continue to limit growth potential. The projected rise in the frequency and severity of natural disasters and the impact of climate change cast a shadow on long-term economic prospects.

9. The external position is broadly consistent with fundamentals and desirable policies. The very narrow base of the economy as well as a range of non-price indicators point to competitiveness challenges, with the main impediments stemming from a poor business environment and a large disconnect between wages and productivity (Annex III).

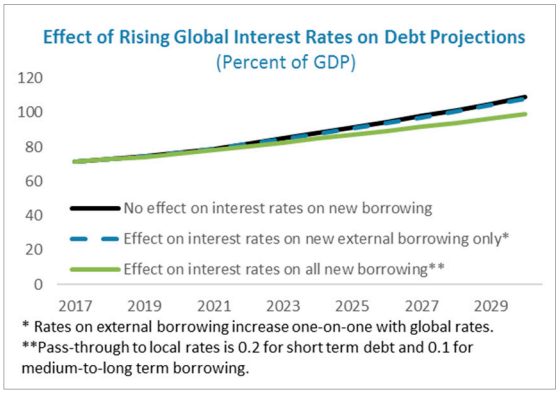
POLICY DISCUSSIONS

A. Attaining Fiscal Sustainability and Resilience to Climate Change and Natural Disasters

10. The deterioration of the fiscal position has its roots in the government's response to the GFC. An expansion of the public service payroll and wage rises in the middle of the crisis increased the wage bill by 2 percent of GDP from 2007 to 2012 (not including temporary work programs). Staff simulations indicate that, had the wage bill been anchored to nominal GDP, the debt target of 60 percent of GDP would have already been attained. A wage freeze in 2013-16 contained the wage bill, but further efforts are needed to fully reverse its previous expansion. Subsequent attempts to correct the fiscal imbalance have been too timid to stabilize debt.



11. In the absence of a correction, financing pressures will persist and public debt will continue to rise. Despite the recent GDP revision, which led to an improvement in the debt-to-GDP ratio, public debt remains high, with a large short-term component generating significant rollover risks.[4] Growing expenditure pressures —related to infrastructure investment, the upcoming negotiation of public employees' compensation, and rising interest rates— will add further to public debt, which is projected to reach 81.3 percent of GDP in 2023.[5] External debt is expected to increase to 74.9 percent of GDP over the same period (Annex IV). Some uncertainty in the projections relates to the degree of transmission of rising global interest rates to domestic rates, which staff assumes is partial based on empirical evidence (Annex V), and the authorities have not fully incorporated in their framework. Nonetheless, even in the absence of passthrough from international to domestic interest rates, the debt trajectory would remain unsustainable.



[4] GDP was revised in 2017 to include commercial property rental activities, introduce the 2008 SNA calculation of Financial Intermediation Services Indirectly Measured, and to better align the coverage in owner-occupied and rented dwelling with the results of the 2010 census. As a result, 2016 nominal GDP increased by 19 percent and the public debt ratio fell from 82 percent of GDP to 69.2 percent of GDP (on a fiscal year basis).

[5] Any wage increases would apply retroactively to the period 2016-18 and would likely take place in FY2019/20.

Central Government Cash Flows Under a Baseline Scenario 1/

(Millions of Eastern Caribbean dollars, fiscal years)

	2017	2018	2019	2020
Gross financing needs	1,091	1,049	1,206	1,081
Overall deficit	129	221	291	210
Debt repayments	962	828	915	871
External	554	355	458	455
Domestic	408	473	458	416
Gross financing sources	1,091	1,049	1,206	1,081
Debt issuance	1,091	1,049	1,206	1,081
External	618	465	603	560
Domestic	472	583	603	521
Use of deposits	0	0	0	0
Memo:				
Central government deposits	174	174	174	174

1/ Projections assume no asset transactions and that existing investors roll over maturing debt. Scenario assumes that there are no significant changes in fiscal policy in the future.

12. Building resilience to climate change and natural disasters could help strengthen the fiscal position and reduce macroeconomic volatility. Given the fiscal costs associated with these events, climate change mitigation and adaptation policies, discussed in in the CCPA pilot (SM/18/131), are a key component of a medium-term fiscal strategy. Appropriate plans could help unlock concessional climate finance and undertake the necessary investment in resilience.[6] Particularly important, in this regard, is the costing of investment plans in the now completed National Adaptation Plan. The development of renewable energy sources will be crucial to attain the authorities' emission target under the Paris accord, lower exposure to oil price fluctuations, and reduce high electricity costs. Together with strong fiscal buffers, these policies can have a growth dividend, which would help in the fiscal adjustment effort.[7]

13. A fiscal adjustment of 2.7 percent of GDP is needed to attain the ECCU debt target of 60 percent of GDP by 2030. The adjustment would be implemented over the next six years to accommodate additional spending for resilience building and the gradual implementation of some revenue and expenditure measures. This approach balances the need to address short-term financing risks and attain the regional debt target with the objective of building resilience to climate change and natural disasters (Figure 3). Elements of such an adjustment include:

[6] Access to concessional climate financing is limited by the lack of defined plans on climate change adaptation, the unsustainable fiscal stance, and institutional capacity, which is a challenge in most small island developing states.

[7] Staff estimates that, in a scenario where the CCPA policies were implemented, GDP growth could be permanently higher by 0.3 percent reflecting the impact of adequate fiscal buffers and resilient infrastructure (Annex VI). The adjustment scenario assumes that this change occurs gradually as resilient infrastructure is built. An additional 0.3 percent would come from the temporary impact on demand of investment in climate change adaptation of 0.5 percent of GDP.

Staff Recommended Adjustment Scenarios 1/

	2018	2019	2020	2021	2022	2023	2030
	(in percent of GDP)						
Baseline (no policy adjustment) scenario:							
Real GDP growth	3.5	3.7	3.1	2.2	1.6	1.5	1.5
Grant revenue	1.4	1.4	1.4	1.4	1.4	1.4	1.4
Interest payments	3.6	3.6	3.8	4.0	4.2	4.3	5.4
Capital expenditure	5.7	6.3	4.6	4.6	4.6	4.6	4.6
Primary balance	-1.0	-2.1	-0.2	-0.1	0.0	-0.1	-0.1
Public sector debt	72.2	74.6	75.5	77.2	79.2	81.3	96.6
Adjustment scenario:							
Real GDP growth 2/	3.8	4.0	3.5	2.6	1.9	1.9	1.7
Grant revenue	1.4	1.9	1.9	1.9	1.9	1.9	1.4
Interest payments	3.6	3.6	3.7	3.9	4.0	3.9	3.6
Capital expenditure	5.7	6.8	5.1	5.1	5.1	5.1	4.6
Primary balance	-1.1	-1.5	0.6	1.7	2.7	2.7	2.9
Public sector debt	72.2	73.6	73.4	72.9	71.7	70.5	60.0
Adjustment measures	**0.0**	**0.6**	**0.8**	**1.7**	**2.6**	**2.7**	**...**
of which:							
Non-interest expenditure items	**-1.1**	**-0.9**	**-0.8**	**0.1**	**0.9**	**0.9**	**...**
Compensation items	0.5	0.8	1.0	1.2	1.2	1.2	...
Social benefits 3/	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	...
Natural disasters fund (transfer to)	-1.4	-1.5	-1.6	-0.9	0.0	0.0	...
Phase out temporary work programs	0.3	0.3	0.3	0.3	0.3	0.3	...
Revenue items	**1.1**	**1.5**	**1.6**	**1.6**	**1.7**	**1.8**	**...**
Broader VAT base	0.3	0.6	0.6	0.6	0.6	0.6	...
CCPA-recommended carbon tax	0.6	0.7	0.8	0.8	0.9	0.9	...
Eliminate non-targeted LPG subsidy	0.2	0.2	0.2	0.2	0.2	0.2	...
Memo Item							
Natural Disasters Fund	1.4	2.8	4.3	5.0	5.0	5.0	5.0
Financing Sources:	1.4	1.5	1.6	0.5	...	...	...
CIP	0.6	0.6	0.6	0.2	...	...	...
CCPA-recommended carbon tax	0.6	0.7	0.8	0.3	...	...	...
Eliminate non-targeted LPG subsidy	0.2	0.2	0.2	0.1	...	...	...

Source: IMF staff calculations

1/ Under the baseline scenario, the government faces an annualized natural disaster cost of 1 percent of GDP, of which 0.66 percent is not covered by insurance. In the adjustment scenario, a saving fund of 5 percent of GDP is built in 2018-2020, with annual replenishment costs of 0.56 percent of GDP.

2/ Higher GDP growth resulting from the temporary impact of adaptation investment on aggregate demand and the permanent impact of the savings fund and resilient capital. See footnote 12.

3/ Including 10 percent of carbon tax revenue to offset negative impact on bottom quintile.

- Reducing the wage bill closer to its pre-crisis level by anchoring it to CPI inflation during the adjustment period. This could be done through a combination of general wage control (using fiscal health parameters in wage negotiations), introduction of performance-based pay, attrition, payroll audits, and private sector participation in the provision of public services (1.2 percent). Once the adjustment is completed, the wage bill could be anchored to nominal GDP (see ¶14).

- Streamlining exemptions to VAT and zero-rated items to reverse the impact of the recent rate cut (0.6 percent).[8]

- Eliminating energy subsidies, allowing fuel prices to move in line with international prices, and introducing a carbon tax to help attain the emission target and speed up the shift to renewable energies (1.1 percent).

- Phasing out temporary work programs (0.3 percent) while increasing targeted social spending, including to protect low-income households from the impact of the carbon tax (-0.5 percent) in an efficient and cost-effective manner.

[8] Priorities include exemptions on transportation, residential property sales, betting and gaming, and zero-rating on foodstuff and fuel.

- Building a saving fund for natural disasters of 5 percent of GDP by 2021, financed by CIP revenues, carbon taxation, with a governance framework based on international best practices.[9]
- Increasing investment in resilience to climate change and natural disasters.[10]

Higher growth in the adjustment scenario will come from both temporary and permanent effects of additional investment in resilience and the saving fund.[11] Other revenue enhancing measures could be considered, including streamlining of other tax exemptions, or the introduction of other taxes with economic or social rationale, such as sin taxes, which are being considered by other countries in the region given the high prevalence of non-communicable disease.

14. Adopting a fiscal rule would support the adjustment effort, as it did in other ECCU countries. Enshrined in a fiscal responsibility legislation, the fiscal rule would define appropriate institutional arrangements; the coverage of government and fiscal aggregates, with due consideration for capital spending; implementation procedures —including links with the budget process and escape clauses—; automatic correction mechanisms; and sanctions and supporting mechanisms for enhanced fiscal transparency and accountability. The fiscal rule could be based on the ECCU debt target for 2030, and include a cap on the wage bill (in percent of GDP). Such cap has proved useful as a coordination device for public wage negotiations in Grenada. The fiscal rule should accommodate the buildup of a natural disaster fund and its annual replenishment (estimated at 0.6 percent of GDP) and include specific clauses linking disbursements from the fund to natural disasters.

15. Continued efforts in enhancing PFM and public investment management are needed to underpin fiscal consolidation and resilience building while a rationalization of tax incentives will reduce fiscal risks. The 2017 PEFA report shows progress in several areas, reflecting also TA support from CARTAC. Several weaknesses, however, remain in budget implementation, dissemination of fiscal planning documents, financial information on the large parastatal sector, public procurement, payroll, and other payment controls. Key measures recommended in the PEFA action plan include revising the Public Enterprise Monitoring (PEM) Act and the PFM Act to expand coverage of parastatals, clearing the backlog and improving annual financial statements of public institutions, and strengthening procurement planning, operations, and transparency. Resuming the

[9] Staff estimates that a savings fund of 8 percent of GDP, replenished on a rolling basis, would be sufficient to cover fiscal costs of natural disasters without incurring additional debt with 95-percent probability (SM/18/131). This estimate does not consider the insurance coverage already provided by the Caribbean Catastrophe Insurance Facility (CCRIF) and private insurance, which can be approximated at some 3 percent of GDP.

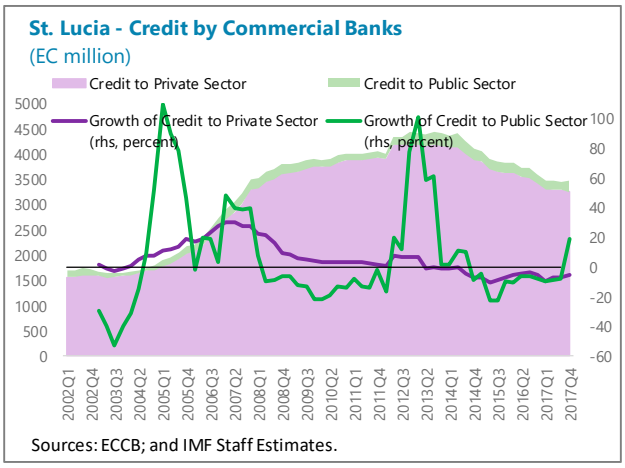
[10] The additional investment (0.5 percent of GDP) would be financed by grants from climate funds that the implementation of the CCPA recommendations would help unlock by establishing a comprehensive plan to effectively address climate change. Concessional funds would also be more readily available following the implementation of an adjustment program that strengthens fiscal sustainability.

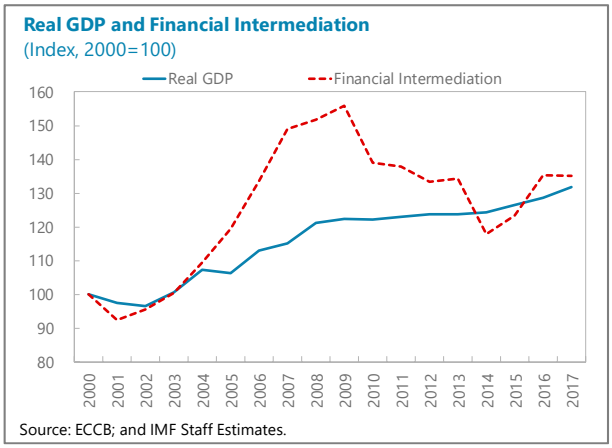
[11] See footnote 7. Fiscal multipliers are negligible in small island economies with high imports and high public debt. Empirical estimates for the ECCU find that only public investment has a multiplier (0.6) different than zero (Gonzalez-Garcia, Lemus and Mrkaic "Fiscal Multipliers in the ECCU", IMF WP/13/117).

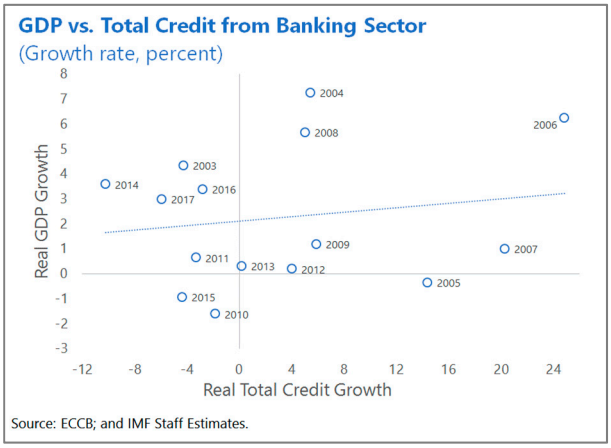
public-sector investment plan (PSIP) and strategies to strengthen appraisal and monitoring would ensure effective implementation.[12] Increased transparency on tax expenditures is particularly important to ascertain their real costs and prioritize their use against other government programs, and comprehensive budgeting for these items should be introduced and published regularly. Rationalizing the structure of tax incentives and introducing a rules-based approach to minimize discretion would reduce the risk of base erosion.

B. Strengthening the Financial Sector

16. Progress in lifting obstacles to bank lending remains slow. NPLs have been gradually declining as banks made efforts to remove bad assets from their balance sheets. However, they remain high, reducing banks' ability and willingness to lend to the private sector. Some progress has been made on new insolvency and foreclosure laws, albeit at slow pace. Capitalization levels are low relative to the rest of the region, and the upcoming implementation of prudential regulations and introduction of IFRS9 could require some banks to increase their capital to reach the regulatory minimum. The implementation of a regional credit bureau is advancing, even though the adoption of the Harmonized Credit Reporting Act is still pending.







[12] An assessment of public investment management systems is included in the CCPA (SM/18/131).

St. Lucia vs. ECCU Financial Soundness Indicators (2013-2017)						
		2013	2014	2015	2016	2017
Non-Performing Loans/Total Loans	LCA	20.6	17.6	18.2	13.1	12.5
	ECCU	18.1	17.6	16.8	10.9	12.0
Provisions for Loan Losses/Non-Performing Loans	LCA	42.5	45.1	48.2	53.6	57.6
	ECCU	38.5	46.8	44.2	45.6	45.7
Liquid Assets/Current Liabilities	LCA	22.6	28.1	34.2	35.4	38.5
	ECCU	29.5	33.1	36.5	37.5	39.7
Tier 1 Capital/Risk Weighted Assets-a/	LCA	12.8	11.9	12.0	7.8	11.4
	ECCU	13.0	10.8	14.7	17.0	17.9
Return on Avg Equity	LCA	-2.3	-1.5	8.9	-7.0	27.1
	ECCU	-1.9	4.0	20.3	14.6	11.9
Return on Avg Assets	LCA	-0.1	-0.1	0.3	-0.3	1.2
	ECCU	-0.1	0.2	0.8	0.8	0.7

a/ Corresponds to indigenous banks only.
Source: Eastern Caribbean Central Bank.

17. The ECAMC needs additional resources and a strong commitment by stakeholders to become fully operational. While the ECAMC, which started operating in mid-2017, has showed capacity to act as a receiver for failed banks, its ability to purchase and/or manage NPLs from regional banks is limited.

18. Financial stability risks may arise from credit unions, where potential difficulties stemming from the rapid increase in lending could affect banks via deposits held by credit unions in the banking system. The expansion of credit unions might be driven by tighter bank credit standards, favorable taxation, and a looser regulatory environment, highlighting the need for a stronger regulatory and supervisory framework. To monitor these risks more closely, the Financial Services Regulatory Authority has implemented risk-based supervision and intensified onsite inspections, but new harmonized legislation on credit unions has not been adopted yet.

19. While the loss of CBRs has been limited for indigenous banks, costs have increased significantly. The loss of CBRs has been confined to money service businesses and the offshore sector, with apparently limited impact on the economy and the financial sector.[13] Indigenous banks have preserved their CBRs, but are actively looking for new ones to minimize risks in a context characterized by uncertainty and heightened pressure from correspondent banks. Fees for most operations have increased substantially in the last two years (from 50 to 100 percent in some cases), but banks have not passed on the additional cost to customers yet. Banks also reported additional

[13] The number of application for new licenses has declined in these sectors, reflecting also more stringent regulatory requirements.

allocation of resources to address AML/CFT requirements and rising cyber security risks. The needed legislative changes to transfer AML/CFT supervisory powers to the ECCB are still pending.

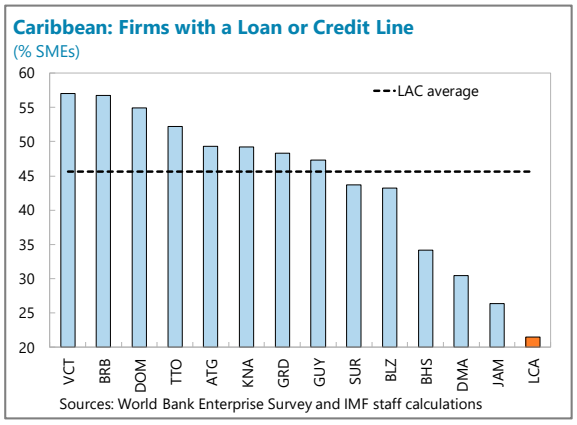
20. Reputational risks arise from the CIP and the international taxation regime. After the changes to the CIP introduced in 2017 (IMF Country Report No. 17/76, Box 3), interest for the program has gradually increased while these programs are under increased international scrutiny for the integrity of the screening process and regional competition has eroded revenues in other countries. St. Lucia has been included by the EU in a "grey list", which comprises jurisdictions that are not in line with EU standards against tax avoidance, but have committed to adjust their rules and practices.

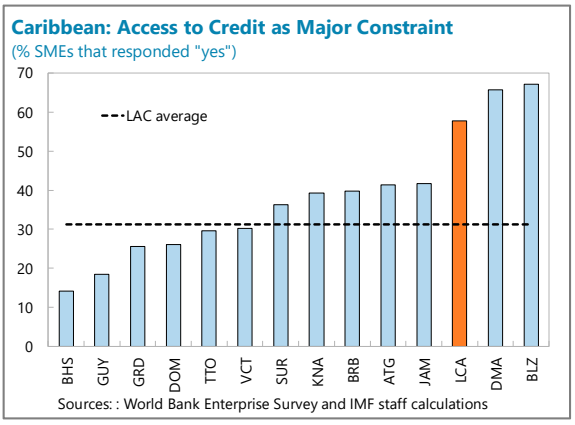
C. Removing Structural Obstacles to Growth

21. Limited access to credit, weak contract enforcement, and high electricity and trading costs remain significant bottlenecks. Owing to these factors, St. Lucia's ranking in the World Bank's Doing Business, has deteriorated steadily in recent years (Figure 4). Several measures, including the establishment of a commercial court, e-payment for government services, and an online application system for trade licenses have been implemented, but their expected positive economic effects will take time to materialize. The authorities are preparing a national competitiveness strategy in cooperation with Compete Caribbean, which will entail the inclusion of St. Lucia in the World Economic Forum competitiveness indicator. Lower electricity prices will be possible only when a significant portion of renewable sources comes on stream, but removing the existing cap for solar energy production could help reduce business costs in the interim. To further reduce operational costs, lower import duties for raw material could be considered. Reforms to institute a credit bureau and broaden the range of assets to be used as collateral, together with an appropriately-regulated non-bank financial sector, should help improve access to credit.[14]

22. Labor market and education system reforms are critical to reduce unemployment particularly among the youth. High structural unemployment, relatively high wages, and a disconnect between productivity and wages reflect a poorly functioning labor market and weigh on external competitiveness (Annex IV and Figure 5). Continued revisions to the labor code are necessary to help alleviate some of these rigidities, including a reform of the lengthy and costly redundancy procedures and generous leave practices. Targeted initiatives are also necessary to address high youth unemployment, including by upgrading skills through targeted training programs, promoting apprenticeships, encouraging entrepreneurship, and better aligning the education system with labor market needs.

[14] Li and Wong, "Financial Development and Inclusion in the Caribbean", IMF WP/18/53, based on the 2010 World Bank Enterprise Survey for St. Lucia, identifies this country as one with the weakest *access to credit* indicators in the region.





23. Expanding the narrow production and export base could help provide buffers against fluctuations caused by external shocks and the seasonal nature of tourism. Backward linkages of tourism, particularly in agriculture, should be strengthened. The authorities' export strategy identifies activities that can increase diversification and exports, which include industries where economies of scale are less important, like business processing, ICT, creative industries, and spa and wellness. The establishment of OJO Labs—the Caribbean's first Artificial Intelligence Contact Centre — should encourage further investment in outsourcing. Business incubators should be further used to promote entrepreneurship. In some industries, like agro-processing, greater access to regional markets will be key.

D. The Authorities' Position

24. The authorities recognized that reaching the ECCU debt target requires corrective measures, which they were considering. The authorities were contemplating revenue-enhancing measures, including streamlining exemptions to VAT, a property tax reform, a reform of taxation of hotel stays, and a new residency program. Some of these measures would be implemented after a new system of targeted social assistance is in place by year end. On spending, the authorities confirmed that continued wage moderation in the public sector is essential. They were considering savings from privatizations, outsourcing of the largest public hospital, closure of some state-owned enterprises, modernization of government services, and pension reform for public employees not covered by the National Insurance Corporation. Their debt management strategy was focused on lengthening maturity and reducing servicing costs.

25. Views differed on the size of the required fiscal adjustment, which the authorities estimated at about 1.5 percent of GDP based on a more optimistic view of interest rates and the non-inclusion of natural disasters costs in their framework. They agreed that a fiscal resilience framework, regardless of whether it includes a savings fund for natural disasters, would help sustain the adjustment effort and were discussing with the World Bank a Development Policy Loan to support work on this issue. On fiscal reforms, they confirmed their commitment to the recently updated PFM action plan, including new legislation on procurement, and plans to strengthen public investment management with capacity building and the revival of the PSIP. They also noted that the

Department of Commerce had started consultations on a more structured and transparent approach to tax concessions for manufacturing.

26. The authorities stressed the urgency of donors' support of policies to enhance resilience to climate change and natural disasters. With assistance from the World Bank, the authorities were preparing a Disaster Risk Financing Strategy based on several components, including insurance (CCRIF) and contingent financing (CAT-DDO), for which discussions with the World Bank were at an advanced stage. They recognized that the annual flows to the contingency fund included in the draft PFM law (0.5 percent of revenues) may be small to accumulate an adequate fiscal buffer, but noted the challenges in building a savings fund of the size proposed by staff and suggested that the recapitalization of CCRIF supported by donors would be a better option. They noted continued progress on the renewables program and a more active approach to secure concessional financing from climate funds and multilaterals.

27. The authorities concurred on steps to strengthen the financial sector. They noted that new legislation on foreclosure, insolvency, assets to be used as collateral, and credit reporting is expected to be completed during the current fiscal year. They supported the full operationalization of the ECAMC, which could benefit some of the indigenous banks. They also agreed on the importance of measures to further strengthen supervision and minimize CBR-related risks, and noted their commitment to address gaps in compliance with international standards on tax rules by year end.

28. The authorities agreed that structural impediments must be addressed to boost sustainable growth and reduce unemployment. Efforts were underway to improve the business environment, particularly to ease access to credit, and boost productivity, including through greater focus on innovation and implementation of new technologies in the public sector. Programs to enhance education and provide an adequate skill set were expected to improve employability of young people. While the focus remained on expanding the tourism industry, the authorities acknowledged potential gains from greater diversification and identified priority sectors within their new export strategy.

STAFF APPRAISAL

29. Growth prospects remain good in the short term, but the longer-term outlook is challenging. Favorable external conditions and a mild fiscal stimulus sustained growth in 2017. A favorable external environment and major private and public investment projects are expected to provide continued support to growth. However, risks to global growth, natural disasters, and fiscal risks weigh on the outlook. Over the medium term, structural bottlenecks, high production costs, and low productivity will continue to dampen growth prospects.

30. Fiscal adjustment, anchored by the ECCU debt target, should focus on broadening the tax base, controlling expenditure, and improving financing terms. Public debt continues to be unsustainable under current policies and its large short-term component magnifies financing risks.

The necessary adjustment should concentrate on streamlining the extensive tax exemptions, which undermine the revenue base and the efficiency of the tax system; and on controlling the government wage bill, inflated by wage and payroll increases during the GFC, through continued wage moderation and public-sector reform. When feasible, targeted social assistance should replace temporary work programs and non-targeted subsidies, which are less efficient and fiscally costlier. Increased reliance on concessional financing and a shift to longer-term instruments should reduce servicing costs and mitigate rollover risks. A fiscal responsibility framework, defining institutional arrangements, coverage of government and fiscal aggregates, implementation procedures, automatic correction mechanisms, and mechanisms for transparency and accountability, would help provide operational targets consistent with the ECCU debt target and the discipline required to attain them.

31. Building needed resilience to climate change and natural disasters is an essential part of the medium-term economic strategy. Investment plans under the National Adaptation Plan should now be costed and fully integrated into development plans and fiscal medium-term frameworks, and a financing strategy, based primarily on grants, prepared. Financial protection against natural disasters requires a layered approach, involving a broad set of tools, including self-insurance, insurance, and financial innovation. However, high public debt and limited risk-transfer instruments suggest that self-insurance has a key role in preparing for natural disasters. Considering the historic cost of disasters and their expected intensification, a savings fund of 5 percent of GDP, with a strong governance framework, would provide the necessary resources for relief and reconstruction without increasing public debt when disasters occur. Revenues from the Citizenship-by-Investment program (CIP) and the new residency program, together with receipts from a carbon tax, could be used to finance this fund. A carbon tax, introduced gradually with appropriate compensation for low-income households, would also reduce risks to attaining emission targets.

32. Continued fiscal reforms should underpin fiscal consolidation and resilience building. Despite progress in several areas, improvements are needed to broaden the coverage of public institutions, enhance timeliness and transparency of financial reporting, and strengthen procurement, in line with the recently updated PFM Action Plan. Reviving the PSIP and further strengthening project appraisal and monitoring will enhance public investment efficiency and adequately support the government strategy to build resilience to climate change and natural disasters. A rationalization of tax expenditures in all economic sectors, based on a transparent rules-based system, is critical to reduce the risk of base erosion and improve revenue predictability.

33. Financial sector policies need to address promptly legacy issues and emerging risks. The rapid approval of new foreclosure and insolvency legislation is needed for the resolution of NPLs and the resumption of bank lending. In addition, the authorities should use their representation powers on the ECCB Monetary Council to ensure that the ECAMC can efficiently collect and dispose of distressed assets. In view of the imminent implementation of IFRS9, and of prudential regulations on provisioning and valuation, indigenous banks' capitalization must be increased. The rapid rise of lending from credit unions and microfinance companies calls for strengthened monitoring and supervision of these entities and a rapid approval of the regionally

harmonized regulation. A swift adoption of the Harmonized Credit Reporting Act and the creation of a credit bureau would help contain future losses from NPLs and facilitate financial intermediation. CBR pressure would be mitigated by sustained efforts in strengthening the AML/CFT regime, including by risk-based supervision; reinforcing governance, transparency, and due diligence procedures of the CIP; addressing gaps in compliance with international tax rules; and deepening collaboration and information sharing between respondent and correspondent banks. In the medium term, transferring AML/CFT supervisory powers to the ECCB would further reduce these risks.

34. Addressing structural impediments and increasing economic diversification would boost sustainable growth and reduce external vulnerabilities. This requires enhancing a weak investment climate and reducing labor market rigidities that delink productivity and wages. Improving access to credit, including by completing the credit bureau, and reducing the comparatively high costs of trading and energy should remain priorities. Training apprenticeship programs and better aligning the education system with labor market needs would help reduce structural unemployment, particularly among the youth. Strengthening tourism backward linkages with agriculture, and developing sectors where economies of scale are less important, including business processing outsourcing, ICT, creative industries, and spa & wellness seem to be promising avenues to increase diversification

35. The 2016 update safeguards assessment found that the ECCB continues to maintain a governance framework that provides for independent oversight. Transparency in financial reporting has been maintained and the external audit mechanism is sound. The ECCB has restructured the internal audit function and established an independent risk management unit in line with leading international practice.

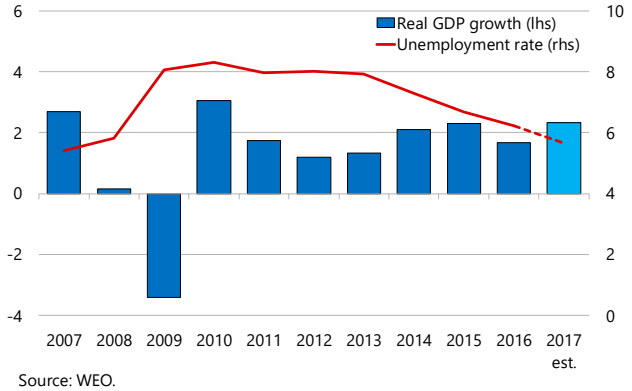
36. Statistics are broadly adequate for surveillance. However, the lack of historical data on the external sector based on BPM6 hampers the assessment of the external position.

37. Staff recommends that the next Article IV Consultation for St. Lucia take place on the standard 12-month cycle.

Figure 1. St. Lucia: Stronger Growth and External Balance on Account of Rising Tourism Inflows

Unemployment in AEs has continued to decline...

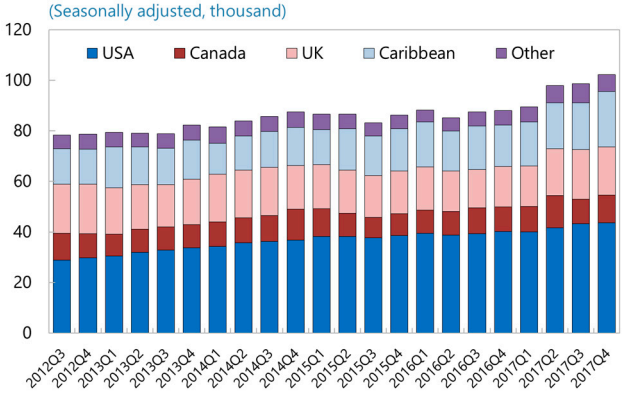
Advanced Economies: Growth and Unemployment
(In percent)



Source: WEO.

...boosting tourism demand...

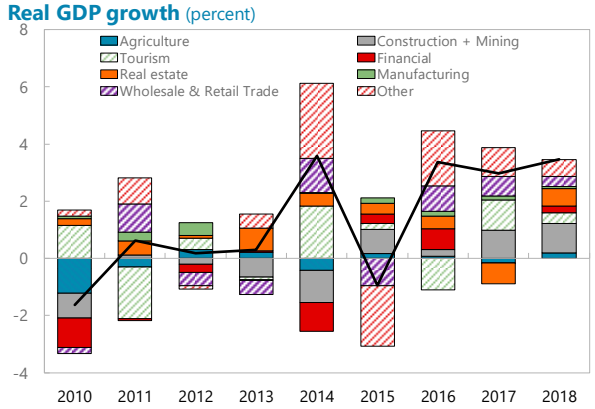
Tourist Arrivals
(Seasonally adjusted, thousand)



Sources: ECCB; and IMF Staff Estimates.

...and growth, also driven by strong construction activity with the completion of major hotel projects...

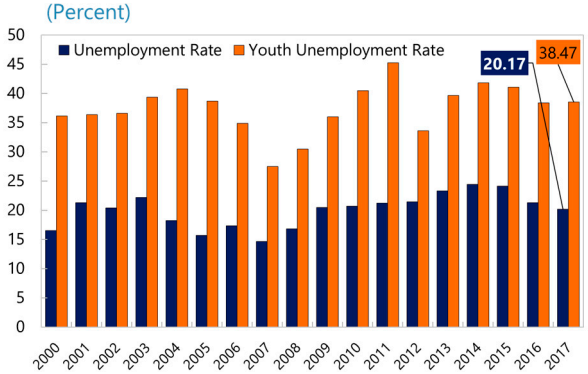
Real GDP growth (percent)



Sources: ECCB; and IMF Staff Estimates.

...which helped reduce unemployment.

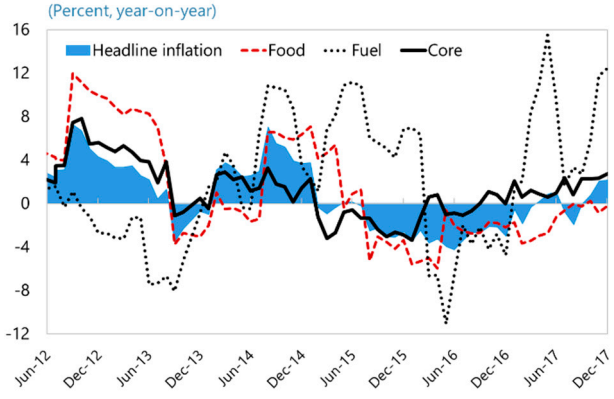
Unemployment Rates
(Percent)



Sources: Country Authorities Review of the Economy.

Inflation has picked up on the back of higher fuel prices, which were only partially offset by lower food prices...

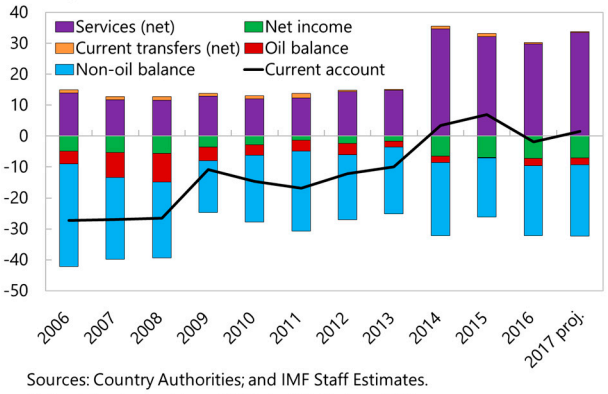
CPI and its Components
(Percent, year-on-year)



Sources: ECCB; and IMF Staff Estimates.

... while the current account moved into a small surplus.

Current Account Balance
(In percent of GDP)



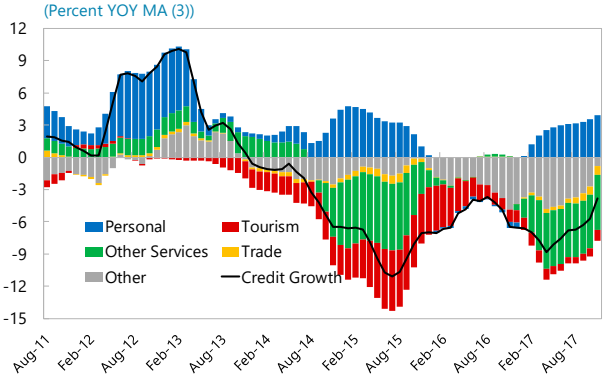
Sources: Country Authorities; and IMF Staff Estimates.
Note: data changed from BPM5 to BPM6 since 2014.

Figure 2. St. Lucia: Persistent Weaknesses in the Financial Sector

Credit of commercial banks continued to decline in 2017…

Contribution to Credit Growth

(Percent YOY MA (3))

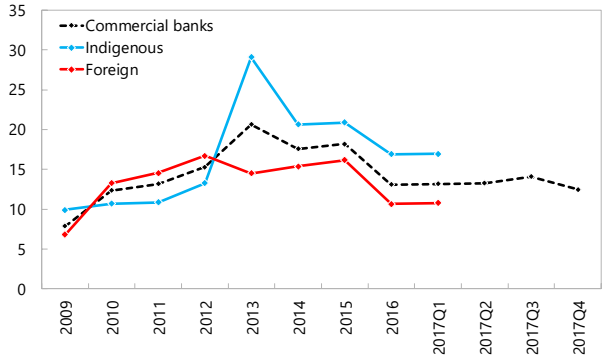


Sources: ECCB; and IMF Staff Estimates.

…while progress in reducing NPLs was slow.

NPLs

(In percent of total loans)

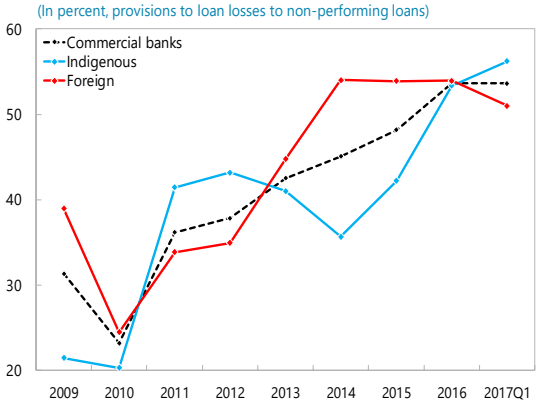


Sources: ECCB; and IMF Staff Estimates.

Provisioning continued to increase in indigenous banks…

Provisions to NPLs

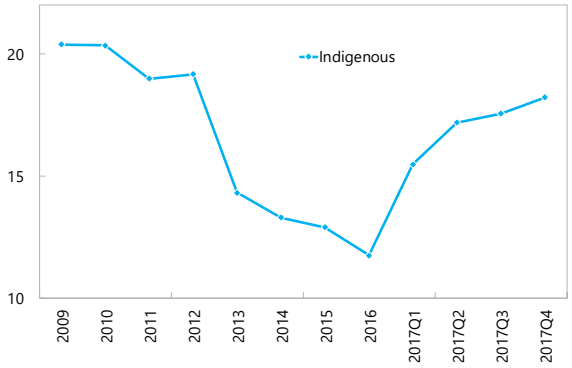
(In percent, provisions to loan losses to non-performing loans)



…and bank capitalization recovered slightly …

Capital Adequacy

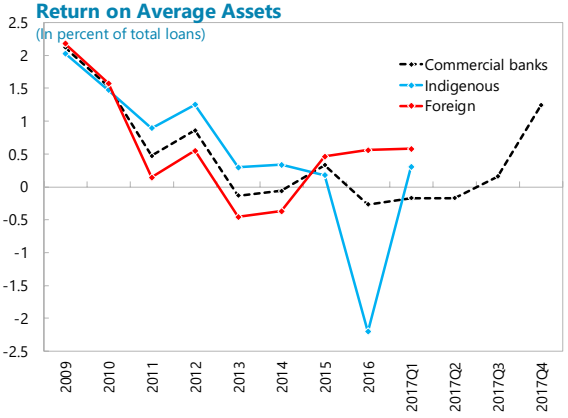
(In percent, total capital/risk-weighted assets)



… but profitability is still very low.

Return on Average Assets

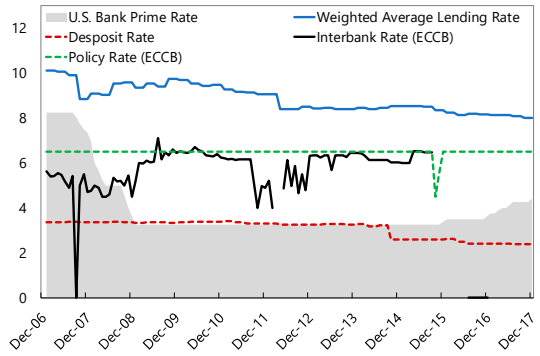
(In percent of total loans)



Rising U.S. interest rates may help profitability if they pass-through to the local market.

Interest Rates

(Percent)

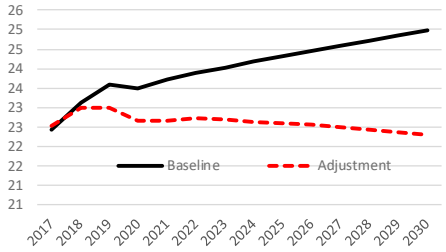


Sources: Country authorities; and IMF staff estimates.

Figure 3. St. Lucia: Baseline and Adjustment Scenarios
(Central Government, percent of GDP)

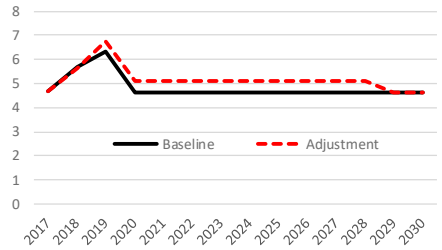
The proposed adjustment is centered on containing current expenditure…

Current Expenditure



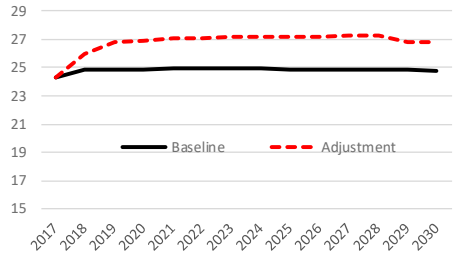
…and increasing capital expenditures for adaptation to natural disasters…

Capital Expenditure



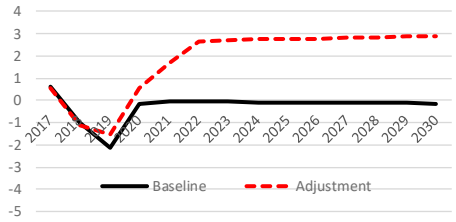
…while reversing recent revenues losses and increasing grants to finance enhanced adaptation investment…

Total Revenue, inc. Grants



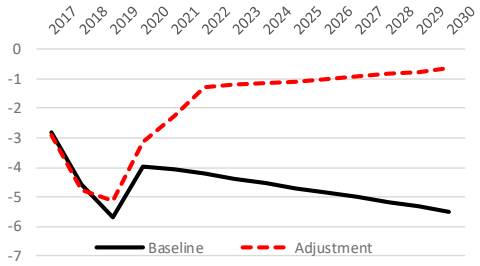
…delivering a higher primary surplus….

Primary Balance



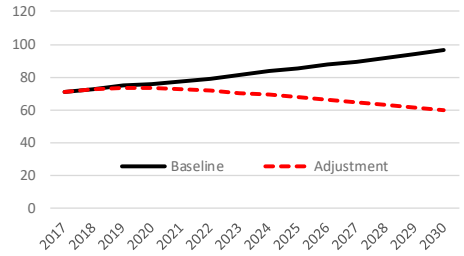
… which will lead to overall fiscal surpluses…

Overall Balance



… consistent with the 2030 debt target.

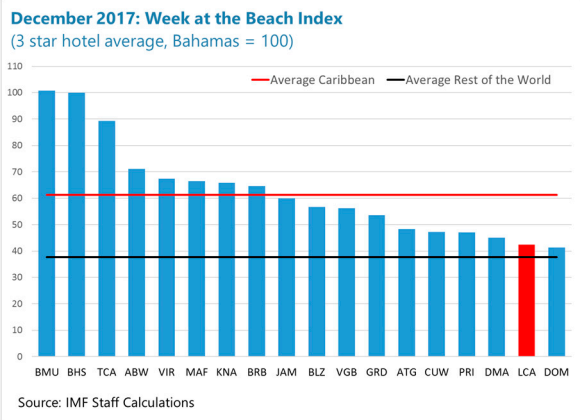
Public Debt



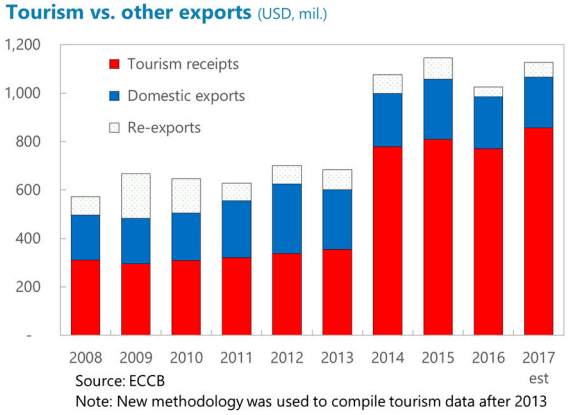
Sources: Country authorities; and IMF staff estimates.

Figure 4. St. Lucia: External Competitiveness and Structural Weaknesses

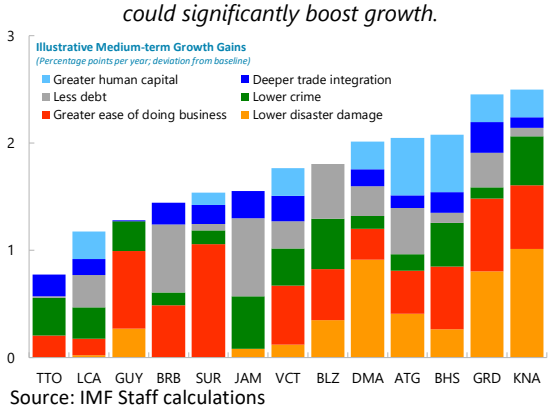
St. Lucia's tourism seems competitive in the Caribbean, which however is by far the most expensive region in the world...



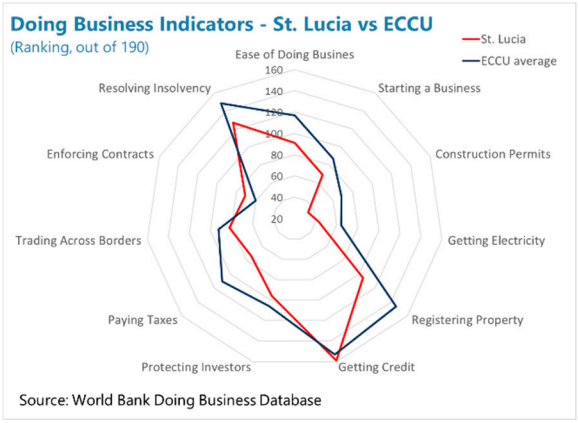
...but other exports remain very low, pointing to structural weaknesses.



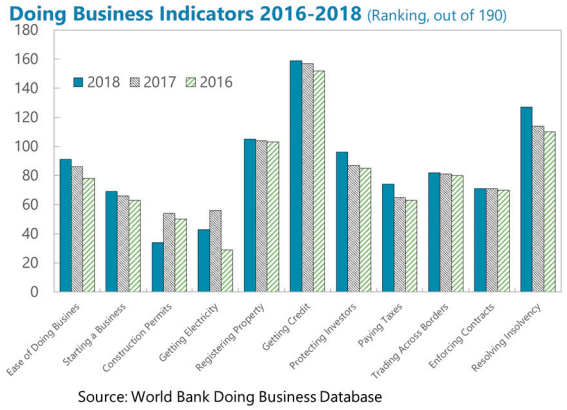
Deeper trade integration, greater human capital, and greater ease of doing business are among the factors that could significantly boost growth.



Despite being a strong performer relative to its regional peers in the Doing Business Indicators...



...St. Lucia overall ranking is low and declining, with scores on financial indicators being particularly poor.



High electricity cost is also a constraint.

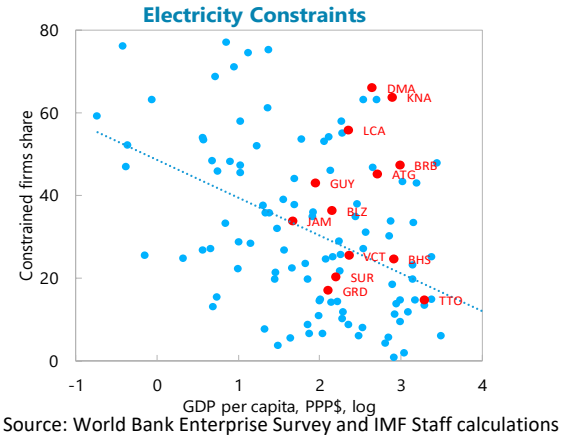
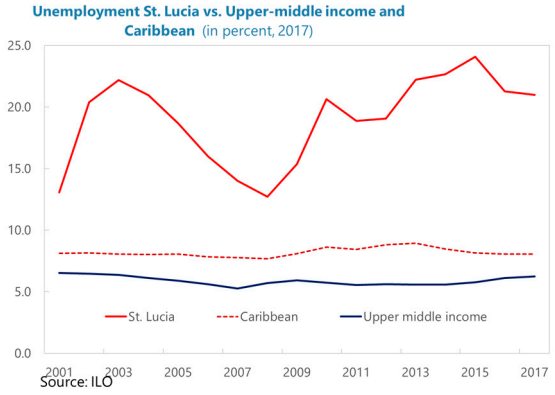


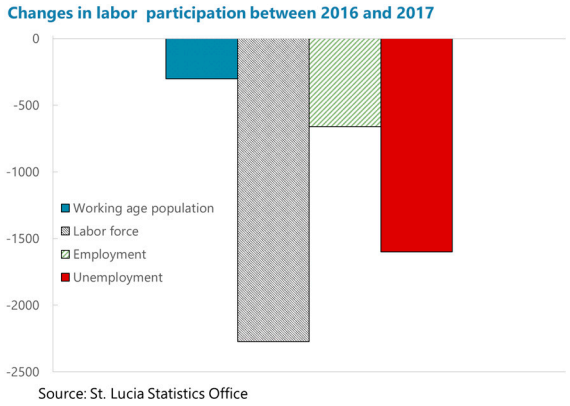
Figure 5. St. Lucia: Unemployment

Unemployment in St. Lucia remains high by international standards despite its recent decline.



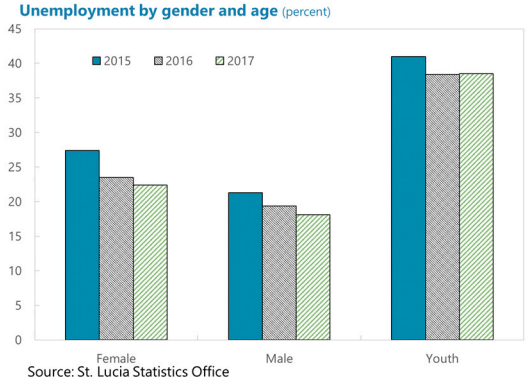
Source: ILO

Employment and labor force participation have also declined in 2017…



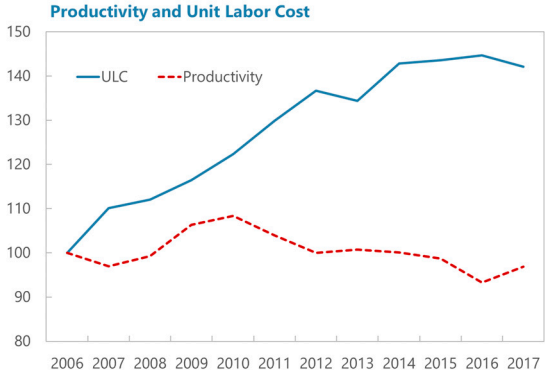
Source: St. Lucia Statistics Office

Youth unemployment remains very high, but the gender gap in unemployment has narrowed slightly.



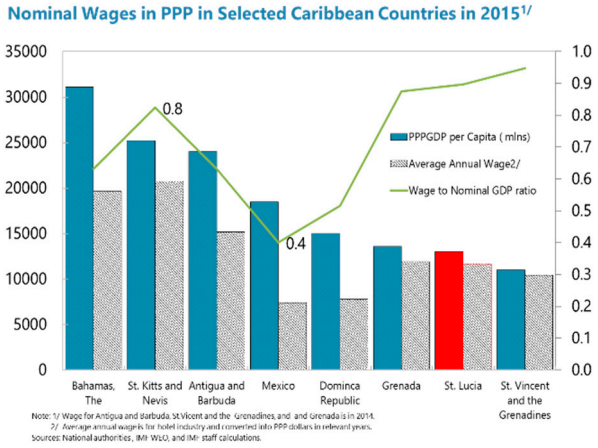
Source: St. Lucia Statistics Office

Strong growth helped reduce the long-standing gap between unit labor costs and productivity…

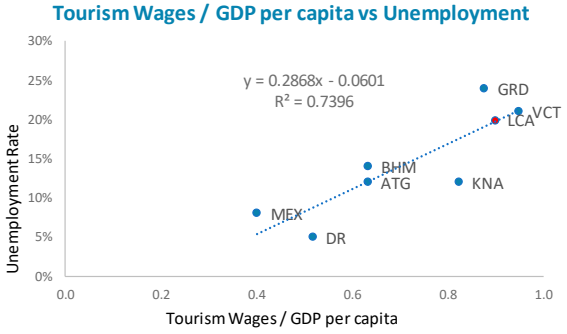


Source: St. Lucia authorities

…but further narrowing will be needed to bring St. Lucia's wages closer in line with the rest of the region, …



…which is characterized by a strong link between unit labor cost and unemployment.



Note: nominal GDP in 2016 in PPP terms.
Source: National Authorities, IMF World Economic Outlook and staff calculations.

Table 1. St. Lucia: Selected Social and Economic Indicators, 2014–2023

I. Social and Demographic Indicators

Area (sq. km)	616	Infant mortality (per thous. live births, 2015)	12.7
		Human Development Index ranking (of 188 countries, 2015)	92
Population Characteristics			
Total (2017)	175,531	Gross Domestic Product (2017)	
Rate of growth (average 2008-2013)	1.1	(millions of US dollars)	1,686
Population density (per sq. km., 2015)	285.0	(millions of EC dollars)	4,553
Net migration rate (per thousand, 2012)	-3.5	(US$ per capita)	9,607
Adult illiteracy rate (percent, 2009)	5.2	Gross National Income per Capita (US$, 2017)	8,933
Life expectancy at birth (years, 2015)	75.1		

II. Economic and Financial Indicators

				Est.	Projections					
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
	(Annual percentage change, unless otherwise specified)									
Output and prices										
Real GDP (at market prices)	3.6	-0.9	3.4	3.0	3.5	3.7	3.1	2.2	1.6	1.5
Real GDP (at factor cost)	0.5	1.8	1.7	2.5	3.2	3.7	3.1	2.2	1.6	1.5
Consumer prices, end of period	3.7	-2.6	-3.0	2.2	1.4	1.5	1.5	1.5	1.5	1.5
Output gap (percent of potential GDP)	1.0	-1.6	-0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.0
Unemployment rate (% annual average)	24.4	24.1	21.3	20.2	...	...	...	...	...	...
Real effective exchange rate (annual average, depreciation -)	103.4	108.4	105.4	104.2	...	...	...	...	...	...
	(In percent of GDP, unless otherwise specified)									
Central government balance 1/										
Revenue	23.3	23.6	24.3	24.3	24.9	24.8	24.8	25.0	25.0	25.0
Taxes	20.9	21.3	21.9	21.8	21.9	21.9	21.9	22.0	22.0	22.0
Non-tax revenue	1.1	1.0	1.1	1.6	1.5	1.5	1.5	1.5	1.5	1.5
Grants	1.3	1.3	1.3	0.9	1.4	1.4	1.4	1.4	1.4	1.4
Expenditure	26.7	26.3	26.0	27.1	28.8	29.9	28.1	28.4	28.5	28.7
Current primary expenditure	19.2	18.5	18.5	19.0	19.6	20.0	19.7	19.7	19.7	19.7
Interest payments	3.6	3.5	3.5	3.4	3.6	3.6	3.8	4.0	4.2	4.3
Capital expenditure	4.0	4.2	4.0	4.7	5.7	6.3	4.6	4.6	4.6	4.6
Natural disaster (ND) annualised cost	...	...	...	...	0.7	0.7	0.7	0.7	0.7	0.7
Primary balance, excl. ND cost	0.2	0.8	1.8	0.6	-0.4	-1.5	0.5	0.6	0.6	0.6
Primary balance, incl. ND cost					-1.0	-2.1	-0.2	-0.1	-0.1	-0.1
Overall balance excl. ND cost	-3.4	-2.8	-1.7	-2.8	-3.9	-5.1	-3.3	-3.4	-3.6	-3.7
Overall balance, incl. ND cost	...	...	...	...	-4.6	-5.7	-4.0	-4.1	-4.2	-4.4
Central government debt (incl. guaranteed)	70.7	67.8	69.2	70.7	72.2	74.6	75.5	77.2	79.2	81.3
External	35.1	32.2	33.1	36.2	37.8	38.9	39.3	40.0	40.9	41.9
Domestic	35.6	35.6	36.1	34.6	34.3	35.7	36.3	37.2	38.3	39.4
Money and credit, end of period (annual percent change)										
Broad money (M2)	1.2	5.8	2.3	0.2	4.8	5.3	4.7	3.7	3.1	3.0
Credit to private sector (real)	-9.9	-5.8	-4.8	-2.0	-1.5	-1.6	3.1	2.2	1.6	1.5
Credit to private sector (nominal)	-6.7	-6.8	-7.8	-1.9	0.0	0.0	4.7	3.7	3.1	3.0
Balance of payments										
Current account balance, *o/w:*	3.4	6.9	-1.9	1.3	-1.5	-2.5	-1.1	0.0	-0.3	-0.2
Exports of goods and services	65.0	64.1	59.4	63.6	62.9	62.8	62.8	63.2	63.4	64.1
Imports of goods and services	-55.9	-51.3	-54.5	-55.8	-58.1	-59.1	-57.7	-57.1	-57.7	-58.4
Capital account balance	1.4	0.9	0.5	0.9	1.5	1.5	1.5	1.5	1.5	1.5
Financial account balance	4.5	6.9	-3.1	2.2	0.0	-1.1	0.4	1.4	1.1	1.3
Direct investment	-1.3	-4.6	-7.1	-7.5	-7.8	-8.0	-8.1	-7.4	-7.4	-7.4
Portfolio investment	0.6	-0.3	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Other investment	0.8	8.1	3.4	7.1	4.6	4.1	6.1	6.7	6.5	6.6
Net reserves assets	4.3	3.7	-0.8	1.1	1.6	1.3	0.9	0.7	0.6	0.6
Errors and omissions	-0.4	-0.9	-1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External debt (gross) 2/	82.1	72.4	70.1	69.3	71.0	72.0	72.4	73.1	73.9	74.9
Public	35.1	32.2	33.1	36.2	37.8	38.9	39.3	40.0	40.9	41.9
Savings-Investment balance	3.4	6.9	-1.9	1.3	-1.5	-2.5	-1.1	0.0	-0.3	-0.2
Savings	20.8	24.3	15.5	19.4	17.9	18.0	18.8	18.8	18.5	18.6
Investment	17.3	17.4	17.4	18.1	19.4	20.6	19.8	18.8	18.8	18.8
Public	4.5	4.2	4.2	4.6	5.5	6.2	5.3	4.7	4.7	4.8
Private	12.8	13.1	13.2	13.6	14.0	14.4	14.6	14.1	14.1	14.1
Memorandum items:										
Nominal GDP (EC$ millions)	4,095	4,381	4,436	4,553	4,771	5,024	5,259	5,452	5,621	5,793
Net imputed international reserves										
Months of imports of goods and services	3.3	4.3	3.9	3.8	3.9	4.1	4.1	4.1	4.0	4.0
Percentage of demand liabilities	89.2	91.4	90.7	91.1	91.4	91.6	91.6	91.6	91.5	91.5

Sources: St. Lucia authorities; ECCB; and Fund staff estimates and projections.

1/ Fiscal year (April–March) basis.

2/ Comprises public sector external debt, foreign liabilities of commercial banks and other private debt.

Table 2a. St. Lucia: Central Government Operations, 2014–2023 1/

(In millions of EC dollars)

	2014	2015	2016	2017 Budget	Projections 2017	2018	2019	2020	2021	2022	2023
					(In millions of EC Dollars)						
Revenue	**972.2**	**1,035.8**	**1,084.5**	**1,090.9**	**1,118.2**	**1,202.6**	**1,262.4**	**1,317.9**	**1,371.4**	**1,413.6**	**1,457.6**
Taxes	871.5	934.4	977.8	947.7	1,002.3	1,059.4	1,112.0	1,160.8	1,208.8	1,245.9	1,284.7
Taxes on income	224.1	241.5	258.5	253.4	247.5	258.1	271.1	283.8	294.7	304.3	313.8
Taxes on property	9.4	10.7	12.0	11.5	12.0	6.6	7.0	7.3	14.0	14.5	14.9
Taxes on goods and services	244.2	255.2	258.1	219.1	253.2	252.7	265.6	277.4	287.2	296.0	305.3
Taxes on international trade and transactions 2/	393.8	427.0	449.3	463.7	489.6	542.1	568.2	592.3	612.9	631.0	650.7
Grants	53.8	58.7	57.9	87.4	41.0	69.7	73.3	76.5	79.2	81.7	84.2
Other revenue	46.9	42.7	48.8	55.7	75.0	73.4	77.2	80.6	83.4	86.0	88.7
Property income	0.0	0.0	0.0	4.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Sales, fees and fines	23.5	27.3	29.5	46.6	58.7	57.1	60.1	62.7	64.9	66.9	69.0
o.w. Citizen by Investment Program (CIP)	0.0	0.0	5.9	43.0	27.8	29.0	30.5	31.9	33.0	34.0	35.1
Other nontax revenue	23.4	15.3	19.3	4.5	16.2	16.3	17.1	17.9	18.5	19.1	19.7
Expenditure	**1,114.0**	**1,156.9**	**1,160.2**	**1,378.9**	**1,247.5**	**1,391.5**	**1,519.9**	**1,493.3**	**1,559.0**	**1,616.3**	**1,675.2**
Expense	**947.0**	**970.2**	**982.5**	**1,068.0**	**1,032.9**	**1,117.4**	**1,199.2**	**1,247.2**	**1,304.3**	**1,353.6**	**1,404.4**
Compensation of employees	378.6	377.9	380.5	408.2	381.5	403.3	442.4	448.9	464.7	479.1	494.1
Purchase of goods and services	163.7	174.6	182.6	214.8	203.7	223.1	234.6	244.9	253.6	261.4	269.6
Interest	148.6	156.0	157.6	170.1	158.6	171.8	183.6	200.4	220.7	237.0	252.8
Social benefits	101.7	102.5	112.2	102.5	119.3	118.7	128.7	134.4	139.2	143.5	148.0
Retirement benefits	80.0	84.9	94.4	81.9	98.4	103.3	108.6	113.4	117.4	121.0	124.8
Public assistance and casual relief	21.7	17.6	17.8	20.6	21.0	15.4	20.1	21.0	21.8	22.4	23.1
Subsidies	13.9	8.7	8.3	9.9	4.7	5.8	10.1	10.5	10.9	11.3	11.6
Other	7.8	8.8	9.5	...	16.3	9.5	10.0	10.5	10.9	11.2	11.5
Other expense	154.4	159.1	149.6	172.4	169.6	200.5	209.8	218.6	226.1	232.7	239.9
Transfers to public-sector institutions 3/	154.4	159.1	149.6	172.4	169.6	200.5	209.8	218.6	226.1	232.7	239.9
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net acquisition of nonfinancial assets	**167.0**	**186.7**	**177.7**	**310.9**	**214.6**	**274.2**	**320.7**	**246.1**	**254.8**	**262.7**	**270.9**
Grant-financed capital expenditure	53.8	58.7	57.9	87.4	58.2	69.7	73.3	76.5	79.2	81.7	84.2
Other capital expenditure 4/	113.0	128.0	119.5	223.5	156.3	204.3	247.3	169.4	175.4	180.8	186.5
Capital revenue	0.2	0.1	0.3	0.0	0.1	0.1	0.1	0.1	0.1	0.2	0.2
Natural disaster (ND) annualised cost 5/	**...**	**...**	**...**	**...**	**...**	**31.9**	**33.5**	**35.0**	**36.3**	**37.4**	**38.6**
Gross Operating Balance	**25.3**	**65.6**	**102.0**	**22.8**	**85.4**	**85.2**	**63.3**	**70.7**	**67.2**	**59.9**	**53.3**
Net lending/borrowing (overall balance, excl. ND cost)	**-141.7**	**-121.1**	**-75.7**	**-288.1**	**-129.2**	**-189.0**	**-257.4**	**-175.4**	**-187.6**	**-202.7**	**-217.6**
Net lending/borrowing (overall balance, incl. ND cost)	**...**	**...**	**...**	**...**	**...**	**-220.9**	**-291.0**	**-210.4**	**-223.9**	**-240.1**	**-256.1**
Net financial transactions	**-141.7**	**-121.1**	**-75.7**	**-288.1**	**-129.2**	**-220.9**	**-291.0**	**-210.4**	**-223.9**	**-240.1**	**-256.1**
Net acquisition of assets	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	**201.8**	**49.5**	**71.0**	**142.0**	**124.3**	**220.6**	**290.7**	**210.1**	**223.6**	**239.8**	**255.8**
Domestic	75.2	90.4	0.2	67.8	-62.6	60.3	145.3	105.1	111.8	119.9	127.9
Foreign	126.6	-40.9	70.8	74.2	186.9	160.3	145.3	105.1	111.8	119.9	127.9
Statistical discrepancy	*-60.1*	*71.6*	*4.7*	*146.1*	*4.9*	*0.3*	*0.3*	*0.3*	*0.3*	*0.3*	*0.3*
Memorandum items:											
Primary balance (excl. ND)	6.9	34.9	81.9	-118.0	29.4	-17.2	-73.8	25.0	33.1	34.2	35.2
Primary balance (incl. ND)	...	...	...	...	...	-49.1	-107.3	-10.0	-3.2	-3.1	-3.3
Central government debt (incl. guaranteed) 6/	2,946	2,980	3,091	...	3,258	3,488	3,789	4,009	4,240	4,487	4,750
Domestic	1,485	1,565	1,614	...	1,592	1,660	1,813	1,926	2,044	2,169	2,303
Direct	1,414	1,504	1,505	...	1,442	1,502	1,648	1,753	1,864	1,984	2,112
Guaranteed	71	61	109	...	150	158	166	173	179	185	191
Foreign	1,461	1,415	1,477	...	1,666	1,829	1,976	2,083	2,197	2,318	2,447
Direct	1,409	1,368	1,439	...	1,626	1,786	1,931	2,036	2,148	2,268	2,396
Guaranteed	52	47	38	...	41	43	45	47	48	50	52
Nominal GDP fiscal year (EC$ millions)	4,166	4,395	4,466	4,722	4,607	4,834	5,083	5,307	5,494	5,664	5,842

Sources: Ministry of Finance; and Fund staff estimates and projections.

1/ Fiscal year (April–March) basis.

2/ Includes revenue from the Airport Development Tax, which is fully transferred to St. Lucia Air and Sea Ports Authority.

3/ Includes transfer to St. Lucia St. Lucia Air and Sea Port Authority corresponding to the Airport Development Tax.

4/ Includes roads rehabilitation in 2018 and 2019, implemented by private Special Purpose Vehicle, financed through a US$50 million from the government of the Taiwan, Province of China.

5/ Natural disaster costs are annualized estimated costs (see Box 1).

6/ Direct debt and debt of the parastatal entities (including debt guaranteed by the central government).

Table 2b. St. Lucia: Central Government Operations, 2014–2023 1/

(In percent of GDP)

	2014	2015	2016	2017 Budget	2017	2018	2019	2020	2021	2022	2023
					Projections						
					(In percent of GDP)						
Revenue	**23.3**	**23.6**	**24.3**	**23.1**	**24.3**	**24.9**	**24.8**	**24.8**	**25.0**	**25.0**	**25.0**
Taxes	20.9	21.3	21.9	20.1	21.8	21.9	21.9	21.9	22.0	22.0	22.0
Taxes on income	5.4	5.5	5.8	5.4	5.4	5.3	5.3	5.3	5.4	5.4	5.4
Taxes on property	0.2	0.2	0.3	0.2	0.3	0.1	0.1	0.1	0.3	0.3	0.3
Taxes on goods and services	5.9	5.8	5.8	4.6	5.5	5.2	5.2	5.2	5.2	5.2	5.2
Taxes on international trade and transactions 2/	9.5	9.7	10.1	9.8	10.6	11.2	11.2	11.2	11.2	11.1	11.1
Grants	1.3	1.3	1.3	1.9	0.9	1.4	1.4	1.4	1.4	1.4	1.4
Other revenue	1.1	1.0	1.1	1.2	1.6	1.5	1.5	1.5	1.5	1.5	1.5
Property income	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Sales, fees and fines	0.6	0.6	0.7	1.0	1.3	1.2	1.2	1.2	1.2	1.2	1.2
o.w. Citizen by Investment Program (CIP)	0.0	0.0	0.1	0.9	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Other nontax revenue	0.6	0.3	0.4	0.1	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Expenditure	**26.7**	**26.3**	**26.0**	**29.2**	**27.1**	**28.8**	**29.9**	**28.1**	**28.4**	**28.5**	**28.7**
Expense	**22.7**	**22.1**	**22.0**	**22.6**	**22.4**	**23.1**	**23.6**	**23.5**	**23.7**	**23.9**	**24.0**
Compensation of employees	9.1	8.6	8.5	8.6	8.3	8.3	8.7	8.5	8.5	8.5	8.5
Purchase of goods and services	3.9	4.0	4.1	4.6	4.4	4.6	4.6	4.6	4.6	4.6	4.6
Interest	3.6	3.5	3.5	3.6	3.4	3.6	3.6	3.8	4.0	4.2	4.3
Social benefits	2.4	2.3	2.5	2.2	2.6	2.5	2.5	2.5	2.5	2.5	2.5
Retirement benefits	1.9	1.9	2.1	1.7	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Public assistance and casual relief	0.5	0.4	0.4	0.4	0.5	0.3	0.4	0.4	0.4	0.4	0.4
Subsidies	0.3	0.2	0.2	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.2
Other expense	3.7	3.6	3.4	3.7	3.7	4.1	4.1	4.1	4.1	4.1	4.1
Transfers to public-sector institutions 3/	3.7	3.6	3.4	3.7	3.7	4.1	4.1	4.1	4.1	4.1	4.1
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net acquisition of nonfinancial assets	**4.0**	**4.2**	**4.0**	**6.6**	**4.7**	**5.7**	**6.3**	**4.6**	**4.6**	**4.6**	**4.6**
Grant-financed capital expenditure	1.3	1.3	1.3	1.9	1.3	1.4	1.4	1.4	1.4	1.4	1.4
Other capital expenditure 4/	2.7	2.9	2.7	4.7	3.4	4.2	4.9	3.2	3.2	3.2	3.2
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Natural disaster (ND) annualised cost 5/	**...**	**...**	**...**	**...**	**...**	**0.7**	**0.7**	**0.7**	**0.7**	**0.7**	**0.7**
Gross Operating Balance	**0.6**	**1.5**	**2.3**	**0.5**	**1.9**	**1.8**	**1.2**	**1.3**	**1.2**	**1.1**	**0.9**
Net lending/borrowing (overall balance, excl. ND cost)	**-3.4**	**-2.8**	**-1.7**	**-6.1**	**-2.8**	**-3.9**	**-5.1**	**-3.3**	**-3.4**	**-3.6**	**-3.7**
Net lending/borrowing (overall balance, incl. ND cost)	**...**	**...**	**...**	**...**	**...**	**-4.6**	**-5.7**	**-4.0**	**-4.1**	**-4.2**	**-4.4**
Net financial transactions	**-3.4**	**-2.8**	**-1.7**	**-6.1**	**-2.8**	**-4.6**	**-5.7**	**-4.0**	**-4.1**	**-4.2**	**-4.4**
Net acquisition of assets	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	**4.8**	**1.1**	**1.6**	**3.0**	**2.7**	**4.6**	**5.7**	**4.0**	**4.1**	**4.2**	**4.4**
Domestic	1.8	2.1	0.0	1.4	-1.4	1.2	2.9	2.0	2.0	2.1	2.2
Foreign	3.0	-0.9	1.6	1.6	4.1	3.3	2.9	2.0	2.0	2.1	2.2
Statistical discrepancy	*-1.4*	*1.6*	*0.1*	*3.1*	*0.1*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Memorandum items:											
Primary balance (excl. ND)	0.2	0.8	1.8	-2.5	0.6	-0.4	-1.5	0.5	0.6	0.6	0.6
Primary balance (incl. ND)	...	...	...	...	...	-1.0	-2.1	-0.2	-0.1	-0.1	-0.1
Central government debt (incl. guaranteed) 6/	70.7	67.8	69.2	...	70.7	72.2	74.6	75.5	77.2	79.2	81.3
Domestic	35.6	35.6	36.1	...	34.6	34.3	35.7	36.3	37.2	38.3	39.4
Direct	33.9	34.2	33.7	...	31.3	31.1	32.4	33.0	33.9	35.0	36.2
Guaranteed	1.7	1.4	2.4	...	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Foreign	35.1	32.2	33.1	...	36.2	37.8	38.9	39.3	40.0	40.9	41.9
Direct	33.8	31.1	32.2	...	35.3	36.9	38.0	38.4	39.1	40.0	41.0
Guaranteed	1.2	1.1	0.9	...	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Nominal GDP fiscal year (EC$ millions)	4,166	4,395	4,466	4,720	4,607	4,834	5,083	5,307	5,494	5,664	5,842

Sources: Ministry of Finance; and Fund staff estimates and projections.

1/ Fiscal year (April–March) basis. Figures shown for a given calendar year relate to the fiscal year beginning on April 1 of that year.

2/ Includes revenue from the Airport Development Tax, which is fully transferred to St. Lucia Air and Sea Ports Authority.

3/ Includes transfer to St. Lucia St. Lucia Air and Sea Port Authority corresponding to the Airport Development Tax.

4/ Includes roads rehabilitation in 2018 and 2019, implemented by private Special Purpose Vehicle, financed through a US$50 million from the government of Taiwan, Province of China.

5/ Natural disaster costs are annualized estimated costs (see Box 1).

6/ Direct debt and debt of the parastatal entities guaranteed by the central government.

Table 3. St. Lucia: Balance of Payments Summary, 2014–2023

	2014	2015	2016	Est. 2017	Projections 2018	2019	2020	2021	2022	2023
					(In millions of US Dollars)					
Current account balance	**51.8**	**112.2**	**-31.2**	**21.4**	**-26.4**	**-47.3**	**-21.2**	**-0.6**	**-7.1**	**-3.9**
Exports of goods and services	985.6	1040.3	976.4	1073.3	1111.6	1168.3	1222.4	1276.6	1320.4	1375.8
Goods	164.0	187.4	165.8	175.7	191.4	201.0	208.6	215.1	221.5	228.0
Tourism	778.2	810.0	769.9	855.2	871.4	911.3	952.2	994.7	1030.0	1076.8
Other services	43.4	42.8	40.7	42.3	48.7	56.0	61.5	66.8	68.9	71.0
Imports of goods and services	-848.4	-832.1	-895.8	-940.1	-1025.9	-1100.5	-1123.3	-1153.8	-1201.9	-1252.0
Food	117.4	113.4	108.3	117.2	128.0	140.3	149.8	155.4	160.1	165.4
Fuel	63.4	42.1	42.1	45.4	54.0	56.1	58.3	60.3	61.9	64.0
Other goods	371.3	346.4	425.5	442.2	487.1	525.9	523.0	533.0	560.5	588.7
Services	296.3	330.3	319.8	335.4	356.7	378.3	392.2	405.2	419.4	434.0
Net Income, o.w.	-99.3	-111.1	-118.2	-118.2	-118.8	-122.1	-127.7	-131.1	-133.7	-135.9
Public interest payments	-20.2	-19.3	-21.3	-21.9	-23.7	-28.4	-35.2	-39.6	-43.0	-46.1
Net current transfers, o.w.	13.9	15.1	6.3	6.5	6.8	7.1	7.4	7.7	8.0	8.3
Remittances	26.8	26.8	27.2	27.9	28.4	28.3	27.6	28.2	28.7	29.3
Capital Account	**21.5**	**14.0**	**8.7**	**15.2**	**25.8**	**27.1**	**28.3**	**29.3**	**30.2**	**31.2**
Financial Account	**67.5**	**111.9**	**-50.3**	**36.5**	**-0.6**	**-20.1**	**7.1**	**28.8**	**23.1**	**27.3**
Direct Investment	-19.3	-75.1	-116.4	-126.9	-137.1	-148.0	-157.6	-149.8	-154.4	-159.1
Portolio Investment	9.6	-5.1	24.3	25.0	26.1	27.5	28.8	29.9	30.8	31.7
Other Investment	11.8	131.4	55.3	120.1	81.6	76.8	119.2	135.0	134.8	142.6
Net Reserve Assets	65.5	60.8	-13.5	18.3	28.8	23.5	16.7	13.7	11.9	12.0
Errors and omissions	**-5.8**	**-14.3**	**-27.7**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
					(In percent of GDP)					
Current account balance	**3.4**	**6.9**	**-1.9**	**1.3**	**-1.5**	**-2.5**	**-1.1**	**0.0**	**-0.3**	**-0.2**
Exports of goods and services	65.0	64.1	59.4	63.6	62.9	62.8	62.8	63.2	63.4	64.1
Goods	10.8	11.6	10.1	10.4	10.8	10.8	10.7	10.7	10.6	10.6
Tourism	51.3	49.9	46.9	50.7	49.3	49.0	48.9	49.3	49.5	50.2
Other services	2.9	2.6	2.5	2.5	2.8	3.0	3.2	3.3	3.3	3.3
Imports of goods and services	-55.9	-51.3	-54.5	-55.8	-58.1	-59.1	-57.7	-57.1	-57.7	-58.4
Food	7.7	7.0	6.6	7.0	7.2	7.5	7.7	7.7	7.7	7.7
Fuel	4.2	2.6	2.6	2.7	3.1	3.0	3.0	3.0	3.0	3.0
Other goods	24.5	21.3	25.9	26.2	27.6	28.3	26.9	26.4	26.9	27.4
Services	19.5	20.4	19.5	19.9	20.2	20.3	20.1	20.1	20.1	20.2
Net Income, o.w.	-6.5	-6.8	-7.2	-7.0	-6.7	-6.6	-6.6	-6.5	-6.4	-6.3
Public interest payments	-1.3	-1.2	-1.3	-1.3	-1.3	-1.5	-1.8	-2.0	-2.1	-2.2
Net current transfers, o.w.	0.9	0.9	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Remittances	1.8	1.7	1.7	1.7	1.6	1.5	1.4	1.4	1.4	1.4
Capital Account	**1.4**	**0.9**	**0.5**	**0.9**	**1.5**	**1.5**	**1.5**	**1.5**	**1.5**	**1.5**
Financial Account	**4.5**	**6.9**	**-3.1**	**2.2**	**0.0**	**-1.1**	**0.4**	**1.4**	**1.1**	**1.3**
Direct Investment	-1.3	-4.6	-7.1	-7.5	-7.8	-8.0	-8.1	-7.4	-7.4	-7.4
Portolio Investment	0.6	-0.3	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Other Investment	0.8	8.1	3.4	7.1	4.6	4.1	6.1	6.7	6.5	6.6
Net Reserve Assets	4.3	3.7	-0.8	1.1	1.6	1.3	0.9	0.7	0.6	0.6
Errors and omissions	**-0.4**	**-0.9**	**-1.7**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum Items:										
Trade balance (percent of GDP)	**-25.6**	**-19.4**	**-25.0**	**-25.4**	**-27.0**	**-28.0**	**-26.8**	**-26.4**	**-26.9**	**-27.5**
Services balance (percent of GDP)	**34.6**	**32.2**	**29.9**	**33.3**	**31.9**	**31.7**	**31.9**	**32.5**	**32.6**	**33.3**
Net imputed international reserves										
Millions of US dollars, end of period	235.3	308.7	353.6	379.6	397.1	415.3	432.4	449.5	467.7	486.6
Months of imports of goods and services	3.3	4.3	3.9	3.8	3.9	4.1	4.1	4.1	4.0	4.0
Percentage of demand liabilities	89.2	91.4	90.7	91.1	91.4	91.6	91.6	91.6	91.5	91.5
Gross external debt (percent of GDP)	82.1	72.4	70.1	69.3	71.0	72.0	72.4	73.1	73.9	74.9
Public sector	35.1	32.2	33.1	36.2	37.8	38.9	39.3	40.0	40.9	41.9
Private sector 1/	47.0	40.2	37.1	33.1	33.1	33.1	33.1	33.1	33.0	33.0
GDP (in US$ millions)	1,517	1,622	1,643	1,686	1,767	1,861	1,948	2,019	2,082	2,146

Sources: Ministry of Finance and Planning; ECCB; World Bank, and Fund staff estimates and projections.

1/ Includes largely gross foreign liabilities of commercial banks and other private debt.

Table 4. St. Lucia: Monetary Survey, 2014–2018

	2014	2015	2016	2017	Projections 2018
	(In millions of EC dollars, end of period)				
Net foreign assets	-305.2	268.4	486.3	820.0	897.2
Central bank	635.4	804.9	780.4	829.9	907.6
Commercial banks (net)	-940.6	-536.5	-294.1	-9.9	-10.4
Assets	985.2	1,226.2	1,350.4	1,499.3	1,571.0
Liabilities	-1,925.8	-1,762.7	-1,644.5	-1,509.2	-1,581.4
Net domestic assets	3,193.1	2,786.3	2,638.7	2,312.4	2,384.9
Public sector credit, net	-199.1	-253.7	-272.4	-361.3	-358.3
(real terms)	-166.6	-217.9	-241.3	-313.2	-306.4
Central government	257.2	226.7	205.0	191.8	198.4
Other public sector	-456.3	-480.4	-477.4	-553.0	-556.7
Private sector credit, net	3,778.6	3,522.9	3,249.1	3,188.8	3,188.8
(real terms)	3,161.5	3,026.4	2,877.8	2,764.5	2,726.8
Other items (net)	-430.9	-478.5	-322.1	-505.5	-445.6
Broad money (M2)	2,887.9	3,054.7	3,125.0	3,132.4	3,282.1
Money	738.5	764.1	851.3	905.0	948.2
Currency in circulation	154.9	153.9	165.8	159.6	167.3
Demand deposits	583.6	610.3	685.6	745.4	781.0
Quasi-money	2,149.5	2,290.6	2,273.7	2,227.5	2,333.9
Time deposits	369.5	387.7	362.1	277.3	290.6
Savings deposits	1,526.5	1,556.0	1,584.8	1,624.3	1,702.0
Foreign currency deposits	243.3	341.9	217.5	227.1	227.1
	(12-month percentage change)				
Net domestic assets	-8.8	-12.7	-5.3	-12.4	3.1
Broad money (M2)	1.2	5.8	2.3	0.2	4.8
NFA contribution	12.0	19.9	7.1	10.7	2.5
NDA contribution	-10.7	-14.1	-4.8	-10.4	2.3
Money	7.4	3.5	11.4	6.3	4.8
NFA contribution	26.3	23.0	-3.2	5.8	8.6
NDA contribution	-18.9	-19.5	14.6	0.5	-3.8
Quasi-money	-0.7	6.6	-0.7	-2.0	4.8
	(In percent of GDP)				
Net foreign assets	-7.5	6.1	11.0	18.0	18.8
Net domestic assets	78.0	63.6	59.5	50.8	50.0
Public sector credit, net	-4.9	-5.8	-6.1	-7.9	-7.5
Private sector credit, net	92.3	80.4	73.2	70.0	66.8
Broad money (M2)	70.5	69.7	70.4	68.8	68.8
Money	18.0	17.4	19.2	19.9	19.9
Quasi-money	52.5	52.3	51.2	48.9	48.9
Interest rates (percent per year) 1/					
ECCB policy rate	6.50	6.50	6.50	6.50	...
US policy rate	0.13	0.13	0.39	0.97	...
Interbank market rate	6.03	6.48	...	...	...
Time deposit rate	2.69	2.43	1.82	1.63	...
Demand deposit rate	0.46	0.44	0.27	0.22	...
Weighted average lending rate	8.54	8.35	8.15	7.99	...

Sources: St. Lucia authorities; ECCB; and Fund staff estimates and projections.
1/ End-of-period rates.

Table 5. St. Lucia: Banking System Summary Data, 2010–2017

Table 5. St. Lucia: Banking System Summary Data, 2010–17

	2010	2011	2012	2013	2014	2015	2016	2017
				(Percent of GDP)				
Balance Sheet								
Total assets	149.0	145.7	151.0	142.4	137.8	130.9	130.2	130.5
Gross loans	107.3	104.5	114.3	111.1	100.3	87.3	79.1	76.1
o/w NPLs	13.3	13.8	17.5	22.9	17.6	15.9	12.7	9.5
Provisions for NPLs	3.1	5.0	6.6	9.8	7.9	7.7	5.6	5.5
Due from ECCB	6.2	5.9	7.0	6.1	11.0	12.5	10.9	13.2
Due from banks abroad	3.9	2.0	5.7	7.8	8.4	9.8	9.8	9.5
Total liabilities	143.8	140.6	145.7	137.2	132.8	126.2	125.5	124.2
Deposits	92.7	91.7	95.9	93.4	92.0	90.5	90.1	91.2
Deposits (FX)	5.1	6.0	7.0	7.3	8.9	10.1	9.1	9.7
Due to ECCB	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0
Due to banks abroad	10.8	13.1	14.7	12.9	11.9	8.6	8.2	7.1
Capital	5.3	5.1	5.3	5.2	5.0	4.7	4.7	6.3
				(Percent)				
Profitability								
ROAE	18.8	5.9	11.5	-2.3	-1.5	8.9	-7.0	27.1
ROAA	1.5	0.5	0.9	-0.1	-0.1	0.3	-0.3	1.2
Capital Adequacy 1/								
CAR	20.3	19.0	19.2	14.3	13.3	12.9	11.8	18.2
T1R	18.5	17.2	17.1	12.8	11.9	12.0	7.8	11.4
Asset Quality								
NPL ratio	12.4	13.2	15.3	20.6	17.6	18.2	13.1	12.5
Net NPL/capital	83.8	88.4	103.2	219.7	199.9	196.9	135.2	78.3
FX Risk								
FX assets/assets	17.4	16.6	18.2	18.7	16.1	14.7	13.9	13.4
Foreign-currency-denominated liabilities to total liab	14.8	16.7	17.5	17.0	17.6	16.5	15.2	14.7
Liquidity Risk								
Liquid assets/total assets		19.6	20.0	20.8	26.3	32.2	33.6	36.7
Liquidity coverage ratio		22.5	22.5	22.7	28.8	35.5	37.6	42.0
Liquid assets/total deposits		31.1	31.5	31.7	39.4	46.7	48.5	52.6
Funding Risk								
Core/non-core liabilities	191.8	198.0	203.3	224.9	237.9	266.0	267.9	295.1
Core/non-core liabilities (ECD)	258.4	282.4	292.3	326.6	335.2	341.3	340.5	361.0
Core/non-core liabilities (FX)	33.8	35.6	40.0	46.2	61.6	93.4	89.0	111.1
Leverage and Concentration Risk								
LD ratio	115.8	114.0	119.2	119.0	109.0	96.5	87.8	83.5
LD ratio (ECD)	97.7	96.8	104.6	108.0	104.5	97.2	87.8	84.1
LD ratio (FX)	424.9	362.0	303.2	248.0	150.8	90.4	87.4	78.4
Memo								
Nominal GDP (EOY)	3,731.3	3,881.7	3,879.4	3,968.4	4,094.8	4,380.6	4,436.5	4,553.1
Lending rate (% wa)	9.5	9.0	8.5	8.4	8.5	8.3	8.1	8.0
Total deposits (% wa)	3.3	3.1	2.9	2.8	2.0	1.9	1.6	1.5
ECCB's discount rate (%)	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5

1/ Correspond to indigenous banks only.

Sources: ECCB; and IMF staff estimates.

Table 6. St. Lucia: Selected Labor Market Indicators, 2010–2017

	2010	2011	2012	2013	2014	2015	2016	2017
Estimated household population (y-o-y % change)	0.5	1.5	0.6	2.2	-0.1	0.2	0.6	-0.3
Population 15 years and over (y-o-y % change)	-3.1	3.8	2.1	3.3	-0.5	2.8	2.1	-0.2
Unemployment rate (%)	20.6	21.2	21.4	23.3	24.4	24.1	21.3	20.2
o/w male	19.5	19.2	19.4	21.3	20.9	21.3	19.4	18.1
o/w female	22.0	23.3	23.6	25.5	28.4	27.4	23.5	22.4
Youth unemployment rate (%)	33.6	35.3	33.9	39.6	41.8	41.0	38.4	38.5
Labor force (% of total population)	51.5	53.6	55.9	56.5	57.0	58.8	60.1	59.0
Labor force participation rate (%)	67.9	69.1	71.0	71.0	71.9	72.2	72.8	71.4
Wages (EC$, annual average)	18,275	18,628	19,538	20,084	20,853	21,281	...	...
o/w public	21,786	22,439	23,365	24,171	25,663	24,949	...	...

Sources: St. Lucia Population and Housing Census and National Insurance Corporation.

Annex I. Implementation of Previous Staff Advice

Progress on 2017 Article IV Policy Recommendations	
Recommendations	Policy Actions
Growth Agenda	
Staff recommended reforms to address bottlenecks:	
Implement the renewable energy initiatives. Remove obstacles preventing a more widespread adoption of solar energy and the passing of savings to final users.	The government is committed to attain 35 percent of energy through renewable sources by 2024. Progress has been made on the implementation of the solar energy component.
Continue modernization of port operations and customs. Reduce costs to trade, including costs of port operations and import duties.	First stage of establishing a border control agency was completed. An online entry system was introduced to clear goods, considerably shortening the process.
Address skills mismatches and improve labor productivity by revising the national curriculum to match market demands and provide better training opportunities.	The authorities have indicated their intention to reform the education system, but no concrete steps have been taken.
Fiscal Policy	
Staff advised urgently developing and implementing a credible, medium-run adjustment strategy to achieve their commitment to the regional debt target of 60 percent of GDP by 2030.	
Introduce a five-year adjustment equivalent to 4.4 percentage points of GDP based on eliminating tax concessions, anchoring wage growth to CPI inflation, attrition, reduction in non-essential transfers and subsidies, reduction in goods and services spending, and restructuring debt to reduce interest rates.	No fiscal adjustment was undertaken, but the shortfall fron the reduction in VAT was partly conpensated with increases in aviation taxes and the road fuel tax. Wage increases for 2006-18 triennal are yet to be negotiated with unions.
Adopt a fiscal rule to strenghten the commitment and support the adjustment.	The ECCB Monetary Council is discussing the adoption of fiscal rules in all ECCU countries. The draft PFM law contains provisions that strenghten the budget process, including the preparation of a medium term macroeconomic and fiscal framework.
Refrain from excessive increase in airport taxation.	Airport taxation was increased significantly less than initially planned.
Financial Sector	
Staff recommended both local and regional reforms to bolster the financial system.	
Establishment and operationalization of the the Eastern Caribbean Asset Management Company (ECAMC)	The ECAMC started operating in July 2017, but faces capacity challenges in purchasing and managing bank assets.
Adoption of a new insolvency legislation.	Insolvency bill has not been passed yet. There has been progress on its draft and needed amendments in accompanying legislation.
Adoption of a new insurance bill to improve regulation at regional level.	No progress.
Continue efforts to implement risk-based supervision and Basel II regulation for banks and non-banking financial institutions.	In progress. The Financial Services Regulatory Authority (FSRA) has implemented a Risk Based Supervision Manual for all regulated entities in Saint Lucia which includes Credit Unions.

Annex II. Risk Assessment Matrix[1]

Source and direction of risks	Relative Likelihood	Impact/Time Horizon	Policy response
Global/External			
Policy and geopolitical uncertainties (↓↑) Two-sided risks to U.S. growth due to uncertain impact of policies. Overall increase in uncertainty following retreat from cross-border integration and intensified risks of fragmentation/security dislocation.	**Medium/ High**	**High/ST**	Pursue fiscal adjustment to attain sustainability and reduce debt rollover risks.
Weaker global growth(↓) Structurally weak growth in AEs and/or significant slowdown in U.S. and/or China.	**Medium/High**	**High/MT**	Address cost and structural competitiveness disadvantages, including high dependence on hydrocarbon fuels, high energy prices, and other bottlenecks that weigh on businesses.
Tourism-related FDIs do not materialize (↓) Major hotel investment projects in the pipeline may get delayed or cancelled.	**Medium**	**High/MT**	Diversify the economy and reduce its dependence on tourism.
Cyber-attacks and pressure on traditional bank business models (↓)may trigger systemic financial instability or disrupt socio-economic activities.	**Medium**	**Medium/MT**	Prepare appropriate crisis management plans. Strengthen financial sector regulation and supervision.
Tighter global financing conditions (↓) Change in global risk appetite could cause a sharp tightening of financial conditions. Higher risk perception, reflecting assessments of poor compliance with international tax rules, could lead to loss/higher costs of CBRs.	**High**	**High/ST**	Pursue fiscal adjustment to attain sustainability and reduce debt rollover risks. Continue efforts to strengthen compliance with AML/CFT and tax transparency standards.
Domestic			
Better than expected CIP revenues (↑)	**Low**	**Medium/MT**	Use additional resources to reduce debt, build fiscal buffers, and invest in resilience. Ensure the effectiveness of the CIP's due diligence process.
Disorderly fiscal adjustment (↓) A weakening fiscal position and tightening financial conditions can force an abrupt fiscal adjustment.	**Low**	**High/MT**	Implement adequate fiscal adjustment to ensure debt sustainability.
Financial sector weakness (↓) Commercial banks cannot reduce NPLs and improve earnings; distress in non-bank financial sector materializes.	**Medium**	**Medium/MT**	Promptly implement remaining elements of the ECCU strategy to strengthen indigenous banks. Enhance regulatory and supervisory frameworks for non-banks.
Natural disasters (↓) Larger or more frequent events than the historical average hit St. Lucia.	**Medium**	**High /ST, MT**	Build fiscal buffers, invest in resilience, and ensure financing, including with risk-transfer instruments, with the assistance of the World Bank.

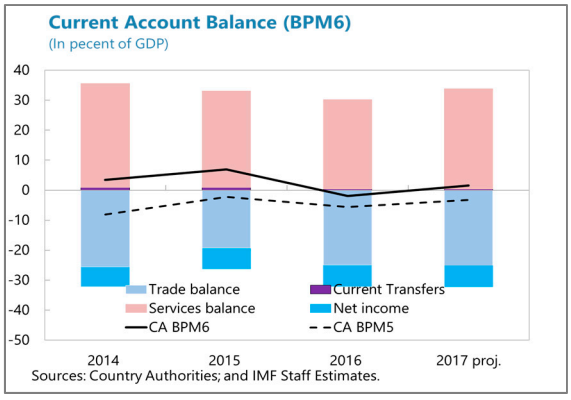
[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" (ST) and "medium term" (MT) are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

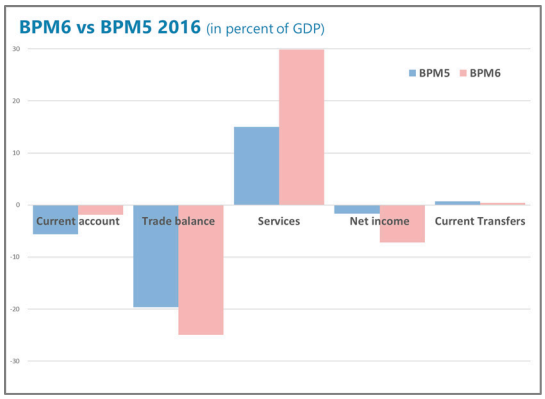
Annex III. External Sector Assessment

Driven by strong performance of tourism, St. Lucia's largest export sector, the external position has improved since last year and is assessed as broadly in line with fundamentals and recommended policies. However, high structural unemployment, a disconnect between wages and productivity, high costs of energy and trading, and poor access to credit, limit non-tourism related exports and point to the need for structural reforms to improve competitiveness and strengthen the external position further.

Balance of Payments – Background and Outlook

1. The shift to BPM6 data dramatically improves 2014-2016 current account (CA) balances. In July 2017 the ECCB published the estimates of the 2014-2016 Balance of Payments (BOP) data for ECCU countries and discontinued compilation of BPM5 data. With the shift to the new methodology, St. Lucia's current account improved markedly, moving from large deficits to large surpluses in 2014 and 2015. The bulk of this adjustment is explained by the balance of services, in which travel expenditures are now based on updated tourist expenditure surveys and include students at offshore universities. The balances on trade and net income have worsened with the move to the new classification, but not sufficiently to offset the improvement in services. However, a recent CARTAC mission has indicated that further adjustment to the historical data is expected due to incorrect estimates of re-exports and possible double-counting of exports of alcoholic beverages. The correction will amount to a reduction in the current account balance of about 2.2 to 3.1 percent of GDP.

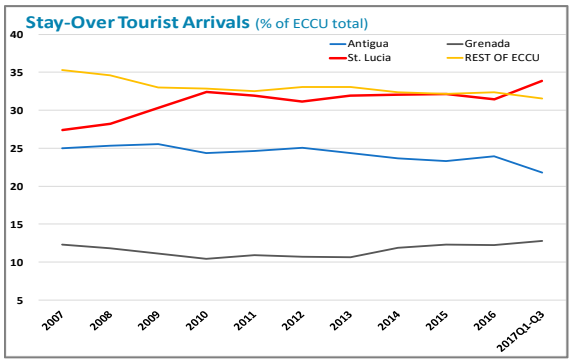


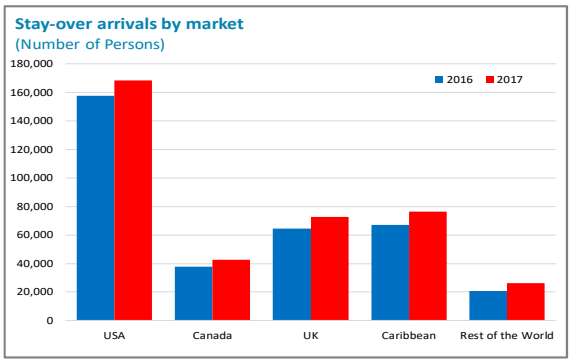


2. St. Lucia's external position improved markedly in 2017 because of a strong tourism performance. After a deficit of -1.9 percent in 2016, St. Lucia's current account has improved significantly. The ECCB has not yet published the 2017 BOP data, but based on preliminary figures on tourism and trade, staff is projecting a current account surplus of 1.3 percent of GDP. After a disappointing performance in 2016, St. Lucia's tourism sector experienced a very strong year, increasing its market share among its ECCU competitors. The sector benefitted from: (i) a 10-percent expansion of hotel room stock, owing to the completion of the 470-room Royalton hotel and several hotel renovation and expansion projects; (ii) the addition of four direct flight routes, expanding the

seat capacity by 5 percent; and (iii) the recovery of the cruise ship segment, which grew by 14 percent after a large drop in 2016. The increase in aviation taxes did not apparently affect arrivals, with all foreign markets showing significant growth. The United States remained the most important market with about half of total arrivals, while arrivals from Europe experienced the strongest growth. Due to expansion in duty-free shopping of cruise-ship passengers and imports of food and hotel supplies, strong tourism translated also into larger exports and imports of goods, but the trade deficit was roughly stable at about 25.2 percent of GDP.

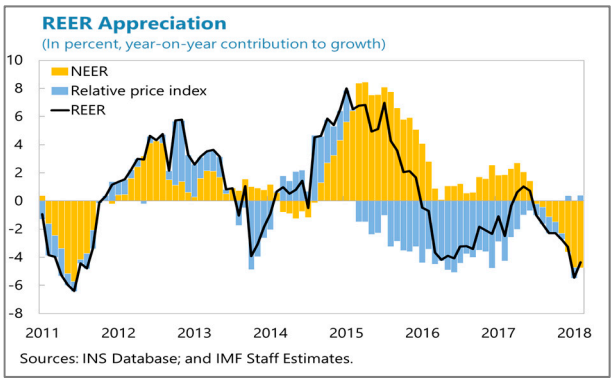
3. In the medium-term, tourism is expected to remain strong, but the external position is expected to worsen due to investment related imports. Due to a pipeline of major hotel investment projects and the completion of a berth allowing docking of quantum vessel of up to 5000 passengers, strong tourism performance is expected to continue in the medium-term, despite further increase of aviation taxes in 2018. Trade balance will worsen significantly due to an anticipated pick-up in imports related to the planned infrastructure and hotel investment projects. Combined with slight worsening of net income balances and steady net current transfers, a significantly negative current account balance is expected for the upcoming years, before returning closer to balance in 2021, when most of the investment projects are expected to be completed. The outlook for the external sector is subject to risks, including some of the hotel investment not materializing, lower than expected growth in major tourist source markets, and natural disasters.

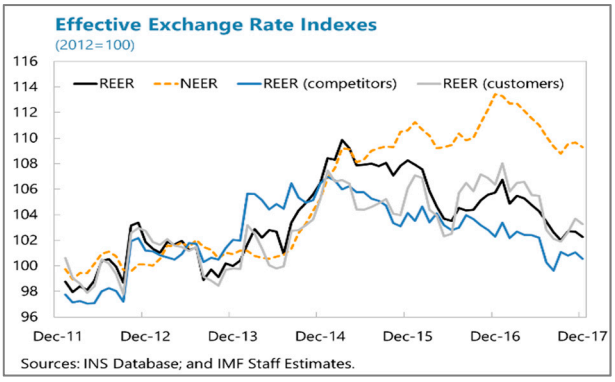




Exchange Rate Developments

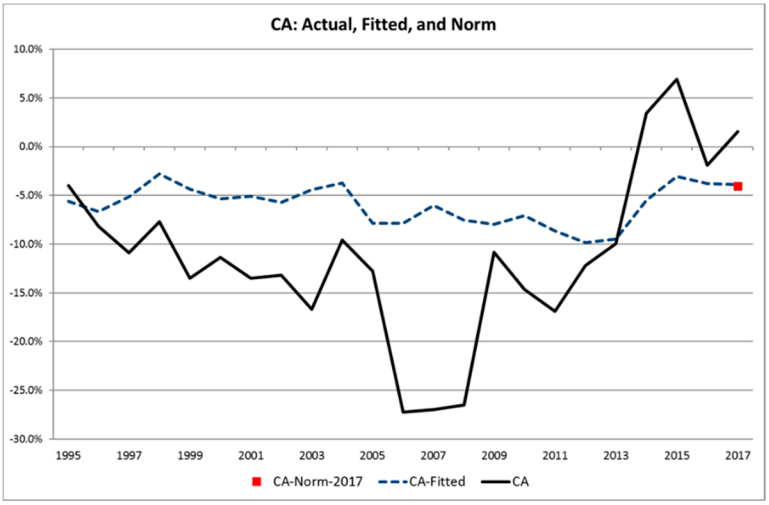
4. The real effective exchange rate (REER) continued to depreciate in 2017. The REER had been steadily appreciating since 2011, mostly reflecting the nominal appreciation of the U.S. dollar to which the E.C. dollar is pegged. The REER started to gradually depreciate in 2015 and this trend persisted into 2017, driven mostly by the US dollar depreciation, boosting St. Lucia's competitiveness.





EBA-lite results

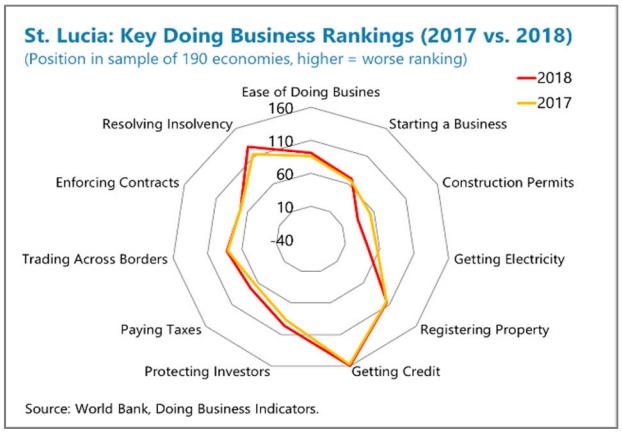
5. The EBA-lite results do not point to an exchange rate misalignment. The CA-regression approach of the EBA-lite methodology yields a CA norm of -3.0 percent of GDP. Applying an adjustment of 2.7 percent of GDP–about the midpoint of the expected statistical adjustments to exports–to the cyclically adjusted actual current account balance of 2.2 percent of GDP, this implies a current account gap of 2.5 percent and a real exchange rate undervaluation of 5.6 percent. The external sustainability approach of the EBA-lite methodology leads to a similar finding. Given the current net IIP of -46.3 percent of GDP and the targeted reduction of public external debt to 29.4 percent of GDP by 2030, the net IIP target was set at-41 per cent in 13 years yielding a CA norm of -3.7 percent, and pointing to an undervaluation of 7.3 percent. On the other hand, the results of the REER model point to an overvaluation of 5 percent.

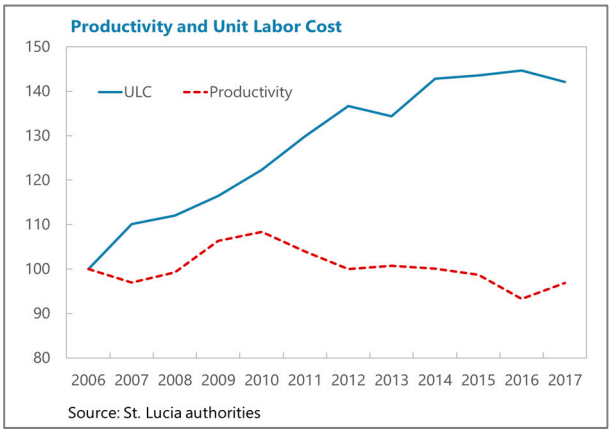


St. Lucia External Sector Assessment EBA-lite Model Estimates (2017 in percent)							
	Cyclically adjusted Current Account Norm	Cyclically adjusted Current Account Balance	Adjusted Current Account Balance 2/	Current Account Gap	REER Gap 1/	Policy Gap	Residual
CA Regression	-3.0	2.2	-0.5	2.5	-5.6	0.3	2.2
REER Regression					5.0	-1.4	6.4
ES Approach	-3.7	2.2	-0.5	3.2	-7.3		
Source: IMF staff estimates and calculations. 1/ Positive number indicates overvaluation. 2/ Includes statistical adjustment related to expected export data correction							

Non-Price Competitiveness Indicators

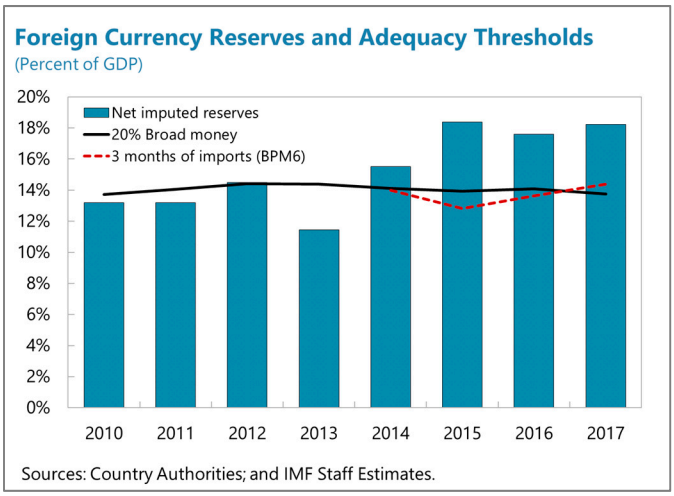
6. Non-price indicators clearly point at a weak competitive position. A narrow exports base, high unemployment, and low output growth in sectors unrelated to tourism or construction seem to indicate low competitiveness. The latest World Bank Doing Business Indicators show that the country's overall ranking has continued to fall from 86 in 2017 to 91 in 2018. St. Lucia scores particularly poorly on indicators related to the financial sector, like getting credit and insolvency and trading across borders, which reflects the high costs of port operations. Despite some improvement in 2017, high unit labor costs and a marked disconnect between wages and productivity —partly reflecting the large share of public sector employment and strong unions— are further weighing on St. Lucia's external competitiveness**.**





Reserves

7. Imputed net international reserves held at the ECCB remain above the reserve adequacy thresholds. As a member of the ECCU, reserve adequacy is assessed based on the net imputed reserves held at the ECCB. The reserve coverage of about 17 percent of GDP in 2017 corresponds to about 3.8 months of imports and 25 percent of broad money, exceeding the benchmarks of 3 months and 20 percent, respectively. The decline in import coverage from 5.1 in 2016 is driven by the switch to BPM6 data, particularly the about twice as large services imports compared to BPM5 data.

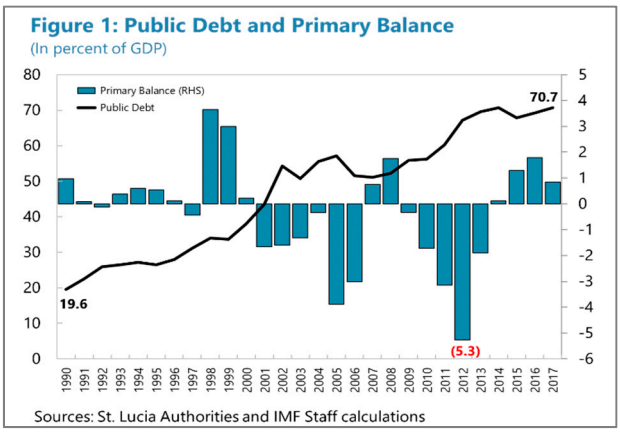


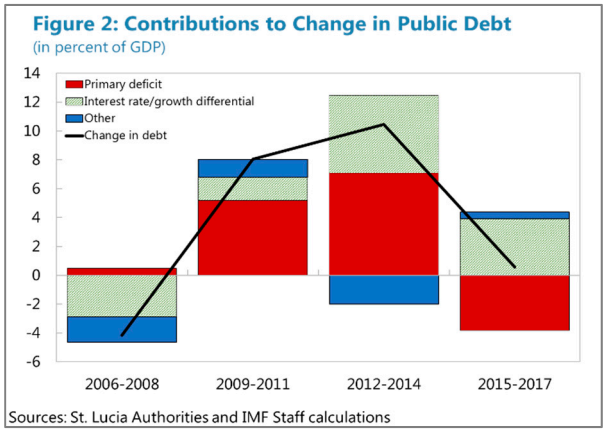
Annex IV. Debt Sustainability Analysis[1]

St. Lucia's public debt continues to be unsustainable under current policies with external debt following a similar upward trajectory. Public debt is projected to rise gradually throughout the medium term to reach 81.3 percent of GDP by 2023, largely reflecting primary deficits and positive interest-growth differentials, while external debt will increase by about 5 percentages points to 74.3 percent of GDP. The financing needs generated under current policies are projected to double over the next 5 years. The baseline debt path is vulnerable to unfavorable shocks from real interest rates, real GDP growth, the primary balance, and natural disasters.

A. Background and Recent Developments

1. St. Lucia's public-sector debt has risen three-fold since the early 1990s. Gross public debt increased from 19.6 percent of GDP in 1990 reaching 70.7 percent of GDP in 2017 (Figure 1)**.** Deteriorating fiscal balances were the main drivers of debt up to 2014 (Figure 2). Since 2001, St. Lucia recorded primary deficits every year, except during 2008-09 period and more recently in the last few years, which has contributed to a dramatic rise in debt. During 2006-2017, debt climbed by 14.2 percent of GDP, of which 8.7 percentage points were due to worsening primary balances. In the years following the GFC, St. Lucia's primary deficit deteriorated significantly, leading to a sizeable increase in the debt-to-GDP ratio of 7 percentage points.

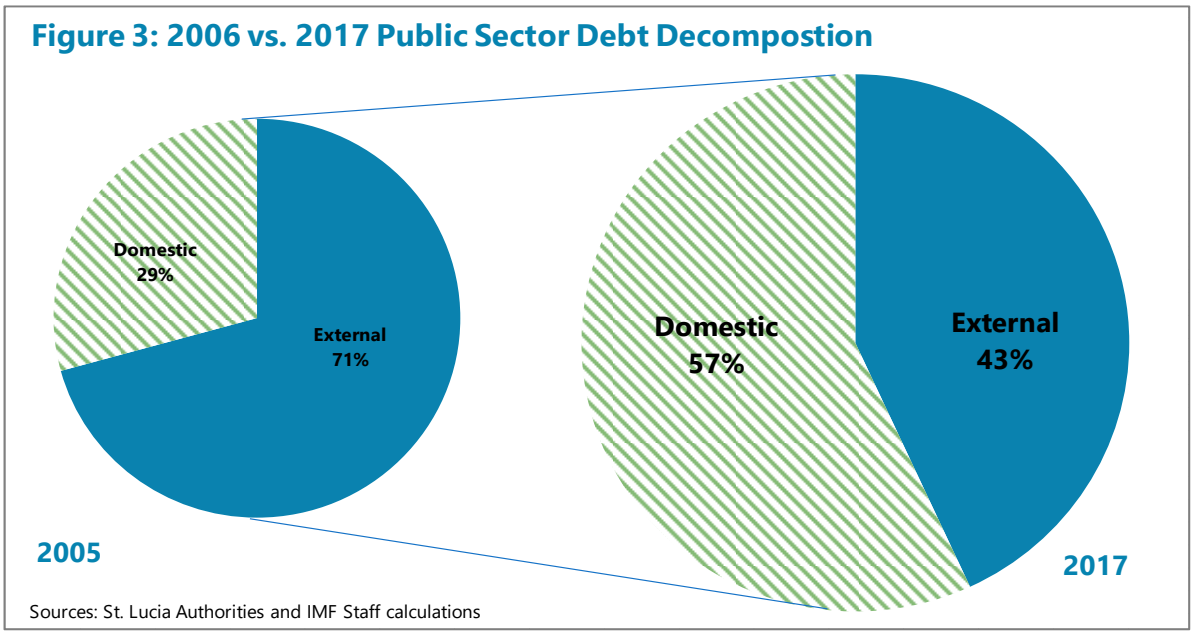




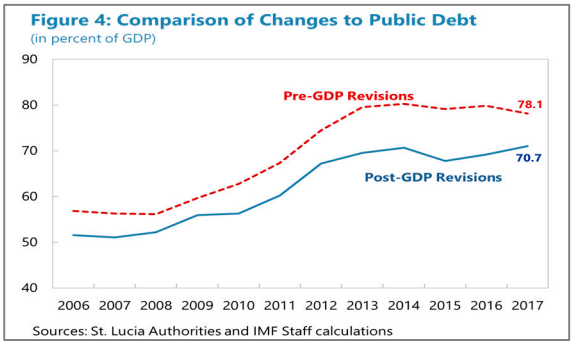
2. Over the past decade, the government has increased its reliance on domestic financing. Consequently, the share of domestic debt doubled from 29 percent of total debt in 2005 to 57 percent in 2017 (Figure 3). Non-bank financial institutions, including the national insurance scheme, and commercial banks are the largest holders of domestic debt. Short-term debt has

[1] Prepared by Anne Marie Wickham. The analysis of public debt sustainability is based on the framework developed for market access countries.
See *Staff Guidance Note for Public Debt Sustainability Analysis in Market Access Countries,* IMF, May 2013.

increased substantially, accounting for 17 percent (less than one year) and 57.5 percent (less than five years) of total debt.



3. A comparison with the previous DSA (2017 Article IV) shows improved debt ratios as a result of revisions to the national accounts series (Figure 4). Following the revision, the debt-to-GDP ratio fell by some 10 percentage points (see footnote 4 in the main text).



B. Public Sector Debt Sustainability Analysis

4. The baseline scenario is built on the following assumptions:

- ***Growth and Inflation*:** Real economic activity is projected to grow by 3.5 percent in 2018 and 3.7 percent in 2019, and to gradually decline before reaching its potential rate of 1.5 percent in 2023. Inflation is projected to converge to 1.5 percent over the medium term, reflecting changes in the terms of trade.
- ***Primary Balance:*** The primary balance is expected to deteriorate from a surplus of 0.6 percent of GDP in 2017 to a deficit of 1 percent of GDP in 2018 (including estimated uninsured costs of natural disasters of 0.7 percent of GDP) and remain close to that level in the medium term.

5. The baseline debt path is unsustainable (Figure A3-A5). Under the baseline assumptions public debt rises throughout the medium term to reach 81.4 percent of GDP by 2023, largely reflecting primary deficits from 2018 onwards and positive interest rate-growth differentials. The primary deficits over the projection period averages 0.5 percent of GDP, while the debt-stabilizing primary surplus is 2.1 percent.

6. The heat map and fan charts highlight significant risks to debt sustainability (Figure A1). Both debt level and gross financing needs exceed the benchmark for emerging market economies. Moreover, the debt profile is also subject to high risks due to the high share of public debt held by non-residents. The fan charts show the possible evolution of the debt-to-GDP ratio over the medium term, based on both a symmetric and an asymmetric distribution of risks. The asymmetric fan chart (where negative shocks to growth, the real interest rate, and the primary balance are considered) shows that debt would reach almost 100 percent of GDP by 2023 if economic conditions were to deteriorate.

7. The projection bias evident in the baseline macro assumptions can be explained by the revision to the GDP series (**Figure A2**). The revised GDP show a much slower growth rate of economic activity for 2012 than previously estimated, generating a large forecast error. The significant forecast errors for the primary balance in 2014-2016 are also explained by the GDP revision. The inflation forecast errors are comparable with those of other countries.

8. Shocks and Stress Tests (Figure A4 and A5)

Under DSA adverse shock scenarios, the baseline debt path worsens, with the most significant impact in a combined shock scenario.

- **Growth shock**- Under a growth shock, output is reduced by 1.8 percentage points in 2019 and 2020 (1 standard deviation of growth over the past 10 years) relative to the baseline projections and inflation declines by 0.4 percentage points each year in 2019-20. Specifically, debt would peak at 86.1 percent in 2023, which is 5.5 points higher than in the baseline. Concurrently, the impact on gross financing needs would result in an increase on average, over the medium-term, of 1.6 percentage points higher than the baseline projections.
- **Primary balance shock** – The primary balance shock of 1.2 percentage points over 2019–20 (½ standard deviations of the historical 10-year average) results in the debt-to-GDP ratio of 83.5 percent of GDP by 2023 (2.9 percentage points higher relative to the baseline).
- **Interest rate shock** – A sustained interest rate shock of 633 basis points (difference between the maximum and average rates over the last 10 years), starting in 2019 to the end of the projection period, would result in an increase in the debt ratio to 88.9 percent of GDP by 2023 (8.3 percentage points higher than the baseline).
- **Combined macro-fiscal shock** –Combining all previous shocks would lead to debt exceeding 100 percent of GDP over the medium term and increasing gross financing needs as a percent of GDP by 8.7 percentage points by 2023 compared to the baseline scenario.

- **Natural disaster shock** – A natural disaster occurring in 2019 comparable to the damage caused by Hurricane Tomas in 2010 would lead to a contraction of real GDP growth of 5, 3 and 2 percent in 2019, 2020 and 2021, and a deterioration in the primary balance of the same amount, increasing the debt-to-GDP ratio to 89.2 percent by 2023, 8.6 points above the baseline.

- **Adjustment Scenario** – Under the staff proposed adjustment policies, assuming lower growth but improved primary balance, debt to GDP would gradually decline to 66.9 percent of GDP in 2023, 13.7 percentage points lower than the baseline scenario and closer to the regional debt target of 60 percent of GDP by 2030. This scenario also results in a reduction of gross financing needs by 8 percentage points by 2023 to reach 10.5 percent of GDP.

- **Contingent liability shock** – Under this scenario, government assumes 10 percent of banking sector's total assets and a 1 standard deviation shock to real GDP growth. This would increase the debt-to-GDP ratio by 16.2 percentage points in 2023, while the gross financing needs-to-GDP ratio would rise to 22.8 percent by 2023 (4.3 points higher than the baseline).

C. External Debt Sustainability Analysis

9. St. Lucia external public debt is projected to steadily increase over the medium term, from 66.9 percent of GDP in 2017 to 73.2 percent of GDP in 2023 (Table A1). The increase in external debt reflects the projected rise in public sector debt. Gross external financing needs are projected to increase from less than 0 percent of GDP in 2017 to an average of 2.7 percent over the medium term.

10. Under the baseline scenario, the external debt path remains highly vulnerable to potential adverse shocks, including from a growth shock, a current account shock, combined scenarios, and a real exchange rate depreciation shock, but is less sensitive to an interest rate shock (Figure A6). Under a growth shock, external debt is projected to increase marginally by 5 percentage points in 2023, reaching 79 percent of GDP, while under the current account shock, external debt is projected to increase to 99 percent of GDP. The combined shock, which incorporates the real interest rate, growth, and current account scenarios, pushes external debt to 89 percent of GDP. The most adverse shock to external debt is the real depreciation shock, which increase the debt-to-GDP ratio to 109 percent in 2023 (34 percentage points higher than the baseline). The vulnerability suggested by this scenario is mitigated by the currency-board arrangement.[2]

[2] Under the ECCB Act (1983), external reserves must be held at not less than 60 percent of demand liabilities, but under current practice they exceed 90 percent of demand liabilities, making the ECCU a currency board.

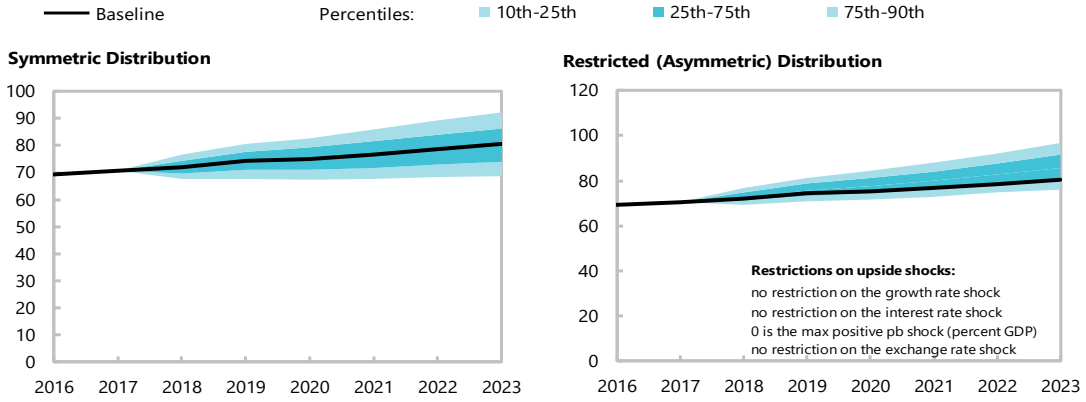
Figure A1. St. Lucia: Public DSA Risk Assessment

Heat Map

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

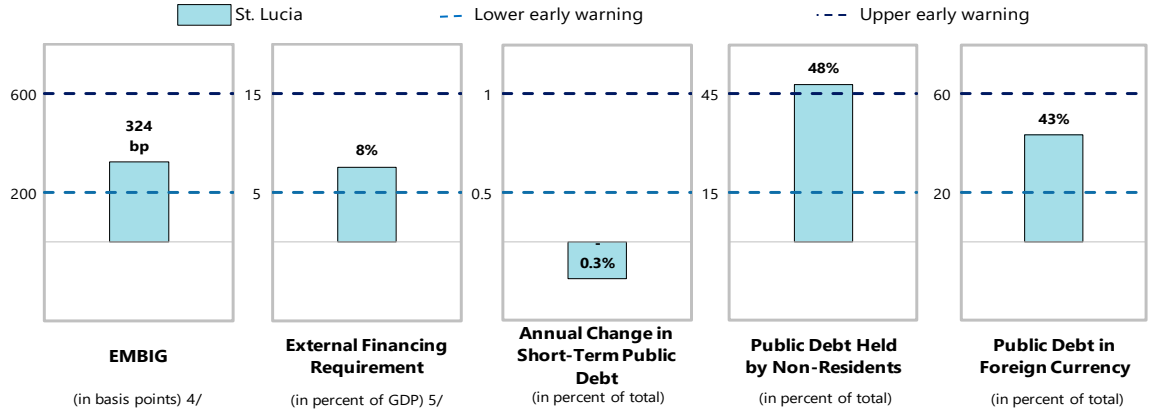
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2017)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

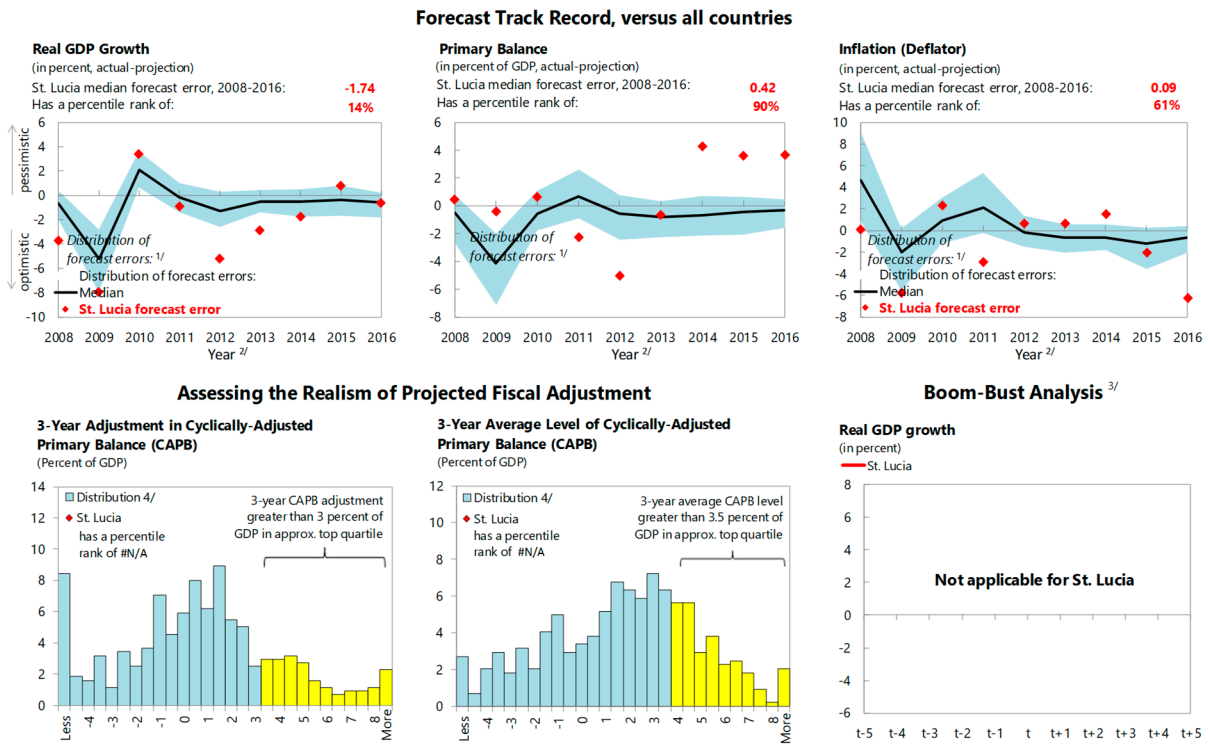
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant,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

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 27-Mar-17 through 25-Jun-17.

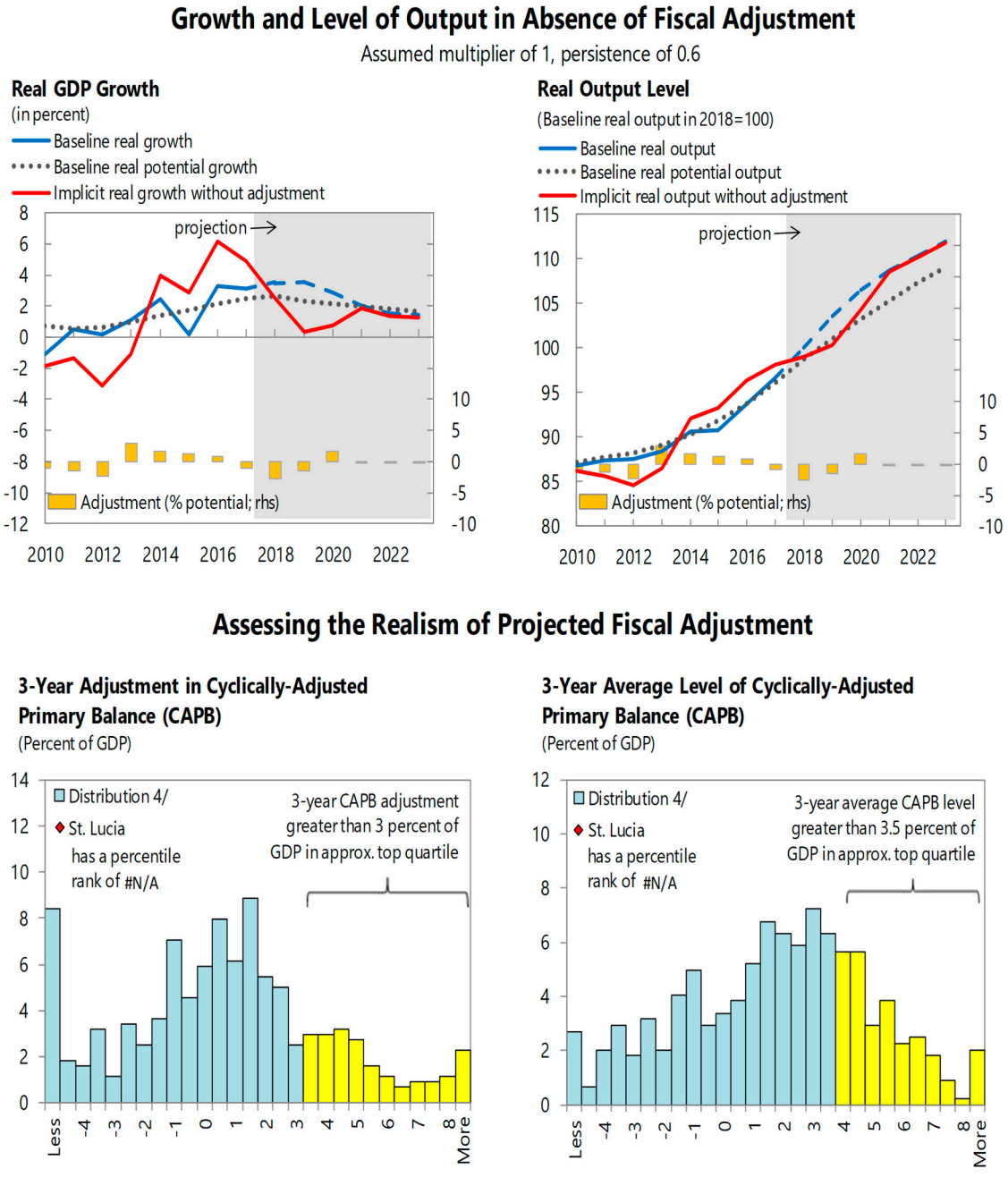
5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Figure A2. St. Lucia: Public DSA – Realism of Baseline Assumptions



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

Figure A2. St. Lucia: Public DSA – Realism of Baseline Assumptions (concluded)



Source: IMF Staff

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

Figure A3. St. Lucia: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP, fiscal-year basis, unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2007-2015 [2/]	2016	2017	2018	2019	2020	2021	2022	2023
Nominal gross public debt	61.2	69.2	70.7	72.2	74.6	75.5	77.2	79.2	81.3
Public gross financing needs	17.0	19.2	23.7	20.8	25.4	20.9	21.7	20.4	18.8
Real GDP growth (in percent)	1.2	3.3	3.1	3.5	3.5	2.9	2.0	1.5	1.5
Inflation (GDP deflator, in percent)	2.6	-1.6	0.1	1.3	1.6	1.5	1.5	1.5	1.6
Nominal GDP growth (in percent)	3.8	1.6	3.2	4.9	5.1	4.4	3.5	3.1	3.1
Effective interest rate (in percent) [4/]	5.2	5.3	5.1	5.0	4.9	5.2	5.5	5.7	5.8

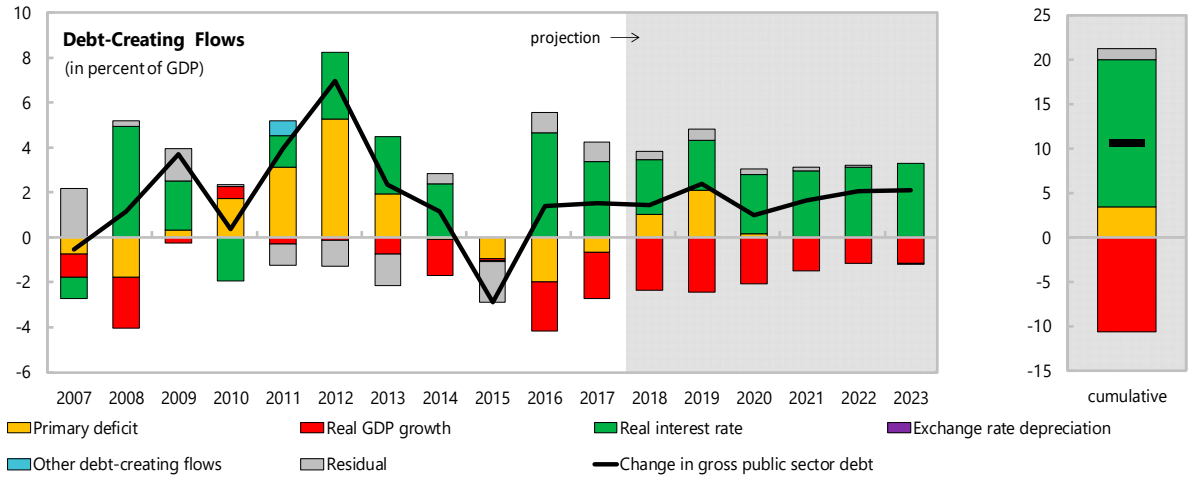
As of February 28, 2018

Sovereign Spreads	
EMBIG (bp) 3/	311
5Y CDS (bp)	237

Ratings	Foreign	Local
Moody's	n.a.	n.a.
S&Ps	n.a.	n.a.
Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.8	1.4	1.5	1.4	2.4	1.0	1.6	2.0	2.1	10.6	2.1
Identified debt-creating flows	2.8	0.5	0.7	1.1	1.9	0.8	1.5	2.0	2.1	9.4	
Primary deficit	1.0	-2.0	-0.6	1.0	2.1	0.2	0.1	0.0	0.1	3.5	
Primary (noninterest) revenue and grants	23.2	24.4	24.3	24.9	24.8	24.8	25.0	25.0	25.0	149.4	
Primary (noninterest) expenditure	24.2	22.4	23.6	25.9	26.9	25.0	25.0	25.0	25.0	152.9	
Automatic debt dynamics [5/]	0.8	2.5	1.3	0.1	-0.2	0.6	1.4	1.9	2.1	5.9	
Interest rate/growth differential [6/]	0.8	2.5	1.3	0.1	-0.2	0.6	1.4	1.9	2.1	5.9	
Of which: real interest rate	1.2	4.6	3.4	2.5	2.2	2.6	2.9	3.1	3.2	16.6	
Of which: real GDP growth	-0.6	-2.2	-2.1	-2.4	-2.4	-2.1	-1.5	-1.2	-1.2	-10.6	
Exchange rate depreciation [7/]	0.0	0.0	0.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Government and Public Sector Finance, Revenu	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-0.8	0.9	0.8	0.4	0.5	0.2	0.1	0.1	0.0	1.2	



Source: IMF staff.

1/ Public sector is defined as central government and includes public guarantees, defined as .

2/ Based on available data.

3/ EMBIG.

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

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

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

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

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

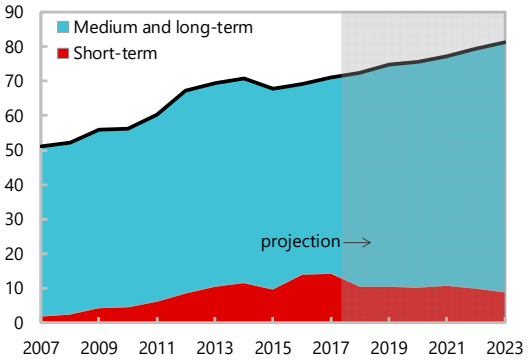
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure A4. St. Lucia: Public DSA-Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

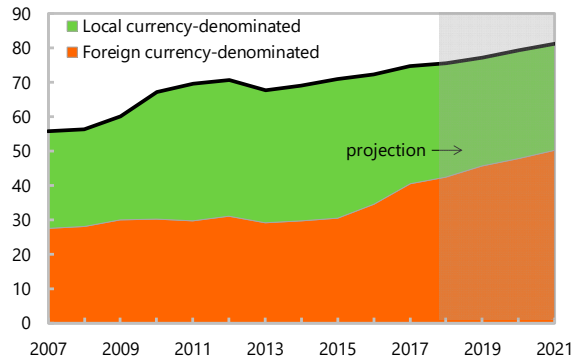
By Maturity

(in percent of GDP)



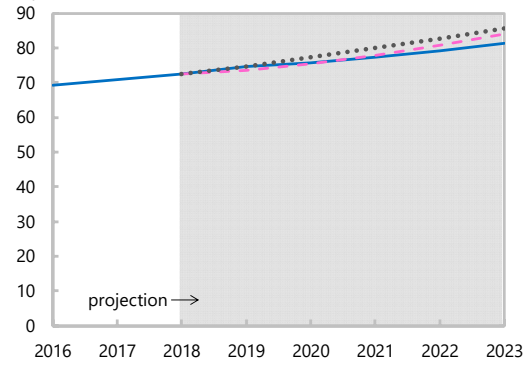
By Currency

(in percent of GDP)



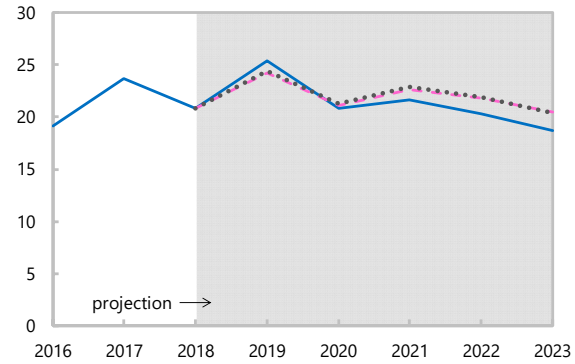
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

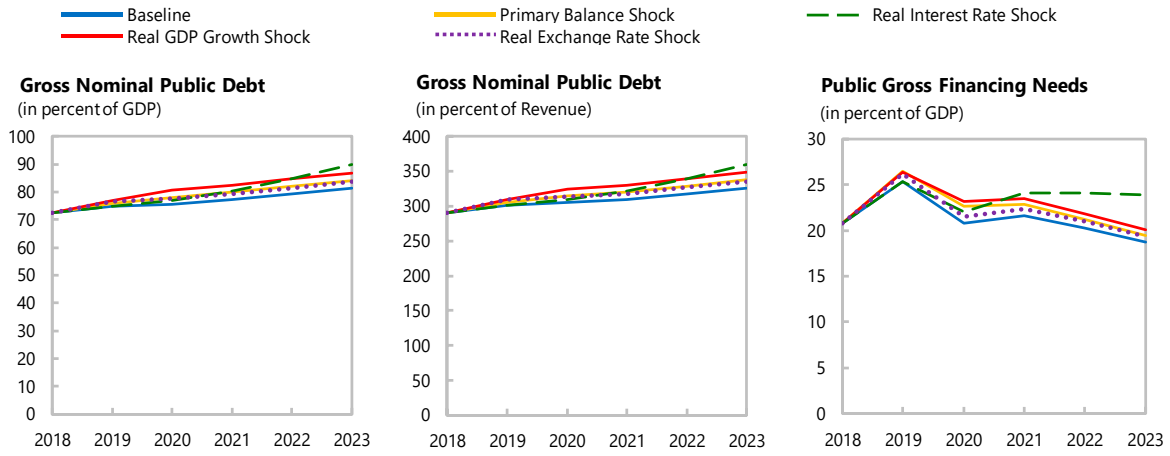
Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	3.5	3.5	2.9	2.0	1.5	1.5
Inflation	1.3	1.6	1.5	1.5	1.5	1.6
Primary Balance	-1.0	-2.1	-0.2	-0.1	0.0	-0.1
Effective interest rate	5.0	4.9	5.2	5.5	5.6	5.8
Constant Primary Balance Scenario						
Real GDP growth	3.5	3.5	2.9	2.0	1.5	1.5
Inflation	1.3	1.6	1.5	1.5	1.5	1.6
Primary Balance	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Effective interest rate	5.0	4.9	5.2	5.5	5.6	5.8

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	3.5	1.5	1.5	1.5	1.5	1.5
Inflation	1.3	1.6	1.5	1.5	1.5	1.6
Primary Balance	-1.0	-0.7	-0.7	-0.7	-0.7	-0.7
Effective interest rate	5.0	4.9	5.2	5.5	5.6	5.8

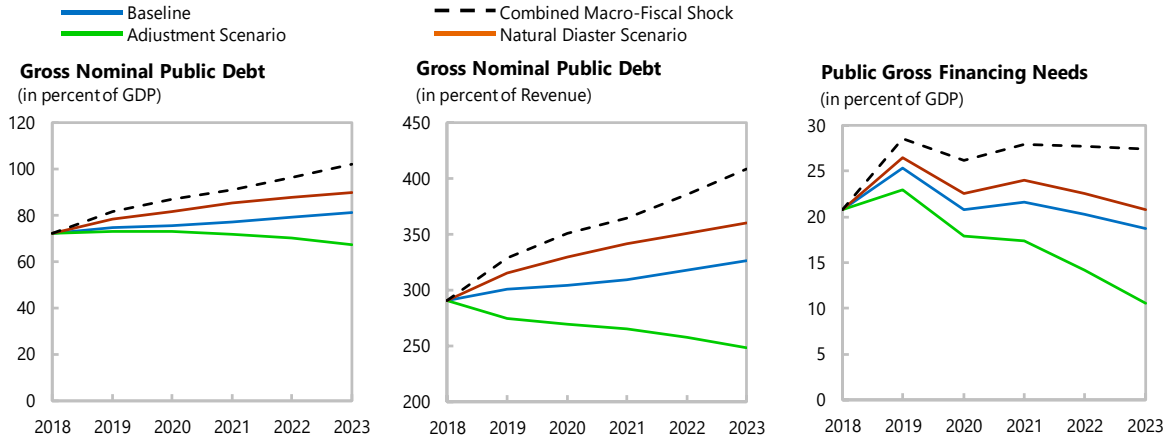
Source: IMF staff.

Figure A5. St. Lucia: Public DSA-Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2018	2019	2020	2021	2022	2023
Real GDP growth	3.5	3.5	2.9	2.0	1.5	1.5
Inflation	1.3	1.6	1.5	1.5	1.5	1.6
Primary balance	-1.0	-3.3	-1.3	-0.1	0.0	-0.1
Effective interest rate	5.0	4.9	5.3	5.6	5.7	5.9
Real Interest Rate Shock						
Real GDP growth	3.5	3.5	2.9	2.0	1.5	1.5
Inflation	1.3	1.6	1.5	1.5	1.5	1.6
Primary balance	-1.0	-2.1	-0.2	-0.1	0.0	-0.1
Effective interest rate	5.0	4.9	6.9	7.8	8.6	9.3
Combined Shock						
Real GDP growth	3.5	1.8	1.1	2.0	1.5	1.5
Inflation	1.3	1.1	1.1	1.5	1.5	1.6
Primary balance	-1.0	-3.3	-1.3	-0.1	0.0	-0.1
Effective interest rate	5.0	5.2	7.0	8.0	8.8	9.4

Real GDP Growth Shock	2018	2019	2020	2021	2022	2023
Real GDP growth	3.5	1.8	1.1	2.0	1.5	1.5
Inflation	1.3	1.1	1.1	1.5	1.5	1.6
Primary balance	-1.0	-2.7	-1.3	-0.1	0.0	-0.1
Effective interest rate	5.0	4.9	5.2	5.6	5.7	5.9
Real Exchange Rate Shock						
Real GDP growth	3.5	3.5	2.9	2.0	1.5	1.5
Inflation	1.3	4.6	1.5	1.5	1.5	1.6
Primary balance	-1.0	-2.1	-0.2	-0.1	0.0	-0.1
Effective interest rate	5.0	5.2	5.2	5.5	5.7	5.9

Source: IMF staff.

Table A1. St. Lucia: External Debt Sustainability Framework, 2013-2023

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2013	2014	2015	2016	2017			2018	2019	2020	2021	2022	2023	Debt-stabilizing non-interest current account 6/
Baseline: External debt	84.1	82.1	72.4	70.1	69.3			**71.0**	**72.0**	**72.4**	**73.1**	**73.9**	**74.9**	**-7.5**
Change in external debt	1.3	-2.0	-9.6	-2.3	-0.8			1.7	1.1	0.4	0.7	0.8	1.0	
Identified external debt-creating flows (4+8+9)	-7.5	-7.3	-16.9	-6.1	-10.6			-8.6	-7.9	-9.1	-8.9	-8.2	-8.3	
Current account deficit, excluding interest payments	-0.8	-4.7	-8.1	0.6	-2.6			0.2	1.0	-0.7	-1.9	-1.7	-2.0	
Deficit in balance of goods and services	-91.4	-120.9	-115.4	-113.9	-119.4			-121.0	-121.9	-120.4	-120.4	-121.1	-122.5	
Exports	41.4	65.0	64.1	59.4	63.6			62.9	62.8	62.8	63.2	63.4	64.1	
Imports	-50.1	-55.9	-51.3	-54.5	-55.8			-58.1	-59.1	-57.7	-57.1	-57.7	-58.4	
Net non-debt creating capital inflows (negative)	-6.3	-1.3	-4.6	-7.1	-7.5			-7.8	-8.0	-8.1	-7.4	-7.4	-7.4	
Automatic debt dynamics 1/	-0.5	-1.3	-4.2	0.4	-0.5			-0.9	-1.0	-0.3	0.4	1.0	1.1	
Contribution from nominal interest rate	1.4	1.3	1.2	1.3	1.3			1.3	1.5	1.8	2.0	2.1	2.2	
Contribution from real GDP growth	-0.2	-2.9	0.7	-2.4	-2.0			-2.3	-2.5	-2.1	-1.5	-1.1	-1.1	
Contribution from price and exchange rate changes 2/	-1.6	0.3	-6.1	1.5	0.2			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	8.9	5.3	7.3	3.8	9.8			10.2	8.9	9.5	9.6	9.0	9.3	
External debt-to-exports ratio (in percent)	203.4	126.3	113.0	118.0	108.9			112.8	114.7	115.4	115.7	116.5	116.8	
Gross external financing need (in billions of US dollars) 4/	0.0	0.0	-0.1	0.1	0.0			0.1	0.1	0.1	0.0	0.1	0.1	
in percent of GDP	1.9	-2.1	-5.7	3.2	0.0			2.8	4.1	2.9	2.0	2.4	2.3	2.8
Scenario with key variables at their historical averages 5/						10-Year Historical Average	10-Year Standard Deviation	**71.0**	**77.1**	**83.9**	**90.8**	**96.9**	**103.3**	**-8.3**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	0.3	3.6	-0.9	3.4	3.0	1.5	2.3	3.5	3.7	3.1	2.2	1.6	1.5	
GDP deflator in US dollars (change in percent)	2.0	-0.4	8.0	-2.0	-0.3	1.4	5.0	1.3	1.6	1.5	1.4	1.5	1.5	
Nominal external interest rate (in percent)	1.7	1.6	1.5	1.8	1.9	1.7	0.1	2.0	2.3	2.6	2.8	2.9	3.0	
Growth of exports (US dollar terms, in percent)	0.7	62.2	5.5	-6.1	9.9	10.2	19.7	3.6	5.1	4.6	4.4	3.4	4.2	
Growth of imports (US dollar terms, in percent)	-2.1	15.2	-1.9	7.7	5.0	3.0	12.1	9.1	7.3	2.1	2.7	4.2	4.2	
Current account balance, excluding interest payments	0.8	4.7	8.1	-0.6	2.6	-3.8	9.6	-0.2	-1.0	0.7	1.9	1.7	2.0	
Net non-debt creating capital inflows	6.3	1.3	4.6	7.1	7.5	7.0	3.3	7.8	8.0	8.1	7.4	7.4	7.4	

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

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

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

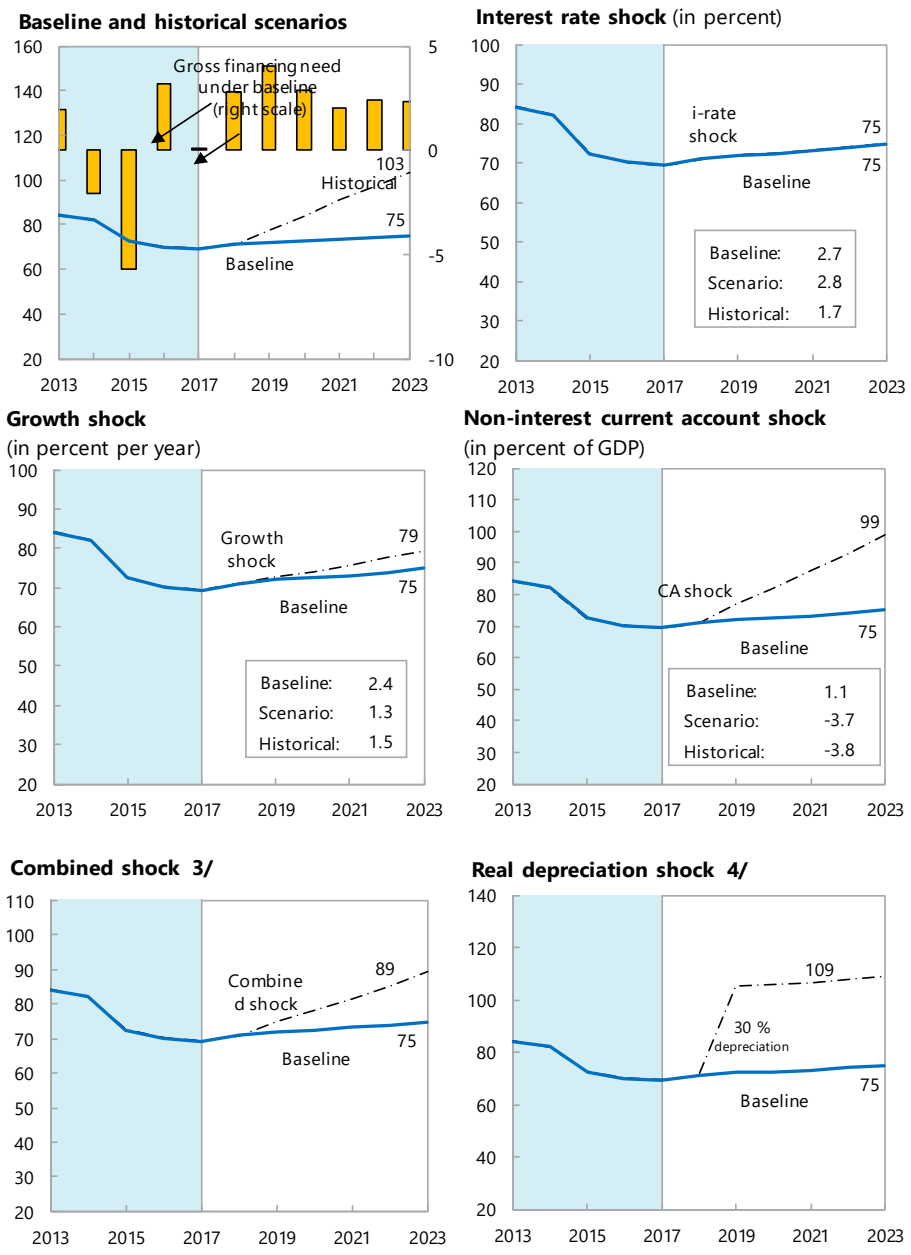
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

Figure A6. St. Lucia: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2010.

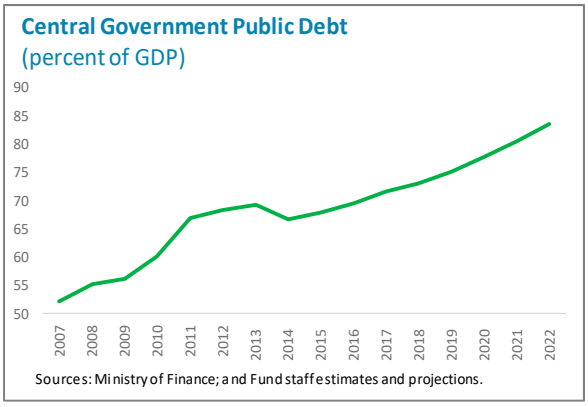
Annex V. Sensitivity of Public Debt Profile to Changes in International Interest Rates[1]

St. Lucia's public debt dynamics are exposed to changes in international interest rates, particularly U.S. interest rates. While the pass-through effect is only partial, its impact can be substantial. A sound debt strategy for St. Lucia must consider the implications of changes in international interest rates, particularly in view of its relatively high levels of outstanding debt.

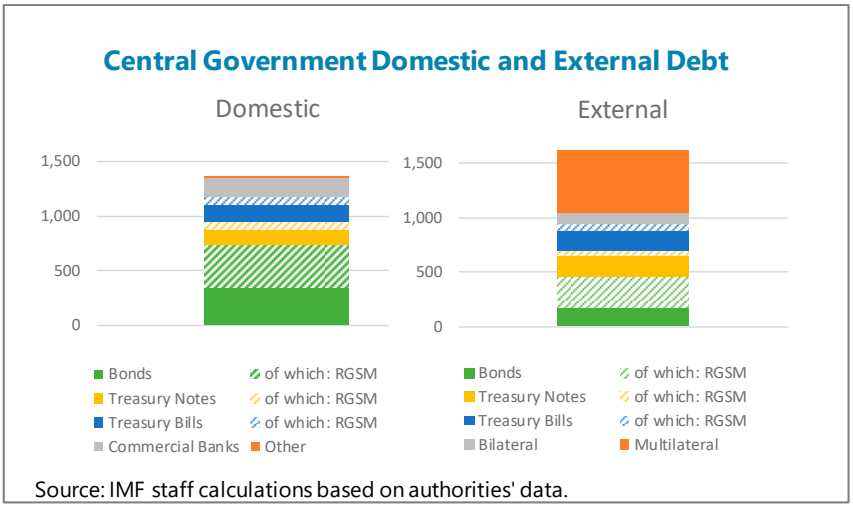
A. Recent Trends of Interest Rates and Public Debt

1. International interest rates, driven by tighter U.S. monetary policy, are expected to rise over the medium term. As a response to the financial crisis, the Federal Reserve kept its policy rate target between zero and 25bp in the period from end-2008 to end-2015. Owing to improved economic conditions, this policy has been officially reversed since 2016, and U.S. interest rates are expected to increase by about 200 bps over the next four years. Depending on the debt composition, this trend could impact the servicing of St. Lucia's public debt, with loans contracted in foreign currency or instruments issued in external markets more likely to be affected by changes in international interest rates. Moreover, interest rates of domestic instruments might also be affected by changes in external rates if interest rate parity holds.

2. St. Lucia's public debt composition suggests that its debt profile might be sensitive to international interest rates. Public debt as a percent of GDP has steadily risen over the past 10 years, and —unless a tighter fiscal envelope is adopted— is projected to follow an upward trend over the medium term. As of 2017, domestic and external debt represent 46 and 54 percent of total public debt of the central government, respectively. Sovereign guaranteed instruments, namely—bonds, treasury notes and treasury bills—are the bulk of total public debt, representing 71 percent of the total; of them, 32pp is contracted externally and 30pp is traded in the Regional Governments Securities Market (RGSM), which is a regional market for trading debt instruments of member states of the Eastern Caribbean Currency Union (ECCU). Multilateral and bilateral external loans represent about 22 percent of total public debt.

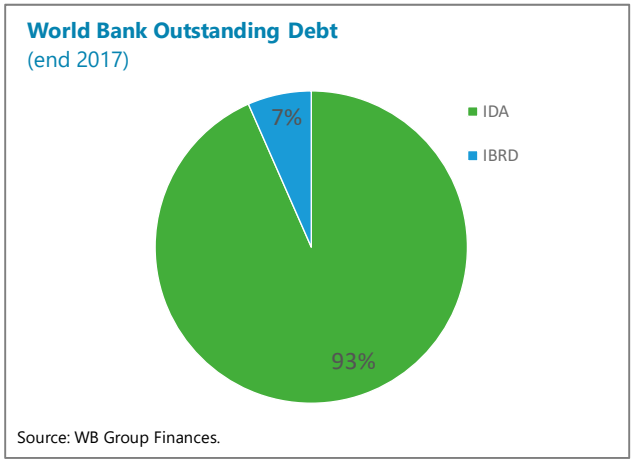


[1] Prepared by Mauricio Vargas and Steve Brito.



Source: IMF staff calculations based on authorities' data.

3. Multilateral and bilateral debt terms, especially interest rates, in some cases adjust and follow international market trends. However, most of St. Lucia's debt is contracted at fixed rates. Although this type of credit might in some cases be established at variable rates, reflecting the opportunity cost of the funds, with the interest rate based on international benchmarks (e.g. LIBOR), most of St. Lucia's debt is at fixed interest rates. Caribbean Development Bank and World Bank's loans account for 96 percent of multilateral outstanding debt. The bulk of World Bank's loans contracted by St. Lucia are concessional under the International Development Association (IDA) facility; IDA interest rates are fixed for their whole maturity period.



Source: WB Group Finances.

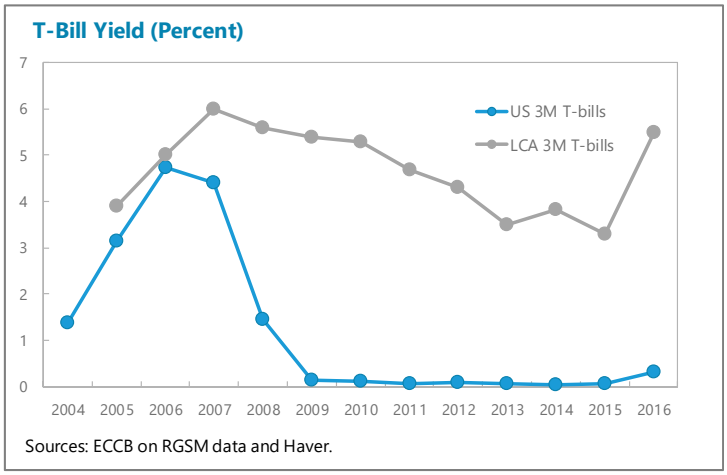
B. Some Stylized Facts on External and Internal Interest Rates

4. The yields on St. Lucia's short-term instruments issued through the RGSM are positively correlated with U.S. instruments. An important part of St. Lucia's treasury bills, treasury notes, and bonds of different maturities are traded in the RGSM. Evidence from comparing short-term instruments suggests a positive association of RGSM's yields with U.S. interest rates.

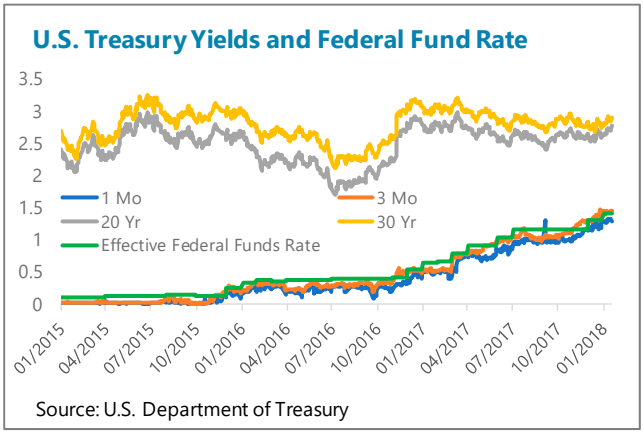
RGSM's T-bill Interest Rates for St. Lucia and its Correlation with Equivalent U.S. Instruments

	3-months	5-months
2004		
2005	3.9	
2006	5.0	
2007	6.0	5.7
2008	5.6	5.6
2009	5.4	5.2
2010	5.3	4.7
2011	4.7	4.5
2012	4.3	5.1
2013	3.5	6.0
2014	3.8	5.4
2015	3.3	3.9
2016	5.5	3.8
Corr	0.4	0.4

Sources: ECCB on RGSM data and Haver.



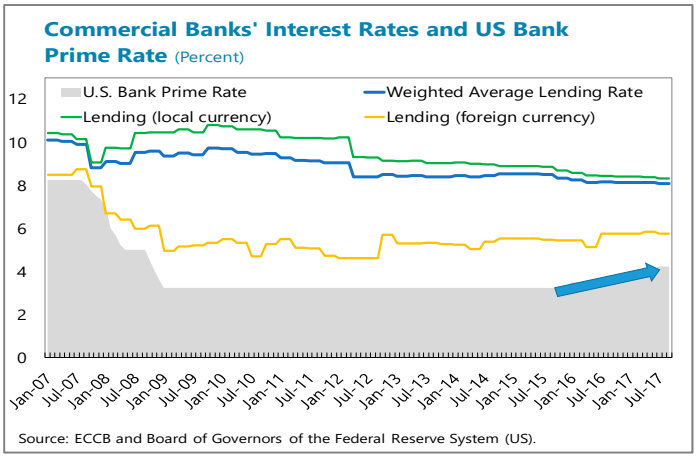
5. The response of bond yields, however, is more difficult to predict. First, owing to the low frequency of issuance of long-term maturity instruments on the RGMS, an association with U.S. interest is more difficult to detect. Second, while U.S. short-term treasury instruments have responded immediately to changes in the Fed funds rate, the response of U.S. long-term instruments is not clear. This result suggests that a transmission mechanism from international rates to St. Lucia's long-term instruments (i.e. bonds), which represent 40 percent of total outstanding debt of the country, is not warranted.



6. Commercial banks' banks' lending rates and U.S. rates are highly correlated, but only for loans issued in foreign currency[2]. Commercial bank loans represent just 6 percent of total central government debt, of which just 1.1 pp were loans contracted in foreign currency. The

[2] For an extensive and complementary analysis of the pass through of U.S. interest rates at regional level for the ECCU, see Myrvoda and Reynaud (2018).

apparent lack of a strong association between lending rates in local currency and external rates might in part be driven by distortions, such as the minimum savings deposit rate established at the regional level by the Eastern Caribbean Central Bank (ECCB). The rate artificially pushes active rates in local currency higher than in a market without frictions, resulting in higher levels of liquidity and nonperforming loans in the regional commercial banking system.



C. Measuring the Pass-Through from External to Internal Interest Rates

Measuring pass-through from external to internal interest rates would help to effectively manage St. Lucia's growing public debt.

Methodology and Data

7. To capture the pass-through effect between external and internal interest rates, we estimate a VAR model. This allows us to measure the dynamic of interest rates controlling by effects of other endogenous and exogenous variables. The benchmark specification setup is:

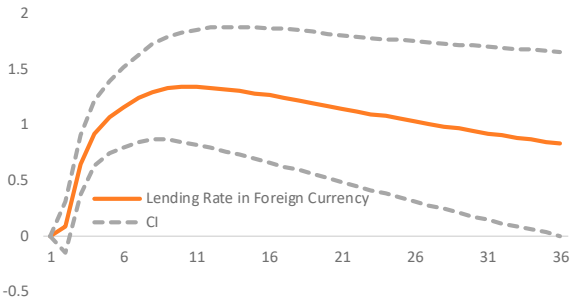
$$y_t = v + A_1 y_{t-1} + \ldots + A_p y_{t-p} + u_t, \qquad t = 0,1,2\ldots,$$

Where $y_t = (i^{US}_{t-bill}, i^{LCA}_{lend}, i^{LCA}_{deposit\_sav}, \pi^{US}, \pi^{LCA})$, i^{US}_{t-bill} is the US 3-month T-bill yield, $i^{LCA}_{deposit\_sav}$ is St. Lucia's savings deposit rate, π stands for inflation rate and i^{LCA}_{lend} stands for two alternative definitions of St. Lucia's commercial banks' lending rates: in local and foreign currency. Finally, v is a vector of intercept terms allowing for the possibility of a nonzero mean, A_i are coefficient matrices and u_t is a multi-dimensional white noise process.

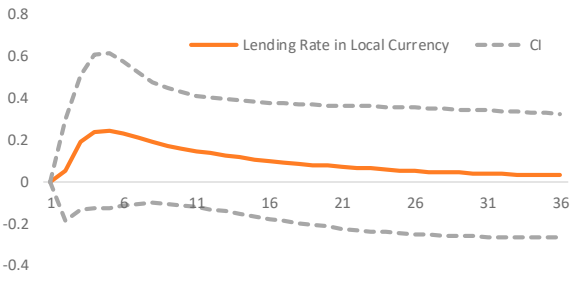
8. Given the nature of financial flows, we base our analysis on monthly data. The main drawback of this approach is that some potential control variables, such as economic activity indicators, had to be excluded from the analysis.

Results

9. Econometric evidence confirms that interest rates of debt issued in local currency are less sensitive to international interest rates changes. Using banking system lending rates as a proxy for domestic interest rates, we estimate that US short-term interest rates would have a full pass-through effect to St. Lucia's foreign-currency lending interest rates, but only a partial pass-through effect to instruments issued in local currency.



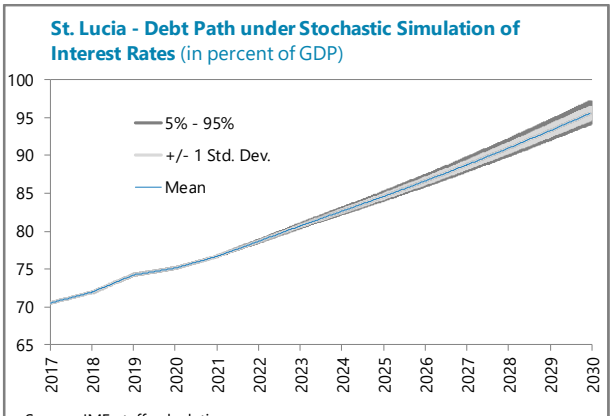
Source: IMF staff calculations.



Source: IMF staff calculations.

D. Public Debt Implications

10. St. Lucia's debt is likely to respond to changes in U.S. interest rates. We calculated the stock of debt of the country in 2030 under two extreme scenarios, full and null pass-through from international interest rates to public debt instruments. Our results show that the stock of debt would reach 101.3 percent of GDP when international interest rates are fully transmitted to debt instruments, and 88.4 percent of GDP when the opposite happens (null transmission of international interest rates to public debt instruments). That represents a difference of 13 pp of GDP between both scenarios.



Source: IMF staff calculations.

11. The results of a simulation show that the actual impact on debt is likely to be between these extremes. Our baseline scenario considers St. Lucia's debt structure and conditions to project a debt path for the country. The debt path reflects a partial pass-through from the expected rise in U.S. interest rates over the next few years. Based on the results from previous sections, we assume that short-term instruments in foreign currency will face a larger pass-through, while interest rates associated with multilateral/bilateral, local currency, and long-term debt will see only marginal changes. We then run a Montecarlo simulation constraining interest rate movements to the same volatility observed in historical data. The results suggest that by 2030 the stock of debt would reach between 93.9 and 97.8 percent of GDP, with a 95 percent confidence interval.

12. Given St. Lucia's current unsustainable debt path, international interest rates developments should be cautiously considered when implementing a debt strategy to put the country back on track to reach the ECCU regional debt target of 60 percent of GDP by 2030.

References

Myrvoda, A. and J. Reynaud, 2018, "Monetary Policy Transmission in the Eastern Caribbean Currency Union", IMF-WP 18/70.

Annex VI. Policy Trade-Offs in Building Resilience to Natural Disasters[1]

Resilience to climate change and natural disasters hinges on two fundamental elements: financial protection, provided by insurance and self-insurance, and structural protection, which requires investment in resilient infrastructure and adaptation to climate change. Using DIGNAD, an extension of the DIG model calibrated to the St. Lucia's economy, this paper studies the conditions under which each of the two strategies provides the best protection against climate change and natural disasters. While structural protection normally delivers a larger output payoff because of its direct dampening effect on the cost of disasters, financial protection is superior when liquidity constraints limit the ability of the government to rebuild public capital promptly. The estimated trade-off is very sensitive to the efficiency of public investment.

A. Introduction

1. Building resilience to climate change and natural disasters is a key priority for St. Lucia. A small island in the Atlantic hurricane belt, St. Lucia is very vulnerable to natural disasters and climate change (see IMF-WB, 2018). Besides significant human and social costs, extreme weather and other catastrophic events have major macroeconomic and fiscal implications, with an average annual cost estimated at 1.5 percent of GDP, of which 1 percent is borne by the government.[2] Despite the surge in donors' assistance that follows these events, disasters leave deep scars in the fiscal position, with public debt increasing and little fiscal space left for government programs, including climate-related ones. Building resilience is therefore necessary not only to reduce the human, social, and economic costs associated with climate and natural disasters, it is also a way to exit the vicious circle of natural disasters/high public debt that St. Lucia has experienced with many other countries in the region.

2. Financial protection and structural protection are key elements of a two-pronged strategy to build resilience. Financial protection is a combination of self-insurance, risk-transfer instruments, and other financial tools that provide the government with the necessary liquidity immediately after the event for relief purposes as well as resources to finance promptly the reconstruction. For a country like St. Lucia, which needs fiscal adjustment to attain debt sustainability, non-debt-creating instruments like insurance and self-insurance are most important. Financial protection has the additional benefit of reducing the government's contingent liabilities and building buffers that improve sustainability and reduce the risk premium on public debt. Structural protection is a series of actions that facilitate adaptation to climate change and minimize the impact of natural disasters. These include investment in resilient infrastructure and roadways, water supply systems, land use planning and management, and agriculture (see IMF-WB, 2018). The additional advantage of structural protection is a more resilient capital stock, which reduces the cost of capital and stimulates private investment.

3. This paper uses a dynamic general equilibrium model (DIGNAD) to evaluate the trade-offs between financial protection and structural protection. Knowing these trade-offs is particularly important to find the optimal combination of policies when resources are severely constrained. We

[1] Prepared by Leo Bonato, Alessandro Cantelmo, Giovanni Melina, and Gonzalo Salinas. Mauricio Vargas helped in the model calibration.

[2] See IMF (2017), Box 1, p.11.

build on the work by Marto, Papageorgiou, and Klyuev (2017), who extend the DIG model (Buffie and others, 2012) to incorporate natural disasters. The model is modified to reflect features specific to St. Lucia and this exercise, and calibrated to the St. Lucian economy. Section B presents the model; section C provides some detail on calibration; Section D reports the results of the simulations; and Section E concludes.

B. The Debt-Investment-Growth (DIG) Model: Incorporating Natural Disasters and Fiscal Constraints

4. The use of a general equilibrium model allows us to analyze the macroeconomic effects of natural disasters jointly with the policy responses. The model used is built on Marto, Papageorgiou, and Klyuev (2017), who extend the DIG model to simulate the impact that cyclone Pam had on Vanuatu in 2015, and study how the country could have built resilience to cope with it. DIG is a real, dynamic, open economy model in which public capital is used as an input of production. The government has access to external and domestic debt while fiscal instruments ensure debt sustainability. Its extension incorporating natural disasters (DIGNAD, henceforth) allows the government to invest in both standard infrastructure and adaptation capital, as well as in a savings fund. Adaptation capital is more resilient to climate change and natural disasters and help preserve standard infrastructure and dampen the damages inflicted to the economy. A savings fund immediately provides the necessary liquidity to start the reconstruction in the aftermath of the natural disaster.[3] Natural disasters affect the economy by damaging both public and private capital and by reducing total factor productivity. To study the policy trade-offs in building resilience to natural disasters, we extend the DIGNAD model further along four dimensions.

5. First, natural disasters are modeled as continuous shocks rather than one-time events. The economy is hit by a continuum of natural disasters of average magnitude with a permanent effect on GDP. This eliminates issues related with the specific timing of the event and simplifies the comparison between policies, making the exercise more relevant for the analysis of frequent average intensity disasters.

6. Second, the government replenishes the savings fund regularly. After withdrawing the necessary resources to start the reconstruction without issuing new debt, the government replenishes the savings fund to keep the liquidity buffers needed to withstand future natural disasters. We thus allow for endogenous dynamics of the savings fund as follows:

$$\mathfrak{s}_t = (1 + r^f)\mathfrak{s}_{t-1} + \mathfrak{s}_t^{in} - \mathfrak{s}_t^{out}, \quad (1)$$

where r^f is a risk-free real interest rate earned on the stock of resources held in the previous period, while $\mathfrak{s}_t^{in}$ and $\mathfrak{s}_t^{out}$ are money injections and withdrawals, respectively. While money withdrawals equal the investment needed to reconstruct public capital, money injections are such that the government endogenously restores the savings fund up to the initial level, that is:

$$\mathfrak{s}_t^{in} = \phi^{\mathfrak{s}}(\mathfrak{s}_{t-1} - \mathfrak{s}_0), \quad (2)$$

[3] For simplicity, we assume that the only financial protection is provided by the savings fund.

where $\phi^{s} > 1$ is a parameter governing the speed at which money is injected in response to the deviations of the stock of financial resources from the initial level s_0.

7. Third, the reconstruction of public capital is endogenous and limited by financial constraints. While Marto, Papageorgiou, and Klyuev (2017) define an exogenous path of public investment in response to the natural disaster, we let the government reconstruct the destroyed public capital within the year according to a reaction function. Investment in public standard and adaptation capital follow respectively:

$$i_{zi,t} = \phi^{z}[z_0^{i} - (1 - \delta_{zi})z_{t-1}^{i}], \quad (3)$$

$$i_{za,t} = \phi^{z}[z_0^{a} - (1 - \delta_{za})z_{t-1}^{a}]. \quad (4)$$

In both cases, whenever the stock of the non-depreciated capital is lower than the initial stock, the government increases investment to restore it. Parameter $\phi^{z} \in [0,1]$ measures financial constraints and determines the capacity of the government to reconstruct the destroyed capital, i.e. $\phi^{z} = 1$ implies full reconstruction while for $\phi^{z} < 1$ the government can reconstruct only a fraction of the missing capital stock.

8. Finally, we impose a specific fiscal reaction function. We assume that the consumption tax will be adjusted as needed to attain the ECCU debt target of 60 percent of GDP by 2030. To illustrate this point, equation (6) shows a simplified version of the law of motion of government debt in real terms where the only expenditure is for standard public investment and the only source of revenue is a consumption tax:

$$B_{t+1} = (1 + r_t)B_t + i_{z,t} - \tau_t^{C} c_t, \quad (6)$$

where r_t is the real rate of interest on government bonds, B_t; τ_t^{C} is the consumption tax rate; c_t is private consumption so that $\tau_t^{C} c_t$ represents total tax revenues.

C. Calibration

9. The model is parameterized to fit a "typical" LIC when country specific information is not available. In the absence of specific information, we used the parameters of the average LIC in the DIG model, most of which were also used in calibrating the DIGNAD model for the case of Vanuatu. Country-specific initial values were used for public infrastructure investment, public debt and its composition, grants, private external debt, real interest rate on public debt. Country-specific parameters were used for the trend per capita growth rate, imports, and value-added of the non-tradeable sector.

10. Parameters that determine the impact of natural disasters are broadly in line with Marto, Papageorgiou, and Klyuev (2017). Adaptation capital better withstands natural disasters than standard infrastructure, hence the former depreciates at a lower annual rate than the latter, i.e. $\delta_{za} = 3\%$ while $\delta_{zi} = 6\%$. We calibrate the parameter ϕ^{s} such that the savings fund is replenished at the initial

level anytime it is used, i.e. $\text{ś}_t = \text{ś}_0, \forall t$. On average, each year St. Lucia suffers a loss of public and private capital of 1 percent and 0.5 percent of GDP, respectively, due to natural disasters. We therefore calibrate a continuum of natural disaster shocks that generate the observed yearly losses of public and private capital.

D. Simulation and Findings

Simulations Set-up

11. We design alternative policies to build resilience to natural disasters.

- **Policy 1: Do nothing.** As a baseline policy, we simply assume that, despite natural disasters hitting the economy, the government does not revise its plans for public investment, which is kept at the initial level. In this case, there is no reconstruction of lost public capital. This serves as a baseline scenario against which we compare the other two.

- **Policy 2: Financial protection.** In year t-1, the government receives a grant of 8 percent of initial GDP that is spent to build a natural savings fund.[4] The fund is then used exclusively to finance the reconstruction of public capital without issuing new debt. We assume that when the natural savings fund is active, the government has the necessary liquidity to rebuild the destroyed public capital, i.e. $\phi^z = 1$ in equations (3) and (4). Moreover, the immediate availability of funds reduces the sovereign risk premium. We thus assume that the annual interest rate paid on public debt is 50 basis points lower than under the alternative policies.

- **Policy 3: Structural protection.** In year t-1, the government receives a grant of 8 percent of initial GDP that is used to invest in adaptation capital, thus improving resilience to natural disasters.[5] In other words, the entity of all damages is dampened, although the stock of public capital is not entirely reconstructed, due to continuous shocks hitting the economy and absence of liquidity. We therefore calibrate $\phi^z < 1$.

12. The government should be able to rebuild 85 percent of the destroyed capital to be indifferent between policy 2 and policy 3. Given that, when the savings fund is active, the government can rebuild the entire stock of public standard capital destroyed, we first calculate the fraction of destroyed public capital (standard and adaptation) the government should reconstruct in the case of adaptation capital to reach the same level of output after 15 years. We find that the government should be able to rebuild 85 percent of the destroyed stock of standard and adaptation capital (i.e. $\phi^z = 0.85$) to reach the same level of GDP after 15 years as in policy 2.

[4] Guerson (2016) estimates that a savings fund capitalized at 8 percent of GDP and replenished annually with 0.9 percent of GDP would have a 95 percent chance of non-depletion.

[5] This implies that, in year t-1, the share of adaptation capital in the total stock of public capital is 23.5 percent.

Simulation Results

13. Scenario 1: investing in adaptation capital is preferable if the government can rebuild more than 85 percent of the destroyed capital. We assume that, under the option of building adaptation capital, the amount of public capital that can be reconstructed is 10 percent higher than the threshold of 85 percent (i.e. $\phi^z = 0.95$). Figure 1 shows that not engaging in public capital reconstruction (blue line) is very harmful for the economy, with a loss of GDP of more than 3 percent after 15 years. Moreover, tax revenues to GDP increase by almost 13 percent to reach the public debt target. Conversely, when the savings fund is active (red line) the government has the necessary liquidity to promptly reconstruct the destroyed public capital.[6] Indeed, GDP is about 1.5 percent lower than the initial year while tax revenues increase by 10 percent of GDP. The lower increase in tax revenues stems from the joint effect of the reconstruction of public capital financed by the savings fund, the lower loss in GDP and the lower sovereign risk premium. Finally, investing in adaptation capital (yellow line) when the government can reconstruct above the calculated threshold leads to the lowest output loss among the three policies. It also follows that the required increase in tax revenues to GDP is below 10 percent. Indeed, the lower depreciation and higher return of adaptation capital coupled with its intrinsic effect of dampening the damages of natural disasters outweigh the advantages in terms of liquidity and lower sovereign risk premium provided by the savings fund. To sum up, this will hold if $\phi^z \in (0.85,1]$, that is, at least 85 percent of the destroyed capital can be reconstructed.

14. Scenario 2: investing in adaptation capital is less preferable if the government reconstructs less than 85 percent of the destroyed capital. We now assume that the government's ability to reconstruct public capital under policy 3 is 10 percent lower than the threshold of 85 percent (i.e. $\phi^z = 0.75$). Figure 2 plots the same paths under policy 1 (blue line) and policy 2 (red line) as in Figure 1. The tighter constraint on the government's ability to reconstruct public capital under policy 3 (yellow line) leads to a lower GDP level than under policy 2, with a loss of nearly 2 percent after 15 years. Despite the lower damages suffered by the economy due to the stock of adaptation capital, the constraints on public capital reconstruction make building the savings fund a preferable policy. In this scenario, investing in public adaptation capital entails a lower increase in tax revenues due to the lower public investment during the reconstruction. To sum up, this will hold for $\phi^z \in [0,0.85)$, that is less than 85 percent of the destroyed capital can be reconstructed.

Sensitivity of the Threshold of Reconstruction to Alternative Calibrations.

15. The same sovereign risk premium across the two alternative policies lowers the threshold to 83.5 percent. Assuming that building a savings fund does not lower the sovereign risk premium by 50 annual basis points implies that, when investing in adaptation capital, the government should be able to reconstruct 83.5 percent of the destroyed public capital to make the two policies equivalent. Intuitively, removing one of the advantages of the savings fund being in place implies that a lower fraction of public capital needs to be reconstructed to make investing in adaptation capital reach the same output after 15 years.

[6] Note that the stock of public standard capital stabilizes at a lower level due to the continuous shocks hitting the economy. In practice, the government replaces the destroyed capital but, at the end of the same period, a new shock hits hence the stock of public standard capital stabilizes at a lower level.

16. Lower public investment efficiency under the investment in adaptation capital policy substantially increases the threshold. We assume that when the government invests in adaptation capital, public investment efficiency is 2.5 percent lower than when it invests in the disaster fund. Indeed, the lack of available liquidity may make the process of rebuilding the public capital stock slower and less efficient. The implied threshold increases from 85 to 96 percent, so that the government should can rebuild a substantial higher fraction of the destroyed public capital to be indifferent between policies 2 and 3.

17. Increasing the depreciation rate of adaptation capital slightly increases the threshold. We assume that public standard and adaptation capital display the same annual depreciation rate of 6 percent. Each year, the fraction of adaptation capital that needs to be replaced for reasons other than natural disasters is higher. It follows that, with respect to the baseline calibration, an additional fraction of capital needs to be reconstructed following a natural disaster, hence the calculated threshold increases to 87 percent.

E. Conclusions

18. Building resilience is key to cope with natural disasters. Whether the government builds a disaster fund or invests in adaptation capital, building resilience is key to cope with natural disasters. The do-nothing policy delivers dramatic negative outcomes in the economy, with large permanent losses of capital, output, and growth and a much larger increase in taxes needed to attain the fiscal target.

19. Simulations highlight non-trivial trade-offs in building resilience to natural disasters. Financial protection provides resources for immediate relief and reconstruction after a natural disaster and improves the net asset position of the government. Structural protection and resilient public capital soften the impact of natural disasters on the economy and reduce the cost of capital to the private sector. For the case of St. Lucia, structural protection is the preferred policy if the government can reconstruct at least 85 percent of the destroyed public capital stock before the next disaster hits. Should the government's ability to reconstruct public capital be lower, the financial protection policy would lead to a lower output loss. Moreover, low efficiency of public investment would further reinforce the advantage of financial protection. This conclusion can be generalized to countries where financial constraints are prevalent and efficiency in public investment procedures is low. While the paper analyzes two stylized policies, these policies are complementary and both required for an optimal strategy for building resilience.

Figure 1.St. Lucia: Above-Threshold Public Capital Reconstruction

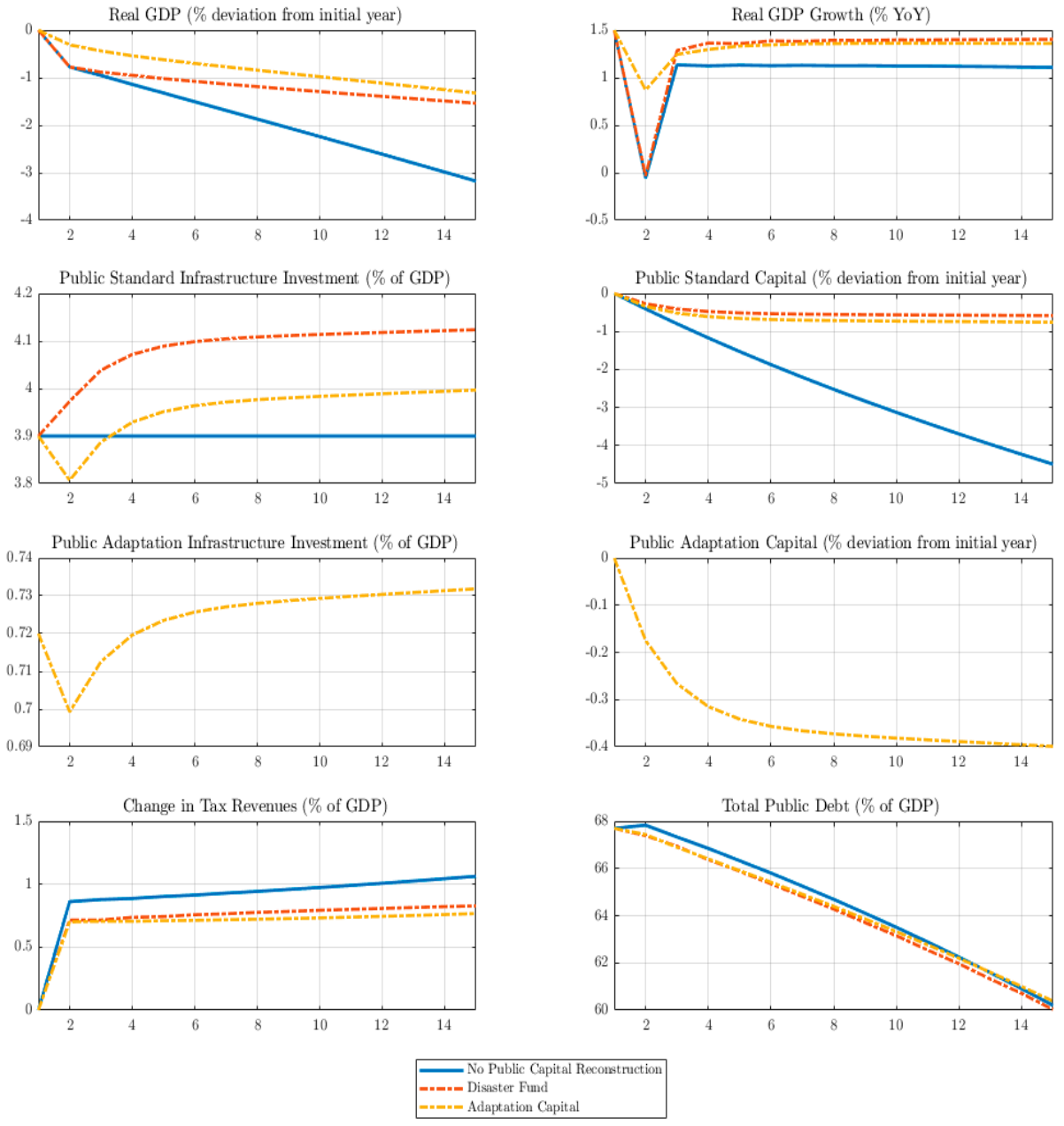
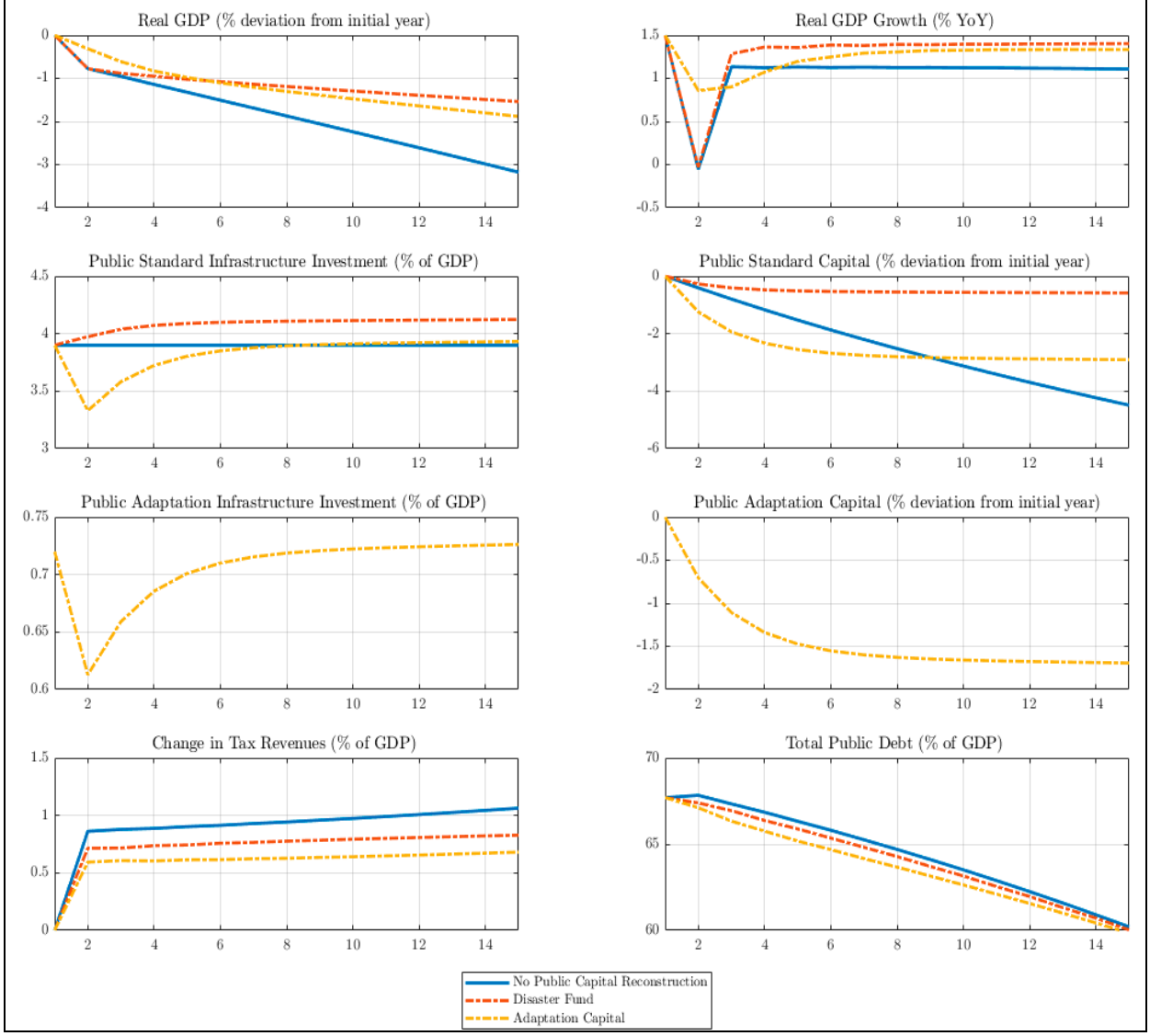


Figure 2. St. Lucia: Below-Threshold Public Capital Reconstruction



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INTERNATIONAL MONETARY FUND

ST. LUCIA

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 29, 2018

Prepared By

Western Hemisphere Department (in consultation with other departments and the Caribbean Regional Technical Assistance Center, CARTAC)

CONTENTS

FUND RELATIONS

(As of April 30, 2018)

Membership Status:	Joined: November 15, 1979; Article VIII

General Resources Account:	SDR Million	Percent of Quota
Quota	21.40	100.00
Fund holdings of currency	19.87	92.85
Reserve Tranche Position	1.53	7.16

SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	14.57	100.00
Holdings	7.49	51.41

Outstanding Purchases and Loans:	SDR Million	Percent of Quota
RCF Loans	2.30	10.74
ESF RAC Loan	2.07	9.66

Latest Financial Arrangements:	None

Projected Payments to the Fund[1/]

	Forthcoming				
	2018	2019	2020	2021	2022
Principal	1.07	2.14	0.77	0.38	
Charges/Interest	0.05	0.06	0.06	0.06	0.06
Total	1.12	2.21	0.83	0.45	0.06

[1/]When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Implementation of HIPC Initiative: Not Applicable

Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

Implementation of Post-Catastrophe Debt Relief (PCDR): Not Applicable

Exchange Rate Assessment: The de jure exchange rate arrangement is a currency board. St. Lucia participates in a currency union with seven other members of the ECCU and has no separate legal tender. The Eastern Caribbean dollar is pegged to the U.S. dollar under a currency board arrangement at EC$2.70 per U.S. dollar. St. Lucia has accepted the obligations of Article VIII, Sections

2(a), 3 and 4, and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

Safeguards Assessment: Under the Fund's safeguards policy, the Eastern Caribbean Central Bank (ECCB) is subject to a full safeguards assessment on a four-year cycle. An update assessment was completed in April 2016 and found that the ECCB has maintained generally strong controls over its key operations. External audit and financial reporting practices remain sound. The ECCB financial statements are compliant with International Financial Reporting Standards and are published on a timely basis. The internal audit function has been reformed to align it with leading international practices and audit committee oversight continues to be strengthened through enhancement of its financial expertise.

Article IV consultation: St. Lucia is currently on a 12-month cycle. The last Article IV consultation was concluded on March 24, 2017 by the Executive Board; the relevant document is IMF Country Report 17/76.

Technical Assistance: St. Lucia has received substantial technical assistance from the Caribbean Region Technical Assistance Center (CARTAC) and the IMF. Technical assistance missions focused on macroeconomic programming and analysis, reforms of the revenue administration, public financial management, real and external sector statistics and the financial sector. St. Lucia has also participated in a wide range of regional seminars and training, as well as internships and attachments.

Macroeconomic Programming and Analysis

- April 2016 (CARTAC): Updating the Macro Framework and drafting the medium-term fiscal framework
- March 2015: To review progress on the GDP Forecasting Framework.
- October 2015: Make Presentation at CARTAC National Accounts Planning Workshop.
- July 2014: To make better use of the high-frequency macro indicators in updating short-term GDP projections.

National Accounts

- September 2018 (CARTAC) National Accounts Mission to provide TA to further improve the national accounts, including SUT and rebasing the GDP estimates.
- September 2017 (CARTAC): National Accounts Mission to compile supply and use tables (SUT) and further improve the national accounts.

- September 2016 (CARTAC): National Accounts Mission to develop the compilation system to produce quarterly GDP by economic activity estimates and to improve the annual GDP estimates.
- September 2015 (CARTAC) A Real Sector Statistics Mission visited Castries to provide TA to the CSO for St. Lucia on reviewing and providing advice to expand and improve the national accounts, including producing SUT and rebasing the GDP estimates.
- March 2014 (CARTAC): Development a plan to assess the quality of the annual GDP estimates; January 2013 (CARTAC) advice on improving the source data to compile quarterly GDP; May 2011 (CARTAC): advice on the development of quarterly GDP, with St. Lucia being a pilot in the OECS.
- December 2010 (CARTAC): real sector projections, including the preparation of scenarios that assessed the impact of Hurricane Tomas on the economy.
- July–August 2009 (CARTAC): national accounts mission aimed at rebasing the GDP estimates to 2006 and exploring the feasibility of producing final expenditure in constant prices.

External Sector Statistics

- September 2018 (CARTAC): Dealing with nonresponse and improving the compilation of trade in goods statistics
- March 2018 (CARTAC): Strengthening the compilation of the recently revised balance of payments and new international investment position (IIP) statistics.
- October 2016 (CARTAC): Reviewing preliminary BPM6-based Balance of Payments and new IIP Statistics for dissemination.
- March 2016 (CARTAC): Assessing sources data for the compilation of Balance of Payments and IIP Statistics according to the BPM6.
- January 2015 (CARTAC): Training on External Sector Statistics for Survey Respondents

Tax Reforms and Revenue Administration

- FY 2018/19 (CARTAC Customs Administration): Provide training on extracting data from the ASYCUDA system to support risk management, trade facilitation and sound management.
- October & November 2017 (CARTAC): Building Technical Capacity in VAT Legislation
- June & Nov 2017 (CARTAC): Building and enhancing HQ capacity, data gathering, analysis, and program reporting

- March 2017 CARTAC Revenue Administration): Follow-up on Developing a Compliance Risk Management Strategy.
- November 2016: Strengthening Performance Management – establishing KPI
- November 2016: IT Support – (via Peer-to-Peer Technical Assistance (TA) Attachment)
- October 2016 (CARTAC Revenue Administration): Developing a Compliance Risk Management Strategy. (follow-up TA in March 2017 to complete this TA)
- October 2016: Data Analytics
- September 2016 (CARTAC Revenue Administration): Developing a Taxpayer Service Strategy.
- June 2016 (CARTAC Revenue Administration): Building Audit Capacity
- June 2016 (CARTAC Customs): Strengthen the Post Clearance Audit Function.
- October 2015 (CARTAC Tax Administration): Technical Assistance to Support the Establishment of a Large and Medium Taxpayers Unit.
- September 2015 (CARTAC Tax Administration): Technical Assistance for Amending the Corporate Income TA and Determining the Presumptive Tax Rate.
- September 2015 (CARTAC Customs Administration): Provide guidance & training on improving & strengthening enforcement intelligence and risk.
- November 2014 (CARTAC Customs Administration): Support Risk Management mission.
- August 2014 (CARTAC Customs Administration): TA to Montserrat Customs and Excise Department.
- May 2014 (CARTAC Customs Administration): Organizational Structure Review of the CED.
- September 1-11, 2015: (CARTAC) Improve the Corporate Income Tax regime.
- July 6-17, 2015 (CARTAC) IRD structural re-organization establishment of the LMTU and DPMU).
- March 16-27 2015, May 11-22, July 27-August 6, 2015: (CARTAC) Property taxation.
- December 9–December 22, 2014: (FAD funded by CARTAC) VAT revenue analysis.
- July, September, October 2014 and April 2015 (CARTAC) IRD structural re-organization.
- April 13-24, 2014 (CARTAC) tax and customs, data matching.
- April 2-15, 2014 (FAD) follow-up on tax and customs administrations after VAT introduction.
- January 27-31 2014, (CARTAC) IRD strategic planning.
- October 14-November 1, 2013 and February 10-24, 2014, (CARTAC) development of VAT audit capacity.

- April 2013: Electronic Auditing for Income Tax and VAT Auditors St. Lucia
- March 2013: SUPPORTING THE VAT AUDIT PROGRAM
- January/February 2013: Basic VAT Assurance Course
- September 2012: Supporting the Establishment of a VAT Collections and Enforcement Function
- June/July 2013: Collection Enforcement Training and support for The Establishment of a Collection and Enforcement Function
- October 2013 (CARTAC): Strengthening the Customs Administration—Valuation workshop and training.
- May 2014 (CARTAC): Strengthening the Customs Administration—Organizational Structure Review.
- December 2008–January 2010 and May 2011-November 2012 (CARTAC): preparations for VAT implementation, including development of the project plan, VAT rate study, drafting the VAT legislation, delivery of training to tax and customs staff, supporting customs and Inland Revenue Department (IRD) preparations for VAT administration, development and implementation of the advisory visits program for potential registrants, and establishing a VAT section within IRD with the necessary procedures for operation.
- June 2012 and November 2012 (CARTAC): special sector tax audits.
- August 2012 (CARTAC): review of customs bonded warehouses.
- June 2008, September 2008, February 2009, August 2009 and May 2012 (CARTAC): development and implementation of Customs Risk Management Program.
- March 2010, June 2010, October 2010 and June 2011 (CARTAC): development and implementation of Customs Post Clearance Audit Program.
- September 2010 and May 2011 (CARTAC): development of an integrity program for Inland Revenue.
- March 2010, June 2010, October 2010 and June 2011 (CARTAC): development and implementation of Customs post clearance audit program.
- June 2008, September 2008, February 2009 and August 2009 (CARTAC): development and implementation of customs risk management program.
- June 2009 and September 2009 (CARTAC): development of Corporate Strategic Business Plan for Inland Revenue and customs.
- April 2003 (FAD): modernization of the tax system in regional (OECS) context.

Expenditure Rationalization and PFM Reforms

- April 2018 (CARTAC): PFM Action Plan
- September 2017 (CARTAC): Budget Workshop with MoF and all Ministries
- July 2017 (CARTAC): PEFA Assessment
- June 2017 (CARTAC): PEFA Workshop
- January 2016 (CARTAC): Diagnostic Assessment of Internal Audit.
- September 2015 (CARTAC): Assist Authorities in Preparing for the 2015/2017 Budget Process.
- October 2015 (PFM): PFM Accountant General's Department review and Pre PEFA assessment.
- September 2015 (PFM): Program Based Budgeting.
- August 2015 (PFM): Develop a comprehensive budget manual.
- December 2014 (PFM): Budget Preparation Mission.
- October 2014 (PFM): Budget Preparation Mission.
- February 2014 (PFM): Assist with finalizing annual budget estimates document.
- January 2014 (PFM): Final Budget Preparation Reform Mission.
- May 2014 (MCM): Strengthening public debt management in ECCU countries. Assessment of Technical Assistance needs provided to the ECCB.
- July 2014 (CARTAC): Improvements to real sector monitoring frameworks to provide for rapid updating of real sector variables using high frequency indicators.
- January 2013, June 2013, November 2013, January 2014 (CARTAC): Budget Preparation Reform;
- February 2013 (CARTAC): Chart of Accounts reform.
- December 2013 (CARTAC): Diagnostic of PFM legislation.
- October 2013 (CARTAC): Improving accountability and performance of Parastatals.
- January 2012 (CARTAC MAC Programme): real and fiscal medium-term projections under baseline and active scenarios.
- May and November 2011 (CARTAC): budget preparation mission.
- June 2010 (CARTAC): preparation of a PFM reform action plan, PFM workshop.
- December 2010 (CARTAC): fiscal projections under baseline and active scenarios.
- August 2010 (FAD): regional project on public expenditure issues, including expenditure trends, policies, and expenditure rationalization options.

- November 2009 (CARTAC): budget preparation and fiscal projections.
- December 2008 (MCM): improving debt management capacity of the government.

Financial Sector

- September 2018 (CARTAC): Technical assistance requests from the Financial Services Regulatory Authority to review and analyze Life and General Insurance Actuarial Valuation reports.
- June 2018 (CARTAC): Stress Testing the Insurance Sector (joint mission for four ECCU countries).
- September 2017 (CARTAC): Developing Financial Health and Stability Indicators for the Insurance Sector (joint mission for four ECCU countries).
- April 2016 (CARTAC): Basel II Implementation.
- February 2016 (CARTAC): Basel II Implementation.
- August 2015 (CARTAC): Dynamic Modelling and Stress Testing of St. Lucian Banks (in conjunction with ECCB).
- August 2015 (CARTAC): Training of Credit Union Regulators on Stress-Testing.
- December 2015 (MCM): Implementation of Risk Based Supervision.
- August 2015 (MCM): Dynamic Modelling Project.
- November 2014 (MCM): Risk Based Supervision Insurance.
- September 2014 (MCM): Risk Based Supervision Framework
- March, May and June 2014 (MCM and LEG): Strategy to resolve indigenous banks. Assistance to the ECCB.
- May 2014 and ongoing (MCM): Collateral valuation. Assistance to the ECCB.
- May 2014 and ongoing (MCM): Credit risk management assessment. Assistance to the ECCB.
- May 2014 (CARTAC): Technical assistance requests from the ECCB to implement Basel II in the ECCU. The ECCB as a part of the Caribbean Group of Banking Supervisors (CGBS), has developed the operational risk guidelines for Basel II and has established a steering committee, made up of regulators from some of the SRUs to look at areas of national discretion for the implementation of Basel II.
- November 2013 and May 2014 (MCM and LEG): Assistance to the ECCB on legislative changes to the ECCB Agreement Act, Banking Act and subsidiary legislation.

- May 2014 (CARTAC): Assistance to the ECCB with the development and implementation of a strategic plan to achieve compliance with the Basel Core Principles for Effective Banking Supervision.
- March 2013 (CARTAC): Review a draft Corporate Governance Guidance for ECCB which covers domestic banking operations in St. Lucia
- December 2013 (CARTAC): Review an Internal Audit Guidance for Banks in the ECCU.
- February 2011 (IMF/WB/CDB): A Joint Task Force on the ECCU Financial System (FSTF) performed a comprehensive diagnostics on the indigenous banks and delivered recommendations to address critical issues.
- December 2008 (CARTAC): development of policy proposals for the Single Regulatory Unit (SRU) Act to be drafted by the authorities in St. Lucia;
- May 2008 (CARTAC): assessment of development needs of the Single Regulatory Unit;
- October 2007 (CARTAC): participation of St Lucia's SRU supervisory staff in Off-shore Mutual Funds Supervision Workshop held in St. Kitts and Nevis and St. Vincent;
- September 2007 (CARTAC): participation of St. Lucia's SRU supervisory staff in Trust Supervision Workshop held in Turks and Caicos.

Technical assistance on the banking sector is provided to the Eastern Caribbean Central Bank (ECCB) as the supervisor and not to individual countries within the Eastern Caribbean Currency Union (ECCU). Currently, MCM has placed three long-term experts at the ECCB, financed by Canada: (i) a bank resolution advisor; (ii) a bank supervision advisor; and (iii) the manager of the regional asset management company.

CARTAC is working with the ECCB to develop a framework for the implementation of the recommendations of the sixth edition of the balance of payments manual for ECCU members, inclusive of St. Lucia. Additionally, a technical Assistance request from St. Lucia to provide assistance with bank supervision, mutual funds and review of insurance treaties is currently under consideration. CARTAC is currently providing technical assistance to the ECCB on Basel II/III Implementation

FSAP: A joint IMF/World Bank team performed an assessment of the financial sector of the member states of the ECCU, in two missions—September 1–19 and October 20–31, 2003. The missions assisted the authorities in assessing the development needs and opportunities for the financial sector, identifying potential vulnerabilities of financial institutions and markets to macroeconomic shocks, as well as assessing risks to macroeconomic stability from weaknesses in the financial sector. The Financial System Stability Assessment (FSSA) was discussed by the Executive Board on May 5, 2004, and subsequently published on the IMF's external website, including the Report on the Observance of Standards and Codes (ROSC) on Banking Supervision.

AML/CFT: A detailed assessment of the AML/CFT regimes of St. Lucia was conducted by the Caribbean Financial Action Task Force (CFATF) in November 2008, and the eighth follow-up report was published in November 2013.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

- World Bank: http://financesapp.worldbank.org/en/countries/St.%20Lucia/
- Caribbean Development Bank: http://www.caribank.org/about-cdb/member-countries/regional-members/st-lucia

STATISTICAL APPENDIX

ST. LUCIA — STATISTICAL ISSUES APPENDIX (As of May 16, 2018)
I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but is broadly adequate for surveillance. Although the statistical database compares well and in some areas has a broader coverage than those of its Eastern Caribbean Central Union (ECCU) peers, the accuracy and timeliness of macroeconomic statistics should be improved in order to achieve more effective economic analysis and policy formulation. There are weaknesses in coverage, frequency, quality, and timeliness, in particular regarding the national accounts, data on the public sector beyond the central government, and the balance of payments.
National Accounts: Nominal GDP data are compiled using the production and expenditure approaches on an annual basis. Real GDP data are compiled only using the production approach. Since 2011, real GDP estimates are compiled with 2006 as the new base year. Preliminary GDP is available about four months after the end of the year and are usually finalized with a two-year lag. Household final consumption expenditure is derived residually. No explicit changes in inventories series are disseminated. Quarterly GDP estimates by the expenditure approaches were developed and released in April 2017 with technical assistance from CARTAC. CARTAC has provided technical assistance since May 2011 on quarterly GDP compilation, with St. Lucia serving as a pilot for the ECCU countries. Additional technical and human resources are required to implement the new developmental work in the area of National Accounts.
Price Statistics: The rebasing exercise of the CPI has been completed—the new CPI basket (base January 2018) is based on the 2016 Household Expenditure Survey. The statistical office has started developing a producer price index covering hotels and restaurants, and is considering developing unit-value based export and import price Indexes.
Government Finance Statistics: Reporting of central government data has improved over the last few years, but deficiencies remain in the compilation of both general government and public sector statistics. The authorities report monthly data on the central government's current revenue and expenditure, using a non *GFSM 2014* presentation with lags of a couple of months. Fiscal data for publication in the *GFS Yearbook* or in *IFS* have been reported to STA in 2013 and 2014, which were converted to a *GFSM 2014* presentation by IMF staff. The authorities would thus benefit from moving to a complete GFSM framework for the compilation of Government Finance Statistics. Additionally, frequent and substantial revisions

suggest that there is a need for further refinement, including improvements to accounting systems for capital expenditures to record outlays associated with grant-financed projects as they are realized. Data for the rest of the public sector (financial and nonfinancial public corporations) are not readily available and should be compiled on a regular basis to improve fiscal monitoring of the overall public sector.

Monetary and Financial Statistics: Monthly monetary statistics are compiled and reported to the Fund by the ECCB, based on standardized report forms (SRF) for the central bank (SRF 1SR) and for other depository corporations (SRF 2SR), since July 2006. In April 2007, a data ROSC mission assessed the monetary statistics with reference to the GDDS and the Data Quality Assessment Framework (DQAF, July 2003). It found that the institutional coverage of other depository corporations was incomplete, as data for mortgage companies, finance companies, building societies, and credit unions—all of which accept deposits—were excluded. Accrued interest was not incorporated into the value of the interest-bearing assets and liabilities, and valuation adjustments were wrongly included in other liabilities. In addition, source data for the commercial banks did not provide the disaggregation recommended by the *Monetary and Financial Statistics Manual* and *Compilation Guide*. Close coordination between the ECCB and the single regulatory unit (which supervises financial corporations other than those licensed under the Banking Act) is crucial. The ECCB is currently working on implementing a new reporting system for commercial banks that is envisaged to address the recommendations made by the April 2007 data ROSC mission.

Financial sector surveillance: The ECCB has implemented the compilation of financial soundness indicators (FSIs) for its member countries. The reporting of FSIs to the Fund and their publication on the IMF website has been approved by the ECCB Board and the ECCB is in the process of finalizing the required technical implementation.

External sector statistics: In July 2017, the ECCB released annual 2014-2016 balance of payments and—for the first time—international investment position statistics on a sixth edition of the Balance of Payments and International Investment Position Statistics Manual (BPM6) basis for the eight ECCU member economies, including St. Lucia. Travel credits are now based on visitor expenditure surveys carried out by the St. Lucia Tourist Board, which are a better data source. Further work is required to produce consistent historical data series and improve the data timeliness and coverage. Direct investment transactions should be strengthened due to the low response rates to the surveys and trade in goods data should be improved as well, to properly record re-exports of goods and the corresponding imports of goods. Actions need to be undertaken in collaboration with the ECCB, which coordinates the compilation of external sector statistics of all its member economies.

The Ministry of Finance compiles detailed public sector external debt and publicly guaranteed private sector external debt statistics (St. Lucia reports public and publicly guaranteed external debt data to the World Bank's Quarterly External Debt Statistics (QEDS) database). Data on external debt of the non-bank private sector are not available.

II. Data Standards and Quality	
St. Lucia is a participant in the enhanced General Data Dissemination System (e-GDDS since September 2000. Its metadata published on the Fund's Dissemination Standards Bulletin Board (http://dsbb.imf.org) was last updated in September 2004.	A Data ROSC for the monetary sector was conducted in 2007, covering the ECCB and ECCU member countries, including St. Lucia.

St. Lucia: Table of Common Indicators Required for Surveillance
(As of May 16, 2018)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	Fixed rate	NA	NA	NA	NA
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	02/2018	05/2018	M	M	M
Reserve/Base Money	02/2018	04/2018	M	M	M
Broad Money	02/2018	04/2018	M	M	M
Central Bank Balance Sheet	02/2018	04/2018	M	M	M
Consolidated Balance Sheet of the Banking System	02/2018	05/2018	M	M	M
Interest Rates[2]	02/2018	04/2018	M	M	M
Consumer Price Index	12/2017	04/2018	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	08/2016	11/2016	M	M	H
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	08/2016	11/2016	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q2/2016	11/2016	Q	H	H
External Current Account Balance	2016	07/22/2016	A	H	H
Exports and Imports of Goods and Services	2017	05/2018	A	Q	Q
GDP/GNP	2016	01/23/2017	A	A	A
Gross External Debt	12/16	02/2017	Q	H	H
International Investment Position[6]	2016	10/2017	A	NA	NA

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D); weekly (W); monthly (M); half-yearly (H); quarterly (Q); annually (A); irregular (I); and not available (NA).

Statement by Nancy Horsman, Executive Director and
Courtney Williams, Senior Advisor
June 13, 2018

Our St. Lucian authorities thank staff and management for the constructive exchanges during the Article IV Mission. They welcome the staff report and value the policy advice and recommendations. In this regard, they will remain focused on implementing policies to stimulate job-rich growth through strengthening the macroeconomic and fiscal frameworks, safeguarding financial sector stability, and enhancing resilience to natural disasters and climate change. Given the criticality of building resilience to weather-related shocks, our authorities especially welcome the Climate Change Policy Assessment (CCPA), which they intend to utilize to catalyze much-needed donor support.

Recent Economic Developments

Growth momentum continued on the back of favorable external conditions and supportive fiscal policy. Economic activity expanded by 3 percent in 2017 and was broad-based, with tourism, construction, and wholesale and retail being the main contributors. The tourism sector benefited from a strong recovery in cruise arrivals, as well as the opening of new hotel rooms and additional airlift, which led to stopover arrivals surging by 11 percent, the fastest growth in the Caribbean. The solid tourism performance contributed to the current account returning to a surplus. In addition to the renovation and expansion of the hotel room stock, public investment also buoyed construction activities. Relatedly, unemployment fell for the third successive year to 20.2 percent. Following consecutive years of deflation, inflation turned slightly positive in 2017 fueled by rising oil prices.

Public debt rose marginally, following a slight slippage in fiscal performance. With revenue remaining flat at just over 24 percent of GDP, increased expenditure led to a deterioration in the overall fiscal stance and, consequently, a slight uptick in the public debt to around 70 percent of GDP. The higher expenditure outlay arose largely from the scaling up of public investment, which contributed to the robust growth outturn and prospects.

There are emerging signs of an improvement in the banking sector though vulnerabilities persist. Key macroprudential ratios improved as profitability and return on equity (ROE) in the banking sector turned positive on the back of a notable turnaround by

indigenous banks. Additionally, capital adequacy remained above the regulatory minimum, and NPLs, though still high, are on a declining path. Meanwhile, the loss of CBR has been limited although costlier requirements continue to burden the banking system.

Outlook and Policies

Maintaining Fiscal Prudence

Debt sustainability remains a top priority for our authorities. They take careful note of the unsustainable baseline debt path presented by staff and acknowledge that further fiscal adjustments are necessary to redirect public debt toward the ECCU target of 60 percent of GDP by 2030. To this end, our authorities are considering a suite of revenue enhancing measures, including streamlining the VAT and diversifying the CIP through a new residency program. These will be complemented by prudent actions to restrain recurrent spending with added focus on measures to limit wage increases, rationalize some government services, and contain interest costs. Regarding the latter, our authorities are considering options for enhancing debt management, including plans to commence work on a new debt law. As part of the process to sustain these and other critical fiscal efforts, our authorities are in discussions with the World Bank toward an agreement on a Development Policy Loan (DPL) before the end of this year. Further, the draft Public Financial Management (PFM) Act entails wide-ranging provisions aimed at improving the budget process, reinforcing fiscal discipline, and promoting fiscal transparency and accountability. The legislation, which will be a useful instrument for anchoring debt on a steady downward path, is slated to be enacted by the end of this fiscal year.

Safeguarding Financial Sector Soundness

Our authorities will continue to advance efforts to reduce financial sector vulnerabilities. They are concerned about the still high NPLs and associated stunted private sector credit growth. To address these risks, our authorities are working determinedly to enact new legislation on, inter alia, foreclosure, insolvency, and credit reporting, and they remain committed to the ongoing regional initiative to establish a credit bureau. In addition, our authorities are cognizant of the risks surrounding the CIP and will ensure that the sound due-diligence process remains intact to protect the integrity of the program. Concerning the EU Blacklisting related to international tax rules, our authorities will work toward ensuring compliance by the end of 2018. They will also sustain efforts to strengthen the AML/CFT framework.

Invigorating Growth

The outlook for growth is positive but our authorities are mindful of notable risks. The tourism and construction sectors are expected to remain robust, as new hotel developments should add 1,200-1,500 rooms in the next 2-3 years. Our authorities are close to finalizing concessional funding from Taiwan, Province of China, to upgrade the international airport and the road network. These projects are part of a package to boost the overall tourism product and sustain inclusive growth. Further, plans are underway to uplift the cruise ship

facilities to position St. Lucia to keep pace with the expanding world cruise market, and to take advantage of opportunities for home porting. High production costs, particularly for electricity and shipping, could limit growth prospects. While diversifying the energy mix is unlikely to reduce the cost of electricity meaningfully in the short to medium term, our authorities will continue to pursue greener energy as a dedicated strategy to promote resilience and mitigate against volatile fuel prices.

To promote economic diversification, our authorities intend to step up plans to establish closer linkages between tourism and agriculture, and will intensify efforts to develop other sectors, such as business process outsourcing. Within this context, they will undertake further work to examine human capital deficiencies and seek to enhance the education system to ensure it is in sync with new labor market demands.

Building Resilience - CCPA

Going forward, our authorities will accelerate initiatives to bolster resilience to natural disasters and climate change. As outlined by staff, important growth and fiscal dividends will accrue from strengthening resilience. In this regard, our authorities appreciate the tremendous effort of Fund and Bank staffs in preparing the CCPA, and broadly concur with the recommendations. The CCPA has provided useful guidance for our authorities to press ahead with initiatives aimed at enhancing financial and structural protection. They welcomed the three-pronged approach to resilience building proposed by staff covering: initiatives aimed at lowering risk insurance premium, including for CCRIF through higher donor contributions; access to climate funds, for which the Fund is planning an interactive seminar involving various stakeholders later this year; and capacity development.

Greater donor support is critical to backstop efforts for bolstering resilience. While our authorities are committed to building fiscal buffers, they consider the Savings Fund of 5 percent of GDP as proposed by staff to be quite challenging. They posit that vulnerable small island developing states (SIDs) like St. Lucia do not have the fiscal space to undertake the requisite investment to alleviate the risks posed by natural disasters and climate change, and hence donor funding is urgently needed. Nevertheless, our authorities remain proactive and, within this context, they have advanced discussions with the World Bank toward finalizing a Catastrophe Deferred Drawdown (Cat DDO) facility later this year. Furthermore, they have engaged a team of engineers from the UK to visit St. Lucia by this summer to compute and compile the costs associated with the six pillars of the CCPA - preparedness, mitigation, adaptation, financing, risk management, and national processes. The objective is to have the engineers undertake the assessments, rank the priorities, and develop a roadmap with the associated costings for presentation to the donor community to unlock ex-ante financing. Our authorities look forward to the seminar being organized by the Fund and will endeavor to have the engineers complete the work in time to inform deliberations at that event.