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SUMMARY

CARIBBEAN REGION QUARTERLY BULLETIN

High fiscal deficits continue to be a major challenge for The Bahamas and Barbados, both of which experienced downgrades in their sovereign credit rating by Moody's over the past 3 months. Conversely, Jamaica's economic and fiscal situation has remained stable as it has been complying with the structural and quantitative targets set in the IMF support program. Growth remains strong in Guyana and Suriname, but 2014 performance will depend on gold prices not falling significantly. Trinidad and Tobago just presented its 2014/2015 Budget with a stronger focus on the social safety net.

SELECTED INDICATORS 2013	Real Growth Rate	Annual Inflation (%, end of period)	General Government Primary Balance (% of GDP)	General Government Overall Balance (% of GDP)	Current Account Balance (% of GDP)	General Government Debt (% of GDP)
1) High-debt countries						
Jamaica	0.6	9.7	7.6	0.1	-10.4	141.6
Barbados	0.2	1.8	-5.1	-12.3	-10.4	97.6
2) Medium-debt countries						
The Bahamas	0.7	0.5	-4.2	-6.5	-19.6	59.0
Trinidad & Tobago	1.6	5.6	-0.7	-2.6	10.0	41.2
3) Low-debt or FSO countries						
Suriname	4.7	0.6	-4.5	-6.4	-2.1	28.0
Guyana	5.2	0.9	-2.9	-4.4	14.2	57.4
Caribbean average	**2.2**	**3.2**	**-1.6**	**-5.3**	**-3.1**	**70.8**

Note: For Guyana, most debt is on concessional terms. FSO = Fund for Special Operations.
Source: International Monetary Fund and country authorities.

Summary of Recent Developments, by Country

The Bahamas' sovereign credit rating was downgraded three notches from Baa1 to Baa2 by Moody's due to weak economic performance and deterioration in the government's balance sheet. Tourism performance remains strong and growth is expected to recover to 1.3 percent this year.

Barbados' growth outlook remains subdued in light of an underperforming tourism sector and the on-going fiscal consolidation. However, reserves have been stable throughout 2014 and the decrease in inflation could support Barbados' competitiveness.

In Guyana, growth projections for 2014 were revised downward from 5.6 percent to 4.5 percent as a result of declining gold prices. In contrast, the turnaround of the sugar industry is gaining momentum. On November 10th, the Standing Government suspended the Parliament, hoping to engage the Opposition in extra parliamentary discussions to arrive at compromise on some key issues. To date, the Opposition has refused to enter into talks.

Jamaica's outlook continues to improve as the IMF's Executive Board is expected to consider the sixth review of Jamaica's IMF-supported program under the EFF in December 2014. The economy has grown 0.9 percent in FY2013/14 and is projected to grow 1—1.5 percent in the current fiscal year. However, challenges remain ahead, especially to accelerate economic growth to support the economic adjustment and improve the livelihood of the population.

Suriname's macroeconomic performance continues to be relatively strong although falling commodity prices are challenging revenue collection. An energy crisis is ongoing given increased demand and reduced supply due to a disabled turbine and low water level in the Afobaka reservoir.

The Government of **Trinidad and Tobago** presented the 2014/2015 budget to parliament in September. The budget further enhances the social safety net by expanding the benefits of existing programs and introducing new initiatives. Trinidad and Tobago has moved up 3 places to position 89 in the 2014 global competitiveness ranking.

Resent statistics show that real growth in the **Eastern Caribbean Countries** slightly resumed in 2013 and reached 0.7 percent, compared with 0.2 percent in 2012. However, the outlook is improving and growth could accelerate to 1.9 percent in 2014. The IMF has recently held discussions on the common policies of members of the ECCU and positively concluded missions to Antigua and Barbuda, Grenada, and St. Kitts and Nevis.

Special Country Reports: Inflation

In the special country reports, we look at experiences of the Caribbean with inflation. The Caribbean countries are small and open economies, which are more susceptible to external price shocks. However, transmission of external price shocks has varied among countries due to divers policies and economic factors. Looking at the historical development of inflation shows that it has remained at tenable levels over the last few years.

Regional Report: Inflation in the Caribbean

Although inflation risks are expected to remain contained in the short and medium term, experience reminds us that Caribbean countries are highly vulnerable to fluctuations in commodity prices. In this vein, the regional report examines the degree of dependence of domestic prices on international commodity prices. Furthermore, it analyzes the determinants and risks associated with inflation for The Bahamas, Barbados, Guyana, Jamaica, Suriname and Trinidad and Tobago (CCB region).

Highlights

In September, Moody's downgraded The Bahamas from Baa1 to Baa2 because of the country's weak economic performance and deterioration in the budget. Outlook is now stable.

Data reveal slow growth in tourism arrivals, but air arrivals show signs of improvement.

Unemployment levels begin to fall, despite remaining at historically high levels.

Economic activity in the Bahamian economy remains mixed the first 9 months of the year. Tourism performance advanced with signs of improvement in the air travel segment. The fiscal situation also improved with a contraction in the deficit as a result of both higher revenue collections and contraction in expenditures. Joblessness remained at double-digit levels alongside persistently high levels of nonperforming loans. At the same time, during the period, external reserves stood at high levels, while bank liquidity remained high.

International reserves have been increasing in 2014. Between July 2013 and July 2014, international reserves increased $232.4 million to $972.1 million, a strong increase compared to the $12.2 million contraction experienced in 2013. Nonoil merchandise import cover for the period under review stands at about 20 weeks of coverage. In the recent past, advances in international reserves have been supported by external borrowing. In particular, international reserves for 2013 included $300 million in foreign currency borrowing toward the latter part of the year.

Tourism performance was characterized by low yet consistent overall growth of 1.1 percent, with notable improvements in the air arrival segment. For the January to April 2014 period,[1] total arrivals resulted in 2.3 million visitors of which 1.8 million were sea visitors. Although air arrivals have consistently declined since the onset of the Great Recession, this component advanced by 3.1 percent to 476,367 air visitors. Meanwhile, the sea component grew by 0.6 percent, resulting in 1.8 million sea visitors for the period under review. New Providence (Nassau) attracts the majority of visitors (almost 60 percent) to the country, recording 1.3 million visitors for 0.9 percent overall growth. The Family Islands experienced 11.8 percent growth, accounting for 764,680 visitors. In contrast, arrivals to Grand Bahama retreated by 22.6 percent to 222,899 because of a significant falloff (30.7 percent) in sea arrivals for that island. Meanwhile, air arrivals (only 12.1 percent) to Grand Bahama advanced by 33.2 percent, resulting in over 46,682 arrivals, considerably less than the sea component.

In contrast, the fiscal deficit tapered for the first 5 months of the year to $379.0 million versus the $444.4 million (5.6 percent of GDP) deficit for the corresponding period of 2013 as growth in expenditures fell while revenues increased. Tax revenue improved as a result of the higher collections for business and professional license fees; meanwhile, nontax collections followed a similar trajectory advancing by 36.8 percent from increases in fines, forfeits, and administrative fees. Regarding expenditure, slight expansions in recurrent spending were noted as a result of higher subsidies, while capital spending was reduced by $2.1 million to $208.5 million, reflecting the downturn in capital formation for infrastructure projects across the country. Figure 1 examines the fiscal balance between FY 2006 – 2014. For the second quarter of 2014, the direct charge on the government expanded by $134.5 million to $5.2 billion (just over 60 percent of GDP), while the total national debt grew to $5.8 billion (63 percent of GDP). Underlying the expansion was primarily the increase in internal debt during the period. The Bahamas' debt-to-GDP ratio prior to the world economic downturn stood at about 30 percent of GDP.[2] The GoBH's medium term fiscal plan is expected to yield fiscal surpluses by FY2016/17. Key to this turnaround is the introduction of a value added tax (VAT), which is scheduled for implementation in January 2015.

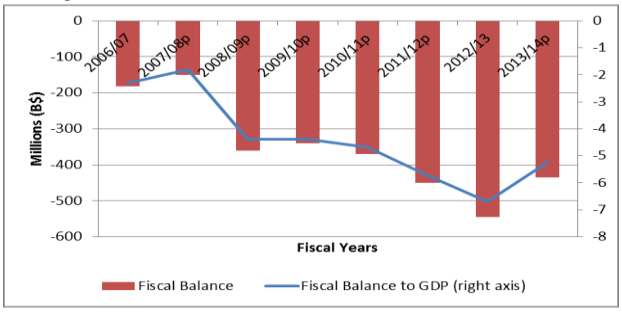
Warnings of downgrades to the country's credit ratings in early 2014 materialized in the recent downgrading of The Bahamas' credit rating. On September 2, 2014, Moody's downgraded The Bahamas' issuer and senior unsecured ratings to Baa2 from Baa1 and changed the outlook to stable from negative. The downgrade was issued because of (a) the continued deterioration of the government's balance sheet, with debt and interest burdens that now exceed those of most Baa-rated peers; and (b) the subdued economic growth, which has been an important factor in the weakening of the government's balance sheet. The stable outlook (a change from the negative outlook given previously) reflects confidence in the government of The Bahamas' fiscal consolidation plan, despite slippages. The Moody's analysis still remains cautious and explained that "even with an effective implementation of fiscal reforms, The Bahamas' debt and interest burdens will remain at levels significantly weaker

[1] Latest information available.

[2] In May 2013, the Government of The Bahamas articulated a Medium-Term Fiscal Consolidation Plan The plan has set targets for recurrent expenditure, to reduce recurrent outlays by 0.5 percent of GDP each year to reach 19.6 percent by FY 2016/17; for capital expenditure, the Government will target an execution rate of 3 percent of GDP per year and, for revenues, to increase by 4 percentage points of GDP from FY 2013/14 to FY 2016/17. The government expects to run fiscal surpluses by FY 2016/17.

than most Baa rating peers over the next two years at least, and over the medium term as well." At present, the country's rating with Standard & Poor's is BBB/A2, while the Moody's rating now stands at Baa2[3] which is equivalent to the S&P rating.

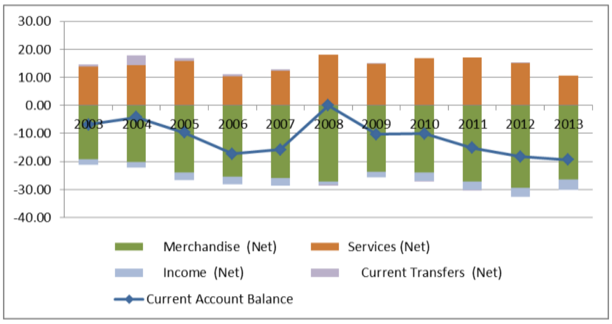
Figure 1. Fiscal Performance (FY2006/07 to 2013/14)



Source: Central Bank of The Bahamas.

The current account is expected to improve. The deficit remains high at 5.4 percent of GDP in FY2013/14. A decline was recorded in the first quarter of 2014 to $298.8 million in comparison with $568.9 million during the last quarter of 2013. The abatement in the deficit mainly reflected a threefold increase in the surplus on the services account, whereas the deficit on the merchandise account remained relatively unchanged. This led to a reduction of almost $300 million in the surplus on the services account. The surplus on the capital and financial account abated by 8.9 percent to $386.4 million. The current account is expected to reach an estimated 15.4 percent of GDP by end-2014, still high compared with the average 10 percent in the pre-crisis years. Figure 2 summarizes developments in the current account between 2003and2013.

Figure 2. Current Account, 2003-13 (share GDP)



Source: Central Bank of The Bahamas.

Unemployment in the country fell from 15.4 percent to 14.3 percent, notwithstanding that it still remains at historically high levels. Declines were attributed to the fall to 15.0 percent unemployment registered in New Providence from 15.9 percent, and the 14.7 percent from 19.5 percent in Grand Bahama. The decrease in the unemployment rate was the result of an increase in employed persons, reflecting some improvement in the labor market. The total labor force has now increased to 197,335, up from 196,880 in 2013. The youth unemployment component remained double the national rate at 28 percent, while the rate for men and women remained almost equal. Participation rates stood at 77.4 percent.

Consumer price inflation increased by 74 basis points to 1.54 percent for the first quarter of 2014 as a result of the rise in international oil prices. The most notable price increases were registered for the alcoholic beverages, tobacco, and narcotics component of the basket by 9.4 percentage points to 10.92 percent followed by advances in transportation, by 4.07 percentage points to 4.97 percent. In contrast, declines in costs were registered for restaurants and hotels by 90 basis points to 3.32 percent. The fuel surcharge charged by the Bahamas Electricity Company in July grew by 4.6 percent at 25.29 cents per kWh on a monthly basis but was 7.4 percent lower than the cost last year. Despite these developments, downward movements in global oil prices are expected to reverse the earlier inflationary impact of oil price increases in the first quarter.

High-Frequency Macroeconomic Indicators	Last data	Period	Prior data	Period
Annual GDP growth (%)	0.7	2013	1.8	2012
Tourism arrivals (annual % chang	3.5	Dec-13	3.5	Dec-13
Exports (12-month growth)	-2.6	Q2 2013	27.3	Q3 2011
Imports (12-month growth)	5.5	Q2 2013	13.9	Q3 2011
Private sector credit growth (%)	-0.9	Jul-14	-1.9	Oct-13
Inflation	0.4	Apr-14	0.5	Dec-13
Exchange rate (end of period)	1.00	Jun-14	1.00	May-13
Unemployment rate (%)	15.4	Dec-13	16.2	May-14

Source: Central Bank of The Bahamas.

[3] The rating action does not affect the Prime-2 short-term foreign currency deposit ceiling or the foreign currency bond ceiling (A2, P-1). The long-term local currency country and deposit ceiling remains unchanged at A1.

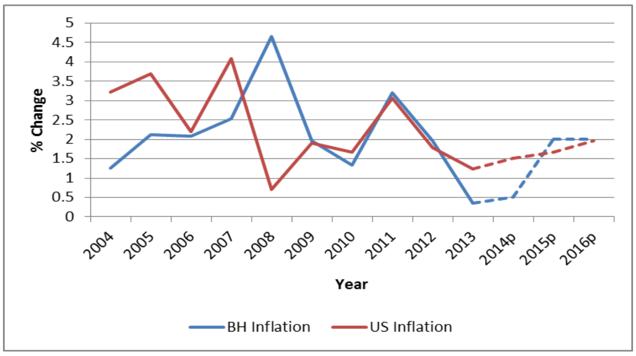
Introduction

In this section, the characteristics of inflation in The Bahamas will be explored through several lenses—international commodity prices, the exchange rate regime, the impending value-added tax implementation and energy. All of these play an integral part in the structure of the Bahamian economy.

The Bahamas has among the lowest inflation rates in the region and it is projected to remain this way during the next few years. Inflation in The Bahamas is highly correlated with U.S. inflation, reflecting the exchange rate peg and the large share of consumer goods imported from the United States. However, the *pass-through* of commodity price changes is higher than in the United States.

During the recession, consumer price inflation fell swiftly and reached a low annual inflation rate of 1.34 percent in 2010, picked up in 2011 and reached 3.20 percent by December 2011, and fell again to 0.4 percent by the end of 2013. Yearly inflation as of May 2014 stood at 0.7 percent as gains softened for housing, water, gas, electricity, water, and other fuels (heaviest weighted component) and for the clothing and footwear component. Figure 3 shows the movements in inflation against US inflation from 2004 – 2016.

Figure 3. Inflation in The Bahamas and the United States, 2004–16



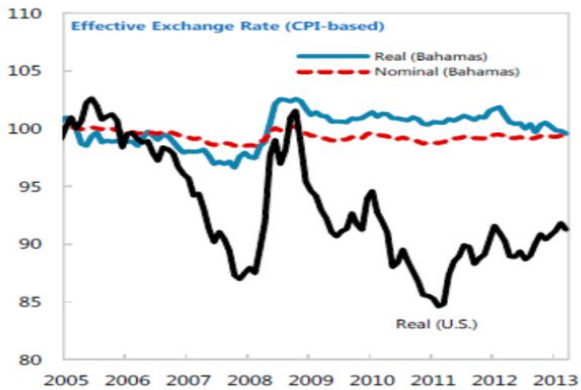
Source: Central Bank of The Bahamas and International Monetary Fund World Economic Outlook, April 2014.

Drivers of Inflation in The Bahamas

Inflation and the Exchange Rate Regime

As a fixed exchange rate regime with capital controls, The Bahamas uses direct monetary policy instruments—reserve requirements, capital controls, the discount rate, prime rate, reserve ceilings, main monetary policy instruments. According to the International Monetary Fund assessments, these instruments, alongside low inflation, have helped to maintain the peg to the US dollar and have underpinned broad nominal and real effective exchange rates stability in the past 5 years. Despite high nonperforming loans and high liquidity in the system, the discount rate, followed by the prime rate were revised downward by 75 basis points to 4.75 percent and 5.50 percent, respectively, to assist with the recovery after the recession.[4] Nonetheless, high levels of imports contribute to upward movements in the inflation levels across the country, despite this, inflation levels remain among the lowest in the region. Figure 4 looks at the effective exchange rate between 2005 and 2013.

Figure 4. Exchange Rate, 2005–13



Source: International Monetary Fund.

Value-Added Tax and Inflation

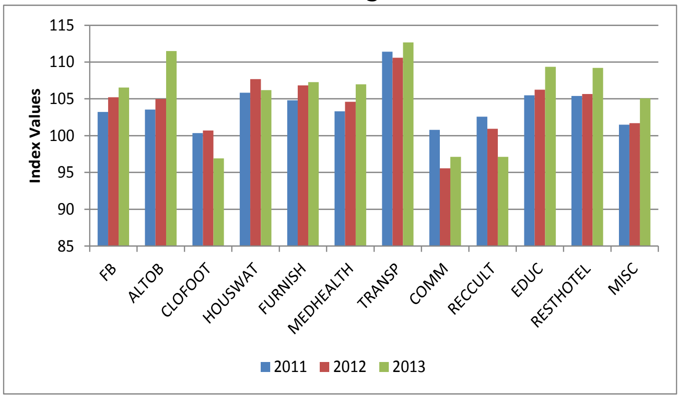
With prospects of increased inflation due to the implementation of the value-added tax in January 2015 under the Government of The Bahamas' medium-term fiscal program, it is likely that the central bank will need to focus more on containing inflation in the short term. On the basis of results from an econometric model conducted under the technical corporation with the government of The Bahamas,[5]

[4] In June 2011, amid signs of a more positive outlook for global growth and the implications for domestic economic activity as well as the improvement in the external reserves position over the past 2 years to historic levels, the Central Bank reduced the discount rate by 75 basis points to 4.50 percent, effective June 6, 2011. The Central Bank requested that financial institutions follow suit with a corresponding reduction in the prime rate, from 5.50 percent to 4.75 percent, and similar adjustments in their lending rate schedules. Commercial banks announced the reduction in the prime rate to 4.75 percent, effective June 8, 2011. This was the first revision of the discount rate since 2005.

[5] The technical corporation with the government of The Bahamas was titled "Conditions for a Sustainable Fiscal Balance in The Bahamas," through the Japan Special Fund, which is administered by the IDB, in the amount of US$612,000.

it is likely that the initial effect on inflation stemming from the implementation of the value-added tax could surge as high as 3 percent above historical values. Inflation should taper to below historical levels from the second year of implementation onward. Figure 5 shows the components of the index between 2011 and 2013.

Figure 5. Components of Retail Price Index in The Bahamas, 2011–13



Source: Central Bank of The Bahamas.

Notes: FB = food and nonalcoholic beverages; ALTOB = alcohol, tobacco, and narcotics; CLOFOOT = clothing and footwear; HOUSWAT = housing, water, gas, and other fuels; FURNISH = furnishing, household equipment, and routine maintenance; MEDHEALTH: health; TRANSP = transport; COMM = communication; RECCULT = recreation and culture; EDUC = education; RESTHOTEL = restaurant and hotels; MISC = miscellaneous goods and services.

Commodity Prices

Although commodity price increases can lead to a higher overall inflation, on the basis of past episodes, its transmission to core inflation is contained. Because The Bahamas depends heavily on imported commodities, any changes in international food and oil prices may create temporary inflationary pressures and volatility. For this country, which imports more than 90 percent of what is consumed, price hikes on the international market for oil and gas as well as food products have a direct effect on inflation. Figure 6 explores monthly inflation between 2010and 2013.

Inflation and Energy

Energy costs in The Bahamas are one of the highest in the region with average tariffs increasing by 44 percent to US$0.40 kWh for residential customers and by 76 percent to US$0.44 for nonresidential customers between 2009 and 2012[6]. Electricity in the country is governed by the Electricity Act of 1956, which established its institutional framework, responsibilities, and its rights. Legislation, equipment, and technology around energy are outdated. However, within the next 1–2 years, the restructuring of the country's electricity corporation[7] could have significant effects on energy costs across the country. This restructuring is expected to result in one company with two distinct divisions—one for transmission and one for distribution. The company will remain wholly owned by the government. It was recently reported that the government is entering the final phase of discussions on the new structure. This process should be concluded by November 2014. This process is expected to relieve some inflationary pressure in the country.

Figure 6. The Bahamas: Monthly Inflation, 2010-13

Source: Department of Statistics.

Conclusions

Low inflation is important for The Bahamas because it allows the country to keep the fixed peg with the US$ while avoiding a real appreciation that would hurt competitiveness. Inflation has indeed been relatively low in comparison with other regional counterparts. However, The Bahamas is experiencing several structural economic changes, particularly the implementation of the VAT and the restructuring of the electricity company that are likely to have inflationary impacts on the economy. As a result, greater efforts from the Central Bank to contain excessive price pressures are expected, while simultaneously managing the effects of the value-added tax implementation. These efforts coincide with

[6] Average tariff rates for the Caribbean in 2012 ranged between US$0.21 per KwH for Belize Electricity Ltd. and US$0.51 per KwH for Turks & Caicos Utilities Ltd.

[7] The Bahamas Electricity Corporation is a public corporation that operates generation, transmission, and distribution systems throughout The Bahamas and serves approximately 85 percent of all electricity consumers in the country.

efforts to manage movements in international oil prices, food prices, and adverse weather patterns on the inflation levels in the country.

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Table 1: Selected Indicators (2009-2015)

	2009	2010	2011	2012	2013 (F)	2014 (F)
(Annual percentage changes, unless otherwise indicated)						
Real Sector - Department of Statistics/IMF						
Real GDP	-4.2	1.5	1.1	1.0	0.7	1.2
Nominal GDP	-5.2	1.1	0.3	3.6	2.5	5.4
Inflation (end of period) - Central Bank	1.3	1.4	3.2	1.9	2.0	2.0
External Sector - IMF						
Exports of goods and services	-9.3	-6.2	1.6	16.0	2.1	3.1
Imports of goods and services	-20.2	2.9	-1.0	9.4	2.4	3.7
Current account (percentage of GDP)	-10.3	-10.1	-15.3	-18.4	-19.6	-14.7
FDI (percentage of GDP)	9.6	12.2	12.3	7.1	n.a.	n.a.
(In percentage of GDP, unless otherwise indicated, on a fiscal year basis)						
Central Government - Ministry of Finance	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Revenue and grants	16.5	16.6	18.3	18.1	16.4	17.1
of which: tax revenue	14.4	16.4	16.2	14.9	15.9	16.9
Recurrent Revenue	n.a.	n.a.	17.9	16.6	17.4	19.4
Total Expenditure	21.0	20.9	22.9	23.7	23.0	22.3
Recurrent Expenditure	n.a.	n.a.	20.4	20.0	20.1	19.9
Current Expenditure	18.1	19.3	19.7	19.0	19.7	19
Capital Expenditure			4.9	4.2	3.4	3
Primary balance	-0.9	-1.0	-3.3	-4.1	-2.4	0.4
Overall balance	-4.4	-3.2	-5.6	-6.5	-5.1	-2.4
Consolidated NFPS balance						
Debt Indicators - IMF & Ministry of Finance						
Central Government Debt - Min of Finance	42.5	47.2	48.8	53.1	59.0	56.6
Central government debt over revenues - IMF (aligned with MTFP)	20.4	4.5	8.1	4.0	n.a	n.a.
External public debt (end of period) - IMF	9.8	11.6	13.2	17.8	17.8	19.7
External debt service as percentage of exports of goods and services - IMF	24.7	11.1	8.0	7.4	11.3	4.9

Source: Central Bank of The Bahamas and International Monetary Fund.

Recent Developments

New tax incentive legislation was announced for the hotel industry. As an incentive to stimulate growth, new tax exemptions were granted in return for private investment and upgrades to facilities. Initially, the scheme was to benefit only the Beaches and Sandals Hotels Group looking to invest US$250 million, but it will apply to all hoteliers.[1] The government is counting on jobs and indirect contribution to economic activity that would come with these incentives.

Barbados joined the Corporación Andina de Fomento in September 2014. With a contribution of US$50 million, the country became a shareholder of the Development Bank of Latin America. This move will make Barbados eligible for additional financing and will widen its currently limited external financing options.

The unemployment rate increased in the second quarter of 2014. The rate rose to 13.2 percent or 19,100 jobless people and stood at 12.8 percent for men and 13.6 percent for women, putting pressure on the National Insurance Scheme's Unemployment Benefit Fund. For the months of June and July 2014, claims were estimated at more than US$1.3 million over budgeted amounts.

Credit rating agencies maintain a negative outlook on the economy. In June 2014, Moody's downgraded its rating for government bonds from Ba3 to B3 with a negative outlook justifying the triple-notch downgrade on the basis of challenges to enforce fiscal consolidation. It cited the level of international reserves and direct Central Bank financing as areas of concern. This was followed by a statement by Standard & Poor's in August 2014 that retained Barbados' BB– rating and its negative outlook.

The rum industry continues to face challenges. Rum exports declined during the first half of 2014, from US$21.5 to 19.6 million or below 1 percent of GDP. The contribution to output from the agricultural sector has been marginal and at around 5 percent of GDP for the past 5 years. This sector has been challenged by unfavorable climatic conditions, high production costs, and a strong Barbadian dollar, which have undermined competitiveness in global markets.

Challenges and Opportunities

Growth in Barbados has not fully recovered from the global downturn. Over the past 5 years, the country has seen low and negative real GDP growth averaging –0.5 percent annually. In 2013, output grew by 0.2 percent, with estimates of 0.3 percent for 2014.[2] Economic activity has been driven by the nontradable sectors, wholesale & retail, construction, and services, while the tradable segments have contracted in tourism, manufacturing, and agriculture. The government's significant contribution of 12 percent of GDP is likely to decline with the fiscal consolidation efforts.

Highlights

New tax incentive legislation and private investment in hotel projects over the medium term would benefit Barbados' tourism sector.

Fiscal consolidation is affecting aggregate demand while reserves have been relatively stable throughout 2014.

A lower inflation than in other Caribbean countries would make Barbados' exports more competitive.

Weak performance in the tourism sector is constraining growth. Tourism is the main driver of growth in Barbados, and it is being affected from lower external demand. It directly contributes around 12 percent of GDP through hotels and restaurants but indirectly more than 40 percent. Over the first 6 months of 2014, long-stay tourist arrivals were stagnant, spending per tourist grew 1 percent, and the average length of stay increased only 1.6 percent.[3]

Barbados' fiscal position poses macroeconomic challenges. The country is facing a high fiscal deficit, which stood at 12.3 percent of GDP in FY 2013/14. Compared with the 5.4 percent of GDP projected deficit, the financing gap more than doubled the 2013 budget estimates. A primary deficit at above 2 percent of GDP over the past 5 years has led to the rapid accumulation of public debt. In 2013, the debt-to-GDP ratio stood at 97.6 percent (130 percent of GDP including the National Insurance Scheme.)

Revenues have been hit by the contraction of GDP. The weaker tourism demand has affected revenues, as well as the tax incentive legislation (tax concessions, waivers, and reduced rates). During 2011–13, total revenue collection declined from 29.2 to 25 percent of GDP, mostly driven by the lower value-added tax collection and declining personal and corporate tax receipts. In 2013, public expenditures were pressured by the wage bill at 10.3 percent of GDP, interest payments at

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[1] It grants 25 years of exemptions in import duties, value-added tax, and levies on local or imported goods and at half the applicable rates thereafter.

[2] Central Bank of Barbados, July 2014. The International Monetary Fund projects a contraction of –0.6 percent of GDP in 2014.

[3] Tourism arrival figures for 2014 show an 8.2 percent increase from the United Kingdom, but a decline of 7.2 percent from the United States and Canada.

7.2percent of GDP, transfers to public enterprises at 7.1 percent of GDP, and grants to individuals at 5.4 percent of GDP.

With the aim to stabilize public finances, the government is implementing a fiscal consolidation program. The measures under its 19-month program launched in August 2013 focus on reducing spending through a lower public sector wage bill and transfers to state-owned enterprises and subsidies, while increasing revenue collection (a temporary high-income surtax, lottery tax, end of car excise rollback, tax on bank assets, tobacco excise tax, and a waste tax on property). During 2014, the Government announced the retrenchment of 3,000 public sector jobs, which represents about 10 percent of the civil service. In addition, efforts were made to strengthen the monitoring of state-owned enterprises with the establishment of a high level oversight committee to monitor performance. As of October 2014, the program has led to 0.9% of GDP in savings and would likely close the fiscal year in March 2015 below its savings target of 5% of GDP.

The financing of the fiscal deficit has focused on domestic instruments and shorter term borrowings. Over the past 3 years, debt accumulated rapidly and its composition changed. During 2013, two thirds of the government's debt issuance was short-term (90 days on average). Interest payments accounted for 7.2 percent of GDP, 29 percent of revenue collection, and 19 percent of total spending.[4]

The level of spending and existing liquidity are pressuring imports and widening the trade balance. The trade balance deficit for the first 6 months of 2014 stood at US$675.1 million or 32.1 percent of GDP, wider than the US$618 million or 29.7 percent of GDP for the same period in 2013. Over the past 5 years, Barbados sustained current account deficits at more than 9 percent of GDP, a trend that improved in 2014 with a weaker import demand that reduced the current account deficit to 6 percent of GDP. While net private capital inflows rose to US$91.8 million (4.4 percent of GDP), they are below their annual average of US$401.4 million for the period 2009–13.[5]

Reserves at 15.1 weeks of imports remained relatively stable during 2014. At the end of June 2014, reserves stood at US$546.7 million. The government received the remaining US$75 million of the US$225 million loan from Credit Suisse in March and improved its reserves position. Their relative stability suggests that lower consumption and investment levels are containing the demand for imports and, to some extent, easing pressures on the demand for dollars and the exchange rate peg.

Private sector credit growth remains subdued. While the financial sector is stable, enjoying liquidity and adequate capitalization levels and domestic interest rates decreased from 10.3% in 2008 to 8.1% in September 2014, there is limited lending. Banks are increasing their exposure to government T-bills, risking crowding out private investment. Banks' holdings of Treasury bills increased by 12% or US$80.2 million, while holdings of other government paper declined by 21% or US$60.1 million, when comparing June 2013 and 2014. This is reflective of the move towards more short-term securities. While profitability declined as a result of the economic downturn, domestic deposits grew by 5.3 percent as of March 2014. In addition, the liquid asset ratio annual average increased from 13 to 18.6 percent for 2009–13. The nonperforming loan ratios of nonbank financial institutions stood at around 8.5 percent and the trust and finance companies recorded 8.7 percent.

Outlook

The government's medium-term growth outlook is modest at 0.3 percent for 2014. The International Monetary Fund suggests a slight contraction of –0.6 percent, while Moody's forecasts –1 percent for the year. The year could likely close with a contraction of GDP as real sector indicators will remain subdued for the remainder of 2014. Private sector credit growth, as well as exports and imports, are likely to decline.

The authorities expect output to increase to 1.2 percent in 2015 and 2.5 percent in 2016. The fiscal consolidation program could improve the fiscal position but would come with an adverse effect on growth. The reductions on public consumption and investment would reduce the government's contribution to GDP going forward. However, tourist arrivals could slowly pick up and if private investments in tourism-related projects kick off—such as the Pier-head Marina, Four Seasons, Sandals Resort, Sugar Point Cruise Pier—the sector could see a gradual rebound and increase its contribution to output over the medium term.

High-Frequency Macroeconomic Indicators	Last Data	Period	Prior Data	Period
Annual GDP growth (%)	0.0	Jun-14	-0.4	Mar-14
Tourism arrivals (annual % change)	-0.2	Jun-14	-1.1	Mar-14
Nonperforming loans (%)	10.5	Mar-14	11.7	Dec-13
BoP current account(% of GDP)	-6.0	Jun-14	-3.2	Mar-14
Foreign Exchange Reserves cover,weeks	15.1	Jun-14	16.0	Mar-14
Inflation	1.7	Jun-14	1.7	Mar-14
Exchange rate (end of period)	2.0	Apr-14	2.0	Mar-14
Unemployment rate (%)	13.2	Jun-14	11.7	Mar-14

Source: Central Bank of Barbados, International Monetary Fund.

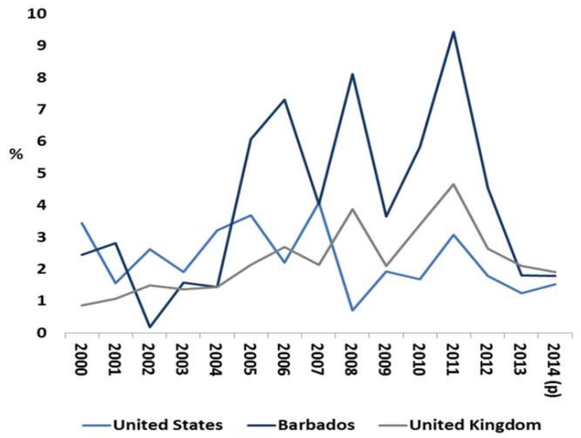
[4]The Central Bank financed about 70 percent of the deficit in 2013.

[5]Remittances averaged 1.3 percent of GDP for 2008–12.

DECLINING INFLATION IN BARBADOS

The decline in prices in Barbados is a combination of external and domestic forces at play. Since 2011, inflation has fallen from 9.4 to 1.8 percent, a trend likely to continue through 2014 with a projection at around 1.4 percent. This drop reflects the lower international prices for commodities and weak domestic demand affecting consumption and investment.

Figure 1.Inflation Trends 2000–14



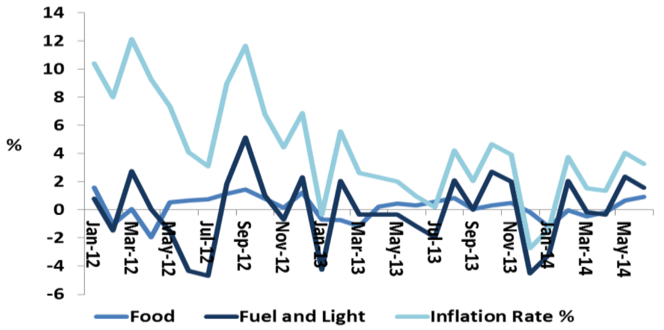
Source: World Economic Outlook database, April 2014.

Inflation in Barbados is driven mostly by food and fuel prices (Figure 1 and 2). Given that the country imports most of its food and fuel, price trends tend to follow that of its main trading partners, the United Kingdom and the United States, but with greater volatility from the fluctuations in international commodity prices. The pass-through of imports to prices in Barbados is high and passed mostly to the ultimate consumer. During the period 2010–12, when international oil prices increased above US$100 per barrel, fuel imports led to rising domestic prices for transportation and electricity, which are important inputs to production. The recent moderation of international commodity prices is to some extent driving down the prices of the consumption basket in Barbados' consumer price index.

Inflation is a good indicator of economic activity and a reflection of domestic expectations. Beyond the external context, weak domestic demand is the main driver of lower prices in Barbados. The stagnation of inflation evident during 2013 and 2014 is indicative of the country's economic contraction. With the layoffs and rising unemployment and a modest growth outlook, consumer sentiment is low. Households and firms are postponing their consumption and investment decisions.

Fiscal consolidation measures are affecting the level of inflation. The government's Fiscal Consolidation Program is

Figure 2. Inflation, 2012–14 (CPI, monthly)



Source: Barbados Statistical Service.

contributing to the decline in demand by reducing disposable income and containing the demand for imports of consumer products and fuel. Since 2012, total import values as a share of GDP contracted by about 2 percent annually. With a lower demand for imports, and subsequently dollars, reserves have stabilized in mid-2014, which would be an indirect effect of the fiscal consolidation program.

The financing of Barbados' fiscal deficit may have triggered inflation, but weaker domestic demand has countered that effect. Because external financing is constrained by increasing rates, the heavy reliance on domestic instruments like the issuance of T-bills and monetization could have pressured prices. However, the fact that inflation did not pick up suggests that the effect of the contraction of output on prices has subdued inflationary pressures arising from monetizing a share of the deficit.

Low inflation is important for Barbados's competiveness, particularly with respect to other Caribbean countries. The IMF estimates that real effective exchange rate has appreciated by about 12 percent since 2009, which undermined competitiveness for the export sectors.[6] The declining trend in prices in Barbados would improve the competitiveness of the exports sectors that are facing high production costs. Lower prices also benefit the most vulnerable groups that are likely to suffer most at times of economic downturn.

[6] IMF Article IV, 2013

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Annex I. Barbados: Selected Indicators

	2009	2010	2011	2012	2013	2014F
(Annual percentage changes, unless otherwise indicated)						
Real Sector						
Real GDP	-4.1	0.3	0.8	0.0	0.2	-0.6
Nominal GDP	1.1	-3.5	-1.5	-3.3	0.1	0.7
Inflation (end of period)	3.6	5.8	9.4	4.5	1.8	1.8
Unemployment	10.0	10.8	11.2	11.6	11.7	15.6
External Sector						
Exports of goods and services (% change)	-13.7	14.0	8.7	4.3	-3.2	2.5
Imports of goods and services (% change)	-23.4	7.8	16.6	-7.6	-0.3	-4.0
Current account (percent of GDP)	-6.8	-5.8	-12.8	-9.5	-10.4	-7.7
International reserves (USD mill)	738.7	711.9	707.4	728.9	572.1	n.a
International reserves cover (weeks)	20.9	18.3	17.7	19.9	15.6	n.a
(In percentage of GDP, unless otherwise indicated, on a fiscal year basis)						
Public Sector						
Central government current expenditure	30.6	32.9	32.2	36.4	35.3	n.a
Central government capital expenditure	1.9	1.5	1.4	1.4	2.0	n.a
Central government primary balance	-2.5	-3.0	1.6	-2.0	-5.1	n.a
Central government overall balance	-7.2	-8.7	-4.4	-8.8	-12.3	n.a
Debt Indicators						
General government debt	63.2	72.0	77.8	85.7	97.6	n.a
General government debt(inclusive of NIS holdings)	83.5	96.9	105.0	116.5	131.6	n.a
Central government debt over revenues	249.6	280.0	266.5	294.7	390.1	n.a
External public debt (end of period)	28.6	34.2	35.1	34.9	27.5	n.a
External debt service as percentage of exports of goods and services	7.0	16.7	6.6	6.9	6.6	n.a

Note: (F) Forecasts numbers for 2014.

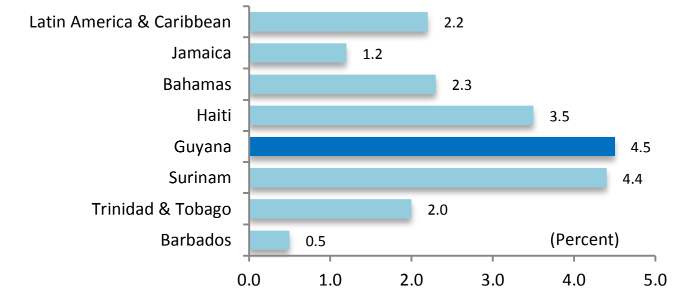
Source: Central Bank of Barbados, International Monetary Fund World Economic Outlook April 2014.

Gold Slump Overshadows Turnaround in the Sugar Sector

Economic growth moderated more than expected in the first half of 2014 to 3.2 percent. The slowdown reflects in large part a marked slowdown in gold mining activity as the price decline continued. As a result, authorities revised downward projected GDP growth rate for 2014 from 5.6 percent to 4.5 percent. However, the much-anticipated rebound in sugar production, the growing services sector and burgeoning rice production are expected to be key drivers supporting another year of positive economic expansion in 2014.

Despite the slowdown ingrowth, Guyana is expected to be the fastest growing economy in the Caribbean and eighth ranked in Latin America, according to the Economic Commission for Latin America and the Caribbean (see Figure 1). While the medium-term economic outlook remains positive, the mounting downside risks stemming from exposure to commodity price volatility and political developments could see growth prospects altered.

Figure 1. 2014 Economic Growth Outlook



Source: Economic Commission for Latin America and the Caribbean.

Turnaround in the sugar industry gains pace. Sugar production in the first half of the year surpassed its mid-year 2013 production level by 66.5 percent (see Figure 2). Authorities at the Guyana's Sugar Corporation attributed the performance improvement to a combination of favorable weather conditions and operational overhauls across the sugar belt that have permitted higher yields and greater efficiency. On the basis of an outstanding first harvest and a promising start to the second crop, sugar is expected to expand by 15.6 percent in 2014. The total year-end production is expected to be more than 200,000 tons.

Rice remains on its record-breaking run; however, frailties reemerge. The first half of the year saw rice production expand by 18.6 percent compared with mid-year 2013. The sector continues to be stimulated by the Petrocaribe rice-oil compensation scheme. Since the preferential rice agreement started in 2009, acreage under cultivation has increased significantly due to guaranteed access to the Venezuelan market at premium prices. Venezuela currently accounts for close to 60 percent of total rice exports; the authorities have commenced initiatives to diversify into alternative markets, such as Haiti and Panama. Rice production is projected to grow by 10.5 percent in 2014, to a record-breaking level of 591,892 tons. Lower international paddy prices could pose problems in attempting to place rice in alternative markets (Figure 3).

Highlights

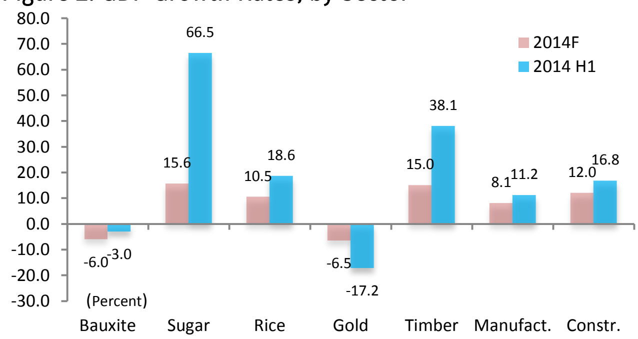
Guyana, despite its many challenges, continues to outstrip its regional counterparts in economic performance and relative external stability.

The concentration of the economy on several volatile commodities, most notably gold, remains the major risk.

On November 10th, the Standing Government suspended the Parliament, hoping to engage the Opposition in extra parliamentary discussions to arrive at compromise on some key issues. As of publication, talks have not materialized.

The Financial Action Task Force (FAFT) finds Guyana to be a jurisdiction with strategic deficiencies in its Anti-Money Laundering framework but with an Action Plan. With the suspension of Parliament on November 10, timeframe for resolution is unclear.

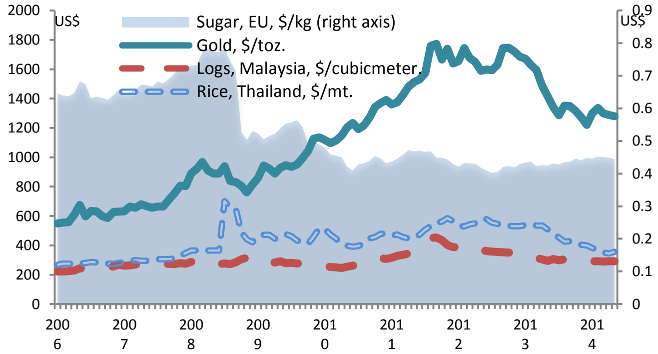
Figure 2. GDP Growth Rates, by Sector



Source: Ministry of Finance.

Ramped up timber harvesting. The forestry sector, which includes hardwoods and processed plywood, recorded a 38.1 percent boom in activity during the first half of 2014. Forestry authorities posit that new incentives to harvesters coupled with strong log and plywood demand, both domestic and external, explained the outturn. The robust construction and furniture manufacturing subsectors are largely responsible for domestic demand, while export of timber products has increased by 31.3 percent in mid-year 2014 compared with mid-year 2013, owing to higher international demand. Authorities anticipate momentum to be sustained resulting in an upward revision of the forestry sector's 2014 performance by 11.7 percentage points to 15 percent.

Figure 3.Selected Commodity Prices



Source: World Economic Outlook Commodity price series.

The gold price decline continues to affect local gold mining declarations; environmental concerns remain. Despite export revenue contracting by 24.6 percent during the first half of the year, gold is expected to remain Guyana's largest commodity foreign exchange earner in 2014. Authorities cited the combined effects of the lower world market prices and increased hoarding and suspected black market transactions as the reasons behind the 17.2 percent fall in official declarations of gold in the first half of 2014. Small and Medium mining representatives claim that production and declarations fell because of the high cost of production relative to the world price. Some of the larger operators are supposedly running at 25-35% capacity and are requesting more assistance. In response to lower prices, authorities have made efforts to increase production, which includes the issuance of new mining permits and prospecting licenses, increasing the availability of land for mining, and rehabilitating access roads to mining districts. Although these measures are likely to increase production, the limited capacity to monitor and to fully enforce mining regulations could exacerbate environmental degradation and makes it more challenging to implement the government's Low Carbon Development Strategy, adopted in 2009 and intended to guide the country toward conserving its forestry resources and reducing reliance on fossil fuels.

The services sector continues to grow in large part due to heightened construction activity. Construction activity grew by 16.8 percent by mid-year 2014 largely owing to the sustained growth of housing stock and both private and public sector spending on infrastructure. Authorities expect activity to remain buoyant throughout the year, reaching a projected 12 percent growth in 2014.

The fiscal situation continues to evolve. For the first half of 2014, Central Government current revenue, net of the Guyana REDD+ Investment Fund (GRIF), amounted to $73.8 billion, 3 percent above the corresponding 2013 level, primarily reflecting growth in several revenue categories consistent with growing levels of productive activity and profitability. Tax revenue collections increased by 3.4 percent to $7 billion primarily attributed to an increase in Bank of Guyana Profits, outweighing the contraction in collections from dividends from equity holdings.

At the same time, growing expenditures from wages and salaries and the provision of goods and services, and transfers continue to slow the pace of fiscal consolidation. At the end of June 2014, non-interest current expenditure totaled to G$54 billion, an increase of 28.7 percent over the corresponding period in 2013. Growth in current expenditures is driven by high public sector employment costs. Personal emoluments increased by 11.3 percent to G$19.7 billion, reflecting a 5 percent increase granted to public servants. Other goods and services amounted to G$15.2 billion, representing a 50.8 percent increase. Transfer payments totaled G$19 billion, 34.9 percent above the 2013 level, primarily on account of the subsidy to GUYSUCO.

Governance and Policy Issues

Political impasse continues. The Opposition Alliance for Change party filed a No-Confidence motion against the People's Progressive Party Government in the National Assembly on August 7, stemming from the unapproved spending of G$4.5 billion. The motion was expected to be debated and voted upon when the Parliament ended its recess. On November 10th the day that the Parliament was to be reconvened, the Standing Government suspended the Parliament under the powers conferred to the President by Article 70 (1) of the Constitution. During the suspension period, the Standing Government hopes to engage with the Opposition and attempt to come to a compromise on several critical legislative items. As of publication, no extra parliamentary meetings have occurred between the Government and the Opposition.

New interest by foreign investors in Guyana's untapped hydrocarbon resources. Canada-based Nexen Energy ULC and US-based Esso Exploration and Production Guyana Limited have expressed interest in pursuing petroleum exploration ventures. The investors intend to hold meetings with the pertinent agencies and stakeholders to better understand Guyana's business structure and the proper procedure for achieving their exploration goals.

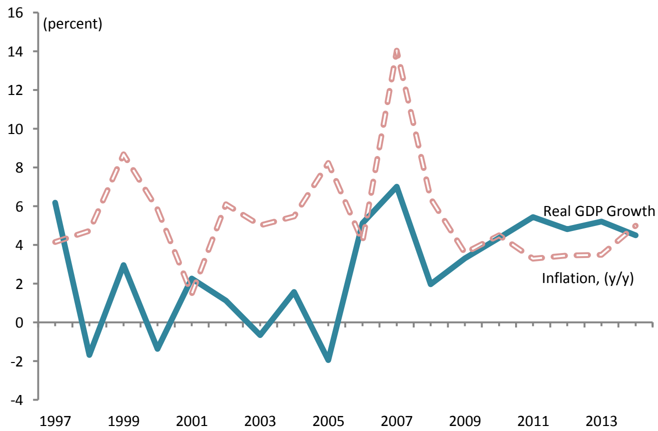
High-Frequency Macroeconomic Indicators	Last data	Period	Prior data	Period
Annual GDP growth (%)	5.2	2013	4.8	2012
Exports (12-month growth)	-2.8	2013	23.6	2012
Imports (12-month growth)	-7.5	2013	11.6	2012
Private sector credit growth (%)	14.5	2013	24.7	2012
Inflation	0.9	2013	3.5	2012
Exchange rate (end of period)	206.3	2013	204.8	2012

Source: Ministry of Finance.

Pass-Through Inflation and Greater Trade Openness

Inflation has remained relatively stable over the past 5 years. Real economic activity expanded by 5.2 percent in 2013 due to broad-based growth in agriculture, manufacturing, mining, construction, and other services. Twelve-month inflation remained low at 3.5 percent, despite higher energy and food prices. Notwithstanding the price-level shock from introduction of the value-added tax in 2007, inflation has remained less than 5 percent over recent years (see Figure 4).

Figure 4. Real GDP Growth and Inflation

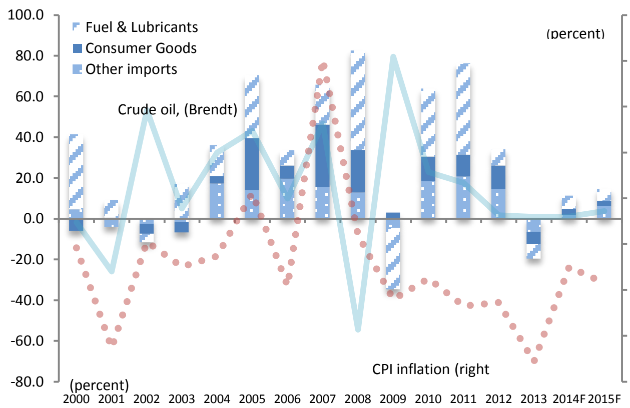


Source: International Monetary Fund World Economic Outlook and Bank of Guyana.

For an open economy such as Guyana, inflation stems not only from internal pressures but also from external factors such as commodity prices and exchange rate volatility. Guyana exports a number of commodities (gold, sugar, bauxite, and timber) but imports of goods and merchandise are larger resulting in the country being a net importer with an import dependency ratio of 61.7 percent of GDP in 2013. The high degree of trade openness, especially via imports, exposes the domestic price level to adverse price shocks in international commodity markets. Nonetheless, Guyana has maintained relative exchange rate stability that has helped subdue pass-through inflationary pressures to the domestic price level. Kamin and Klau (2003) empirically found that the effect of exchange rate changes on inflation in Latin America was significantly higher than those in Asia and industrialized economies. In contrast, internal inflationary pressures have originated primarily from domestic credit growth and increased domestic demand for goods and services. However, DaCosta and Greenidge (2008) found that unemployment is not a significant factor in the inflation process in Guyana, thereby underlining the deterministic importance of domestic interest rates, world prices, exchange rates, and money supply. Proactive fiscal and prudent monetary policy measures by the authorities have largely contained inflation at or below 5 percent in recent years.

High dependence on imported commodities, notably food and fuel, has driven price-level changes over the past decade (see Figure 5). Food imports, which include grains and processed foods, accounted for 12.3 percent of the total import, while fuel and lubricants have contributed to 31.1 percent of import cost.

Figure 5. Composition of Imports



Source: Bank of Guyana and International Monetary Fund Article IV2013

Consumer Price Index

Inflation, as measured by the consumer price index (CPI), reflects the annual percentage change in the cost to the average consumer of acquiring a basket of goods and services that may be fixed or changed at specified intervals. In Guyana, that basket is dominated by food and fuel expenditures, with the latter permeating throughout all fuel dependent goods and services. Guyana's CPI was rebased in 2010 to 2009 prices. Official inflation is derived from the urban consumer price index with does not account for the price disparities in the hinterland that arise from the geographical distances and the impact of high transport costs and its pass-through effects on other commodities.

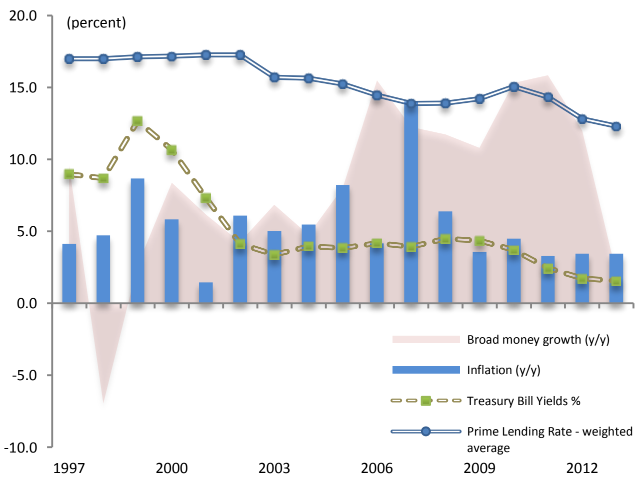
Fiscal Measures: Ad Valorem Fuel Tax

Authorities have adopted an ad valorem tax scheme that is levied on fuel imports and that acts as a buffer against pass-through volatility of international prices. Thus, it helps keep inflation in check. Fuel imports constitute approximately 30 to 35 percent of the merchandise import bill and are largely affected by a combination of steady growth in domestic consumption and volatility in fuel prices. By adjusting ad valorem excise tax rates in inverse correlation with imported oil prices, the authorities have contained pass-through of international prices into domestic inflation. Taxes per liter for both diesel and gasoline have fallen since 2007, with the decline most marked in 2011, particularly for diesel. Excise taxes have varied between 7 and 60 percent for gasoline and 0 and 40 percent for diesel. There is no value-added tax imposed on petroleum products, and kerosene is not taxed. The ad valorem tax also reduces the volatility on the government's fiscal position since revenue is gained when fuel prices are low.

Monetary Measures

The Bank of Guyana conducts monetary policy by targeting monetary aggregates consistent with output and inflation objectives. The Central Bank's principal tool to achieve the targeted amount of broad money in the system is Treasury bill auctions. The Open Market Operation Committee determines interventions through treasury bills on a weekly basis. In addition, the Central Bank deploys other instruments such as reserve requirements, the rediscount rate, and moral suasion to fulfill its statutory objectives of promoting domestic price stability and growth (See Figure 6).

Figure 6. Monetary Aggregates and Price-Level Changes



Source: Bank of Guyana and International Monetary Fund Article IV 2013.

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Guyana: Selected Indicators

	2010	2011	2012	2013	2014 (F)
(Annual percentage changes, unless otherwise indicated)					
Real Sector					
Real GDP	4.4	5.4	4.8	5.2	4.5
Nominal GDP (GYD millions)	400922	460108	511337	n.a.	n.a.
Inflation (end of period)	4.5	3.3	3.5	0.9	5.0
External Sector					
Exports of goods and services	14.6	25.8	20.1	-10.7	n.a
Imports of goods and services	17.9	25.1	14.4	-7.0	n.a.
Current account (percentage of GDP)	-10.7	-16.4	-15.7	-14.2	-15.4
Remittances (percentage of GDP)	18.8	18.3	16.7	11.7	12.8
FDI (percentage of GDP)	9.9	9.9	10.8	7.3	10.6
(In percentage of GDP, unless otherwise indicated, on a fiscal year basis)					
Central Government					
Revenue and grants	26.0	26.5	27.9	22.1	26.7
Current expenditure	18.8	19.8	21.1	19.8	21.8
Capital expenditure and net lending	7.2	6.7	11.1	8.2	13.13
Overall balance	-2.9	-3.2	-4.7	-4.4	-4.9
Debt Indicators					
Central government debt	68.0	69.3	72.1	57.4	n.a.
Central government debt over revenues	261.7	261.6	n.a.	n.a.	n.a.
External public debt (end of period)	46.1	48.6	54.2	41.5	44.8
External debt service as percentage of exports of goods and services	2.6	3.0	n.a.	n.a.	n.a.

Note: FDI= foreign direct investment; (F) Forecasts numbers for 2014.

Source: Central Bank of Guyana, International Monetary Fund World Economic Outlook, April 2013.

Recent Developments

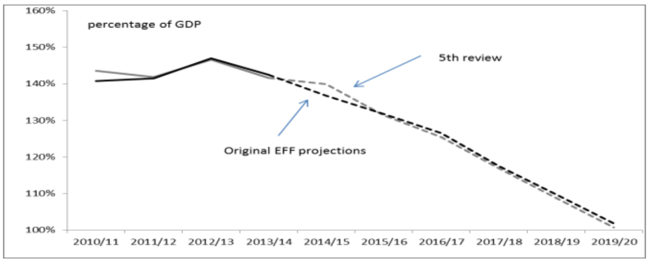
Jamaica's economic outlook remains stable. Following the review mission in November 2014, the IMF's Executive Board is expected to consider the sixth review of Jamaica's IMF-supported program under the EFF in December 2014. According to the IMF, the program is on track and policy implementation remains strong.

Overall, the program continues to benefit from strong support. However, the slow economic recovery could challenge support going forward and cause reform fatigue. In addition, some areas of the tax reform are facing resistance from parts of the private sector, including tourism and manufacturing.

Jamaica moved up in the ranking of the Doing Business Indicator. Mostly driven by improvements in 'Getting Credit', Jamaica moved up 27 ranks to 58th out of 184 countries. Jamaica also moved up eight places to 86 out of 146 countries on the Global Competitiveness Index. Given the state of reforms in the area of insolvency, business registration and construction approvals, Jamaica could make further gains in the Doing Business ranking for next year. However, further reforms to tackle the low competitiveness, including from the high energy prices, will be necessary to accelerate growth.

Jamaica rebased its GDP. On the basis of the new definition, GDP is approximately 1 percent lower than before, leading to a proportional increase in the debt-to-GDP ratio. Compared with the estimate at the time of the fourth review, debt-to-GDP at the end of FY2013/14 increased from 140.2 percent to 141.6 percent. The Jamaican economy grew 0.9 percent in FY 2013/14 and is expected to grow around 1 percent in the current fiscal year.

Figure 1. Debt-to-GDP Projections, 2010/11 to 2019/20

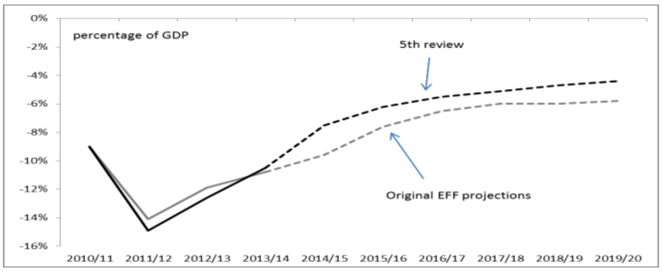


Source: International Monetary Fund.

The downward trend of Jamaica's debt remains intact. The recent bond issuance increases debt-to-GDP in the short run as a part of it has been deposited to retire debt maturing later in the current and in next fiscal year (currently, debt-to-GDP is estimated at around 143 percent including the bond. See also the July 2014 Quarterly Bulletin for details on issuance). However, as the proceeds of the issuance are used to repay other debt, the effect will disappear. On the basis of the assumptions of the Government of Jamaica's macroeconomic framework and Extended Fund Facility, debt-to-GDP is still projected to reach around 100 percent by March 2020 compared to 146.6 in Mach 2013 (Figure 1). Subsequently, the recently introduced fiscal rule targets debt to GDP of 60 percent by 2026.

The current account is projected to overperform. The current account deficit has decreased from a recent high of −15 percent in 2011/12 to −10.5 percent in 2013/14 with projections pointing to a further decrease over the next few years (Figure 2). There are different reasons for the correction of the current account, including the weak demand for imports in light of the fiscal consolidation and still weak domestic economy. In addition, services exports have increased as have remittances.

Figure 2. Current Account, 2010/11 to 2019/20



Source: International Monetary Fund and Bank of Jamaica

While the external situation has improved, risks remain. The projected reduction going forward is based on the more competitive exchange rate and structural reforms that should lead to further improvements in the trade balance. While

Highlights

Jamaica's outlook continues to improve despite continuing challenges ahead.

The IMF's Executive Board is expected to consider the sixth review of Jamaica's IMF-supported program under the EFF in December 2014.

While the recovery of the economy has started, an acceleration of growth would facilitate the achievement of program targets and strengthen the public support for the adjustment.

Jamaica moved up 27 ranks to 58th in the World Bank's Doing Business indicator, the best ranking Caribbean country.

projected lower energy prices will also benefit the current account, a potential disruption of the Petrocaribe agreement remains an important risk (see June 2013 Quarterly Bulletin for details on Petrocaribe). Jamaica would be better able to absorb such a shock compared to one year ago given the lower energy prices and higher level of international reserves but adjustments would still be required.

The depreciation of the Jamaican dollar has slowed. After a 6 percent depreciation of the domestic currency in relation to the US dollar in the first quarter of 2013, the quarterly depreciation has since remained below 3 percent, reaching 0.4 percent in the quarter ending September 2014. The slowing of the depreciation partly reflects an increase in domestic confidence in the Jamaican economy as the Bank of Jamaica did not intervene to strengthen the Jamaican dollar. In addition, the aforementioned improvement in the balance of payment also led to less demand of US dollars for imports.

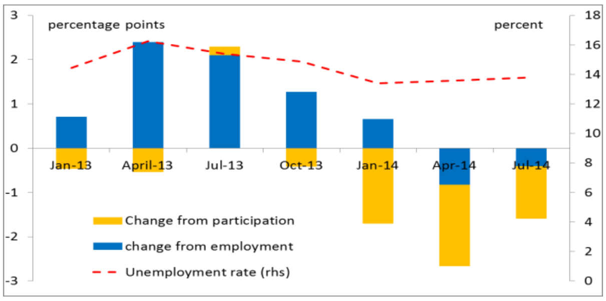
International reserves are approaching comfortable levels. As of September 2014, international reserves were at US$2.2 billion, equivalent to 19.5 weeks of imports of goods and services. The recent US$800 million bond issuance increased international reserves well above the Extended Fund Facility target but maintaining it over the medium to long term will remain a challenge.

Confidence is slowly improving. In the first half of 2014, business confidence was at its highest level in 3 years. While more firms see an improvement in current economic conditions and intend to increase investments, many are still prudent about the speed of the recovery. In addition, consumers indicate that they believe the government program will improve their livelihood, but their current situation remains unfavorable because of still weak employment prospects and decreasing real wages.

S&P revised Jamaica's outlook on its B–rating from stable to positive. The improved external liquidity conditions, return to economic growth, and success in meeting the EFF targets prompted the revision. The positive outlook indicates that Jamaica could be upgraded to B over the next 6 to 18 months.[1]

Despite difficult times for the Jamaican population, there are encouraging signs. After reaching 16.3 percent in April 2013, unemployment has been decreasing on a yearly basis for three quarters. While part of the decrease was caused by a fall in participation, employment has started to increase (Figure 3). Nevertheless, unemployment and poverty remain high and security continues to be a major concern. The number of homicides has decreased since 2010, but some areas remain volatile. Still, after a 10 percent increase in the number of people murdered between 2012 and 2013, compared with last year homicides have decreased by 15 percent through September 2014. In addition, the number of police-caused civilian deaths has also declined in the first half of 2014.[2]

Figure 3. Yearly Changes in Unemployment, January 2012 to April 2014



Source: Statistical Institute of Jamaica.

Conclusion

Jamaica's macroeconomic outlook remains stable over the short to medium term. Some risks have declined, and the authorities have remained on track with the EFF. While these developments have improved confidence, challenges remain. A sustainable trajectory for public wages and pensions, two main areas of reforms for the remainder of the EFF, will be required for long-term sustainability. In addition, growth will be central to the program and the well-being of Jamaicans.

Jamaica also remains vulnerable to external natural and economic shocks.

High Frequency Macroeconomic Indicators

	Last data	Period	Prior data	Period
Annual G.D.P.	1.6	Q1 2014/15	1.8	Q4 2013/14
Inflation (quarterly)	0.8	Q1 (2014/15)	1.7	Q4 (2013/14)
Net international Reserves	2181.5	Jul-14	1376.1	Jun-14
Exchange Rate	112.8	Aug-14	112.2	Jul-14
Unemployment Rate	13.4	14-Jan	13.9	13-Oct

Source: Bank of Jamaica, International Monetary Fund and Statistical Institute of Jamaica.

[1] Moody's currently rates Jamaica Caa3 (positive) and Fitch rates it B– (stable).

[2] 258 civilians lost their lives in incidents involving security forces in 2013 compared with 219 civilian lives lost in 2012 and 210 in 2011.

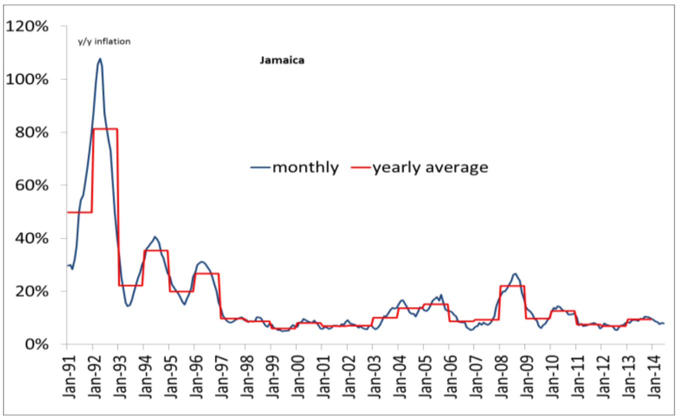
Introduction

Historically, inflation has varied substantially over time in Jamaica. Reflecting the economic woes in early 1992, inflation increased to double digits, spiking at more than 100 percent. More recently, inflation spiked at 26 percent in the height of the economic instability surrounding the world economic downturn in July 2008 (Figure 5).

Besides monetary policy, different triggers of inflation have been identified, including energy and commodity prices, fee and tax changes, and the exchange rate. In addition, weather-related shocks to agriculture can also result in price changes.

Over the past 4 years, Jamaica has managed to bring inflation to tenable levels, with the island currently being on track to achieve inflation of less than 10 percent for the fourth consecutive year.

Figure 5. Year over Year Inflation, January 1991 to July 2014



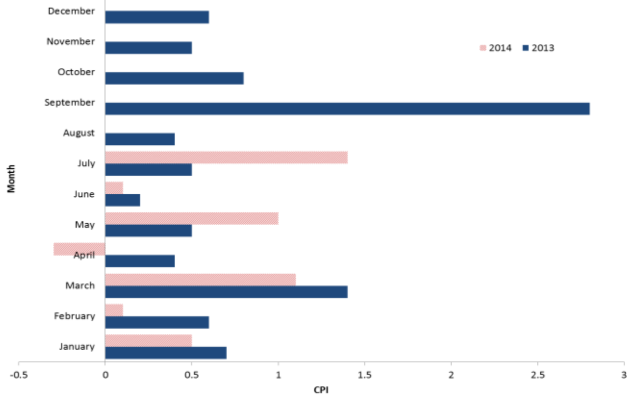
Source: Latin American and Caribbean Macro Watch Database.

Recent Developments

According to Bank of Jamaica data, as of July 2014, year-to-date inflation was 3.9 percent, below the 4.3 percent during the same period last year. The 12-month point-to-point inflation as at July 2014 was 8.8 percent, with 9.7 percent one year earlier. At the same time, monthly inflation has started to increase (Figure 6). Major factors for the remainder of this year include higher prices for agricultural goods in the short term because of the recent drought, and price increases as a result of changes in regulated prices for electricity and bus fares. At the same time, imported inflation has eased as the Jamaican dollar depreciation has slowed down recently.

Despite these factors, the Bank of Jamaica expects inflation to remain in the single digit for the current year. For the fiscal year 2014/15, inflation is forecast between 7 and 9 percent, with projections skewed upwards.

Figure 6.Monthly Inflation, 2013 and 2014



Source: Statistical Institute of Jamaica.

One of the forecast and policy tools that the Bank of Jamaica applies is the inflation expectation survey. At present, the survey shows that firms expect inflation of 10.4 percent for the year ending 2014, higher than projected by the Bank of Jamaica. Since September 2013, there has been a consistent trend in which business expectation of inflation has been greater than actual levels, but the survey is important because firms set prices according to their expectations of future inflation.

Contributors to Inflation

Food and nonalcoholic beverages, housing, water, electricity, gas and other fuels, and transport combined to make up 65 percent of the consumer price index (CPI) basket alone.[3] Of these, food and non-alcoholic beverages as well as housing, water and energy have the strongest impact on inflation, not only because of their weight in the basket but also because they usually experience stronger price changes than the full basket (see Table 1 and Figure 7). As a result, these two subdivisions alone contribute more than 60 percent to inflation.

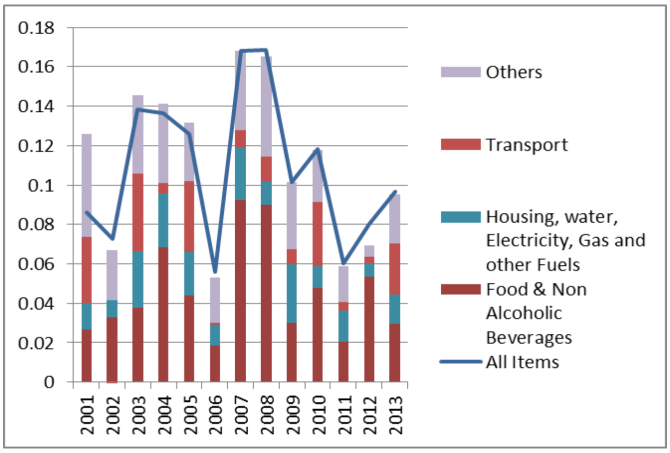
Table 1. Average Contribution to Inflation, by Subdivision (2001–13)

[3]There are different ways to measure inflation but the most common is to use the CPI, which tracks changes in the prices of a basket of different goods, weighted for the share that these goods have in the consumption of a typical household.

	Weight	Average Inflation	Contribution to Inflation
Food & Non-Alcoholic Beverages	37.46	13.70	43.39
Housing, water, Electricity, Gas and other Fuels	12.76	13.74	15.89
Transport	12.82	10.28	13.29
Others	36.98	7.92	28.35
All Items	**1.00**	**11.26**	**100.00**

Source: Statistical Institute of Jamaica.

Figure 7. Contribution to Inflation, 2001–13



Source: Statistical Institute of Jamaica.

What Drives Inflation?

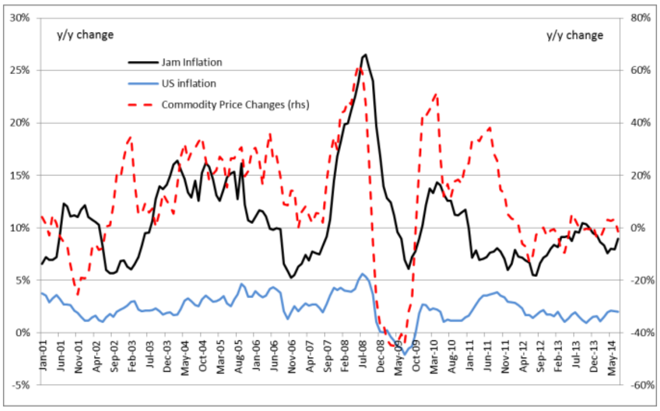
Even though higher and more volatile, inflation in Jamaica is correlated with inflation in the United States (correlation of 33 percent) with one of the main reasons being changes in commodity prices (Figure 8). As a small, open economy, the effect of commodity price changes on domestic inflation is stronger in Jamaica than in the United States.[4] However, domestic factors also play a role.

Government Policy and Inflation

Essential services such as food and transport are heavily affected by state policy, including through subsidies, regulated prices, and taxes. When the Government of Jamaica chose to raise bus fares by 25 percent in August 2013, there was an immediate effect on the CPI. The increase in transport cost accounted for 66 percent of the change in CPI from August to September 2013. This implies that the bus fare increases in August of 2014 will have a similar effect. However, the Bank of Jamaica still predicts inflation will remain within projections.

[4]Regression analysis finds that a 10 percent increase in the commodity index leads to a 0.7 percent increase in inflation in Jamaica. The same value for the United States is 0.4 percent.

Figure 8. Jamaica, the United States, and Commodity Inflation



Source: Latin American and Caribbean Macro Watch

Agricultural Conditions and Food Prices

Weather-related shocks can affect inflation through adverse effects on agricultural output. Given the recent drought conditions in Jamaica, fruits and vegetables experienced inflation of 5.8 percent and 6.4 percent, respectively, from June to July 2014, compared with modest movement of 2.4 percent and 0.8 percent in the corresponding period in 2013. If the drought subsides, the effects of it on yearly food inflation should be contained because it affected mostly short-term crops.

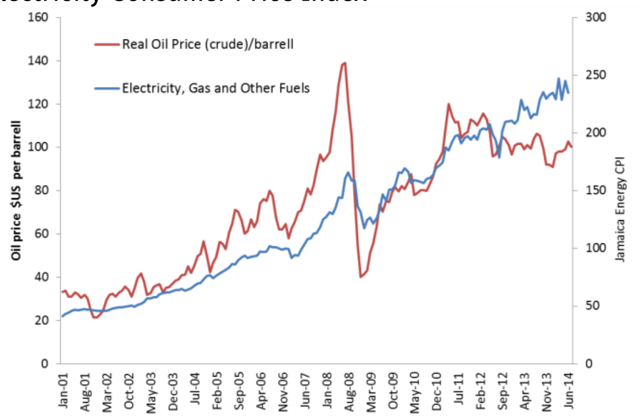
Energy Cost

The price of oil has a large effect on Jamaica's import bill, with Jamaica relying on fuel for energy purposes. Historically, the CPI for electricity, gas, and other fuels has been highly sensitive to fluctuations in oil prices. Hence, energy costs in Jamaica have been a major factor for inflation as the CPI for Electricity Oil and Gas has moved from more than 45 in January 2001 to more than 145 in May 2014.

West Texas Intermediate oil has been decreasing from over US$107 per barrel in June 2014, to below US$80 per barrel as

of November 2014. Forecasts for the price of crude oil indicate stabilization in oil prices over the rest of the fiscal year.

Figure 9. Average Monthly Oil Price and Jamaican Electricity Consumer Price Index

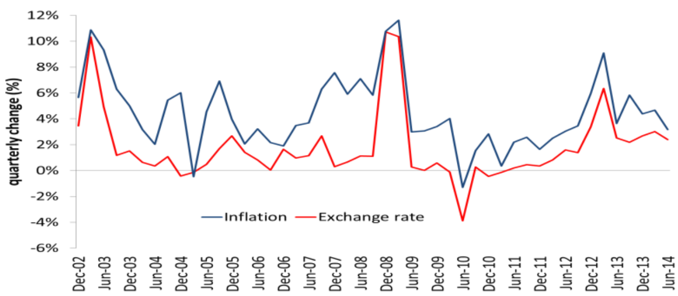


Source: Statistical Institute of Jamaica and International Monetary Fund.

Exchange Rate

Given the import dependence of Jamaica, the exchange rate between the Jamaican dollar and the US dollar can have a significant effect on inflation. However, the relation is in both directions, as increases in inflation can lead to stronger nominal depreciation to avoid a real appreciation. In addition, economic instability as experienced for instance in 2007 and 2008 can affect both inflation and the exchange rate (Figure 10). Given the current slowdown in the depreciation of the exchange rate, inflationary pressure from imported inflation should be moderate.

Figure 10.Inflation versus US$ Exchange Rate



Source: Statistical Institute of Jamaica and Bank of Jamaica.

Conclusion

Jamaica managed to keep inflation at a single digit over each of the past 4 years. Similarly, expectations are that inflation will remain at moderate levels over the short to medium term. However, challenges continue for the Bank of Jamaica, since small, open economies are prone to economic and weather-related shocks. These include high inflation expectations, possible fluctuations in oil and commodity prices, and strong movements in the exchange rates.

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Jamaica: Selected Indicators

	2010/11	2011/12	2012/13	2013/14 (F)
(Annual percentage changes, unless otherwise indicated)				
Real Sector				
Real GDP	-0.6	0.9	-0.7	0.9
Nominal GDP	7.8	7.5	6.1	10.4
Inflation (end of period)	7.8	7.3	9.1	8.3
Exchange rate (end of period)	85.7	87.3	98.9	109.6
External Sector				
Exports of goods and services (yoy, %)	0.8	13.0	3.5	-7.7
Tourism receipts (yoy, %)	2.0	1.1	1.5	0.9
Imports of goods and services (yoy, %)	6.8	13.5	0.4	-6.2
Current account (percentage of GDP)	-9.0	-14.9	-11.5	-9.5
Treasury bill rate (%, end of period)	6.5	6.2	5.8	8.0
(In percentage of GDP, unless otherwise indicated, on a calendar year basis)				
Central Government				
Revenue and grants	26.8	25.6	25.8	26.9
Budgetary expenditure	33.2	32.0	29.9	26.8
Primary balance	4.5	3.2	5.4	7.5
Budget balance	-6.3	-6.4	-4.1	0.1
Public sector balance	-6.9	-6.4	-4.2	0.1
Debt Indicators				
Public sector debt	141.3	143.7	146.4	138.9
Public sector debt over revenues	536.1	563.7	n.a.	516.4
Foreign currency public debt (end of period)	83.3	81.4	76.0	76.4
External interest payments as percentage of exports of goods and services	11.5	10.4	-	-
International Reserves				
Net international reserves (USD Mill)	2553	1777	884	1303
Gross international reserves (weeks of good and services imports)	23.4	17.8	<12	14.4

Note: (F) Forecasts numbers for 2013/14.

Source: Ministry of Finance and Planning, Bank of Jamaica, Statistical Institute of Jamaica, International Monetary Fund and own calculations.

Quarterly Bulletin November 2014

SURINAME

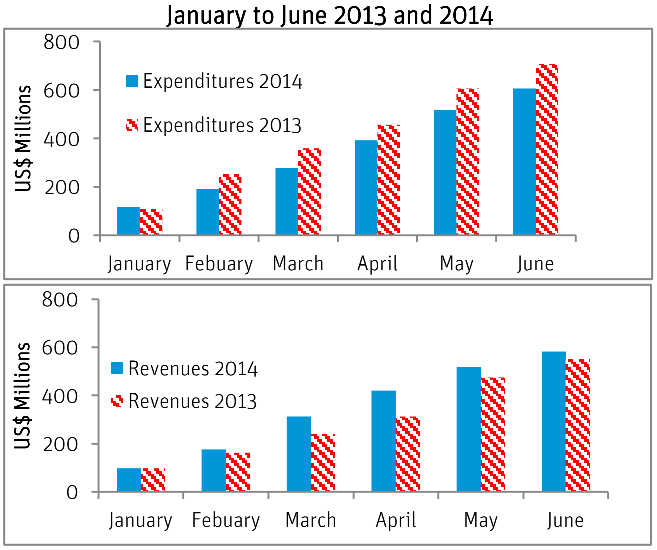
MAINTAINING MACROECONOMIC SUSTAINABILITY

Recent Developments

Suriname has been assigned a BB+ credit rating to the local and foreign currency by Dagong Global Credit Rating Co., Ltd. The rating corresponds to the ones from other rating agencies and indicates that Suriname has a stable outlook for both currencies, taking into account the country's improving political stability and macroeconomic conditions. While noting the country's improvements in fiscal consolidation and its stable debt repayments and political environments, concerns still exist about the high risk of economic volatility from heavy reliance on few exports (in particular commodities) and its vulnerable fiscal and external positions. Dagong is one of China's premier credit rating agencies.

In August, Suriname's parliament adopted a minimum wage law for the first time after decades of debate. Starting January 1, 2015, the official hourly rate will be SRD4.29 (US$1.28) and SRD858 (US $256.12) monthly as calculated by the Bureau of Statistics. The administration plans to gradually adjust the rate every year until 2017, and it is expected to be SRD5.22 (US$1.56) in 2016 and SRD6.14 (US$1.83) in 2017; these figures are based on the estimated SRD1,228 (US$366.56) per month needed for a family of four to survive. The gradual increase in the rate is intended to ease the transition for low wage enterprises. The minimum wage law was part of a social legislation that included laws for pension and a national medical insurance scheme.

Figure 1. Central Government Revenues and Expenditures January to June 2013 and 2014



Source: Central Bank of Suriname, September 2014.

Highlights

Suriname has been assigned a stable BB+ credit rating by Chinese credit rating agency, Dagong.

Suriname has enacted a new minimum wage law after decades of debate.

The country is currently experiencing an energy crisis and is considering higher energy tariffs. Also, plans are in place to build a new dam to meet the increased energy demand.

The government continues to practice financial prudence by reducing expenditures to compensate for falling gold revenues.

Suriname continues with its fiscal consolidating and prudent fiscal performance by reducing nonessential expenditures; however, it is expected that revenues will be constrained by the end of this year. Although revenues have improved in the first half of 2014 (see Figure 1), revenue performance at the end of 2014 is expected to be hindered by falling gold and bauxite prices, and delays in investment plans by the larger gold mining companies, Iamgold and Newmont. Newmont, however, has indicated that they will continue with their investment in the second half of the year. The government has emphasized that it will continue to exercise financial prudence and curb expenditures, which has already declined by 14.3 percent in the first 6 months of 2014 over the similar period last year (see Figure 1). Inflation has remained low at 1.3 percent as of July 2014.

Suriname is currently experiencing an energy crisis as a result of increased demand and reduced supply because of unusually low rainfall and a disabled turbine. In response to the escalating crisis, the government has ordered all government buildings to conserve energy by reducing air conditioning usage, among others. There are plans being drafted to build a new dam in the Kabalebo River, which would be able to cover the entire country's energy demand and produce a surplus for sale to neighboring countries. The government is also considering adjusting energy tariffs that will be informed by the results of a socioeconomic study. If the tariffs are raised, energy bills for households currently paying US$0.06/kWh will increase to US$0.08/kWh. This increase should reduce electricity consumption of these households.

The state oil company, Staatsolie, is nearing the completion of its

refinery, expected to be operational in 2015. When the refinery opens, it will enhance Suriname's energy security and increase output by an estimated 4,000 barrels/day to 16,000 barrels/day. Also, there are plans underway to partially privatize the company with the intention that the state will retain a large controlling portion.

An agreement between the government of Suriname and Venezuela on rice exports from Suriname is being brokered. The deal is expected to provide for Suriname to export 32,000 tons of paddy and 80,000 tons of white rice to Venezuela starting 2015 at a better price than what is offered for exports to other countries. This deal puts into effect the Petrocaribe deal that other Caribbean countries have in place with Venezuela. The deal comes about because rice farmers have complained about the low prices they were being offered for their product; government intervention has since helped to abate this issue.

The government and the De Surinaamsche Bank (DSB), the biggest commercial bank in Suriname, have extended its Micro Credits Program (MKP) by an additional 4 years. The government has allocated an additional US$1.2 million for micro entrepreneurs' who may want to borrow up to US$1500. The government has launched an awareness campaign for the program designed to encourage innovation. Since the start of the program in 2008, more than US$2.4 million has been lent to 5,300 borrowers. The fund, which is managed by the DSB, extends loans to micro- and small-business individuals and institutions.

In addition to the MKP program, the government has restarted the Guarantee Fund for Entrepreneurs. The government, in collaboration with the Nationale Ontwikkelingsbank (NOB), has revived the fund, which allows entrepreneurs to borrow to establish or expand a firm without pledging collateral. The fund is aimed at startups or small and micro enterprises that submit feasible and innovative ideas. The NOB will deposit US$1 million into the guarantee fund, and the government will offer guarantees with an additional 1 million Euros.

Preparations are underway for the National Elections to be held in May 2015. Already political parties have launched their campaigns and formed coalitions, with the Mega Combination, the coalition party in office (comprised of the National Democratic Party and the A-Combination coalitions), again contesting the elections as a coalition. Also, the opposition coalition—the National Party of Suriname—has confirmed that it will enter the elections as a coalition. It is expected that more coalition parties will be formed or individual parties will join the coalition before elections.

The IMF released its 2014 Staff Consultation report on Suriname in October. The report concludes that while Suriname continues to experience robust growth at 4 percent, its macroeconomic conditions weakened in 2013 as gold and oil prices declined. Authorities are encouraged to continue implementing policies to reverse the fiscal and external deterioration, as well as strengthening their institutions, and promote diversification.

High-Frequency Macroeconomic Indicators				
	Last data	Period	Prior data	Period
Annual GDP growth (%)	4.7	2013	4.8	2012
Exports (12-month growth)	-11	Q4 2013	9.2	Q4 2012
Imports (12-month growth)	9	Q4 2013	12.2	Q4 2012
Inflation	1.3	Jul-14	0.6	Dec-13
Exchange Rate (End of Period)	3.35	Mar-14	3.35	Dec-13
Unemployment rate (%)	10.3	2012	9.5	2004

Source: Central Bank of Suriname and country authorities.

Introduction

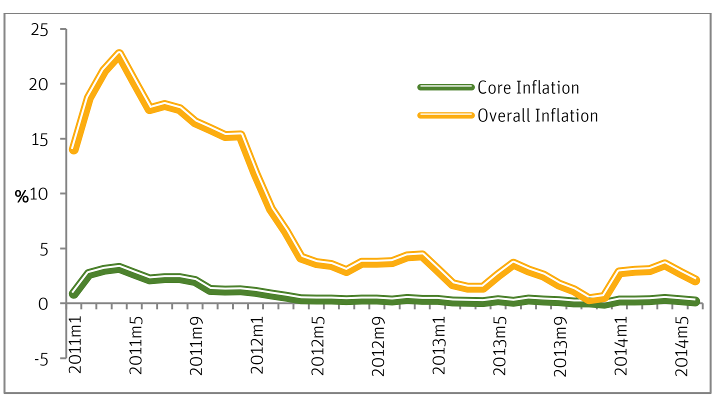
The food and nonalcoholic beverages category is the main driver of inflation in Suriname. This group accounts for about 40 percent of the consumer price basket (see Table 1) and explains approximately 37 percent of headline inflation over the past 3 years.[1] Global food prices are strongly correlated with recent trends in domestic food prices (0.66). Moreover, the pass-through effect of international food prices to local prices has the highest explanatory power at a 3-month lag. The computed core inflation (which mainly excludes food and nonalcoholic beverages and transportation) confirms a downward and stable trend (Figure 1). Therefore, the authorities should monitor the developments of global food prices to limit the likely effects on headline inflation.

Table 1. CPI Weight, by Category

Major groups	Weight (%)
Food and nonalcoholic beverages	40.3
Housing and utilities	14.1
Transport	11.7
Other goods and services	10.7
Furnishings housing	4.8
Recreation, culture, and education	4.1
Communication	3.9
Clothing and footwear	3.6
Alcoholic beverages and tobacco	2.9
Health care	2.6
Outdoor food and food away from home	1.4

Source: ABS Online Statistics and staff calculation.

Figure 1. Computed Core and Headline Inflation Trends



Source: ABS Online Statistics and Staff calculation.

[1] This analysis is based on a bivariate regression of food on headline inflation.

Suriname has a history of high inflation but has managed on average to keep general prices below double digits in the past 10 years. In the past three decades, Suriname experienced volatile inflation levels, ranging from –0.8 percent to 368.5 percent and averaging almost 50 percent. This compares unfavorably to other Caribbean countries in the Caribbean Country Department (CCB) of IDB.[2] In Suriname, inflation was generally high (near hyperinflation) in the 1980s and 1990s. Researchers have attributed the near hyperinflation to (a) weak institutional frameworks that allowed the full transmission of exogenous shocks on the economy and (b) poor macroeconomic policy responses by the then-administration.[3] Since then, the government has recognized the need for a stable economy with low inflation and exchange rate stability. As such, conservative monetary policies that are aligned to sound economic growth are being exercised. Suriname currently has inflation rates that are low and acceptable by international standards.

The following sections analyze inflation in Suriname by discussing its trends, the factors responsible for near hyperinflation episodes, the economic effects of price volatility, and future movements in prices. Three decades are considered: 1984–1993, 1994–2003, and 2004–2013.

The Evolution of Inflation and Its Economic Impact

There were three main bouts of near hyperinflation in the past three decades: 1987, 1992–1995, and 1999–2001 (see Figure 2). In the face of increased aggregate demand pressures from higher government expenditure[4] and large money balances in the economy, inflation was largely repressed within single digits in the 1980s (except from 1985 to 1987). The price controls[5] enacted by the government to restrain inflation levels caused significant exchange rate misalignment, resulting in the parallel rate exceeding the official rate by a factor of 10 (Braumann and Shah 1999). The effect of these controls lasted temporarily as prices surged by 53.4 percent in 1987 over the previous year.

[2] The six countries in the CCB are The Bahamas, Barbados, Guyana, Jamaica, Suriname, and Trinidad and Tobago. Inflation in the CCB countries, excluding Suriname, averaged 10 percent in the past 3 decades.

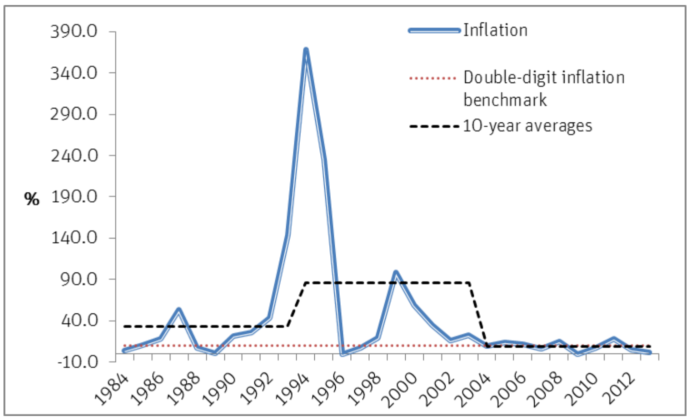
[3] Braumann and Shah (1999) and Fritz-Krockow et al. (2009)

[4] According to Braumann and Shah (1999), the government granted massive wage increases and expanded social expenditure (in particular, health care). The government's current expenditures increased from around 29 percent of GDP in 1982 to 52 percent in 1987.

[5] The controls were effective given that the sanctions were harsh, ranging from confiscating or closing a violator's business to several years of imprisonment.

Also, with large fiscal deficits of more than 20 percent of GDP and exhausted international reserves, the country's economic growth position worsened, and by 1987, it contracted by almost 30 percent following real GDP growth of 1.9 percent in 1981.

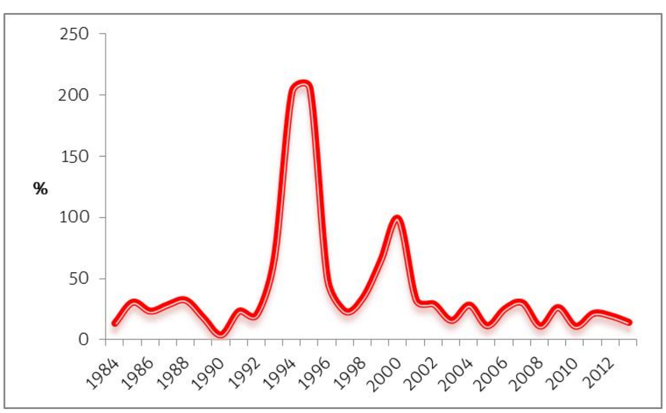
Figure 2. Evolution of Inflation, 1984–2013



Source: World Economic Outlook and staff calculation.

Inflation was at its highest in the 1990s, rising to 368.5 percent in 1994. The deterioration of the nonfinancial public finances and the lack of local capital markets resulted in fiscal deficits being financed almost entirely by the Central Bank of Suriname.[6] Moreover, given that the volatility of real interest rate was lower than that for general prices, the demand for bank credit increased and subsequently the money supply (see Figure 3). Inflation in the second decade picked up on account of the removal of price controls and a monetary overhang that existed since 1989 (Fritz-Krockow et al. 2009).

Figure 3. Growth in Money Supply



Source: World Economic Outlook and staff calculation.

Reforms of the exchange regime and public sector in 1994 briefly halted the macroeconomic crisis. In 1996 and 1997, inflation was on average 3 percent, while economic growth rates were approximately 3.5 percent. However, the economic shift was short-lived as the new government in 1996 implemented loose fiscal and monetary policy measures (Fritz-Krockow et al. 2009). The increased fiscal deficits and money creation not only spurred inflation back into double digits, but also turned real interest rates negative and created exchange rate imbalances.

Inflation fluctuated in the 2004–2013 decade, but was on average lower than previous decades (see Figure 2). During this decade general prices were contained to below 20 percent and have been relatively low (single digit) since 2009; except for 2011 where major policy actions drove prices upwards. The wage reform of the previous administration contributed to the upward movement and pressure on prices in 2010. The exchange rate adjustment and fiscal policy measures in early-2011 had a significant effect because a large share of manufactured goods is imported and the government increased taxes on cigarettes, alcohol, and gasoline. Among the various groups in the CPI basket, the transportation and food groups drove inflation in 2011, with the former outstripping the latter (see Figure 1). Most components rose substantially during the first half of 2011. The implementation of moderate policies and the absence of international food and fuel price pressures helped contain inflation and avoid strong subsequent effects.

Government and Inflation

The government of Suriname will pace future fiscal and monetary policies according to inflation trends. Authorities have expressed commitment to tightening fiscal and monetary policy, if needed, to contain inflation.[7] The government of Suriname expects inflation to remain low as long as private sector employers do not increase wages considerably, resulting in demand-pull inflation, and elevated capital spending could potentially reverse the current downward inflation trend. However, given fiscal constraints and restrictions to Central Bank financing, it appears unlikely that public sector actions will contribute to excessive inflation growth over the next year. As relates to monetary policy, the Central Bank has been making preparations to auction government paper to commercial banks to continue an aggressive institutional strengthening drive. The authorities have also

[6] The central government's net indebtedness to the banking system was 96 percent of GDP by the end of 1991.

[7] In this regard, the IDB's operation under design (Financial Sector Reform) to strengthen the functioning of the Central Bank of Suriname and support its ability to conduct open market operations is critical for maintaining price stability.

indicated a willingness to raise reserve requirements, if necessary.

What Does the Future Hold?

Although there are downside risks, inflation should remain relatively low in the medium-term. The International Monetary Fund projects average inflation at 3.7 percent in the next 5 years given that policies remain consistent with exchange rate regime stability. There are, however, some domestic and external downside risks. The authorities are expected to introduce a value-added tax, which could pull consumer prices upwards. Moreover, given that food and fuel accounts for most price changes, high volatility in world commodity prices could affect the government's ability to maintain price stability.

Conclusion

Careful monitoring of inflation will be a main element for macroeconomic stability and sustainability in light of downside risks. This not only improves monetary policy effectiveness, but also anchors inflation expectations. Both elements are important to achieve price stability, which, in turn, encourages investment and subsequently economic growth.

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SURINAME

SELECTED ECONOMIC INDICATORS

Suriname: Selected Indicators

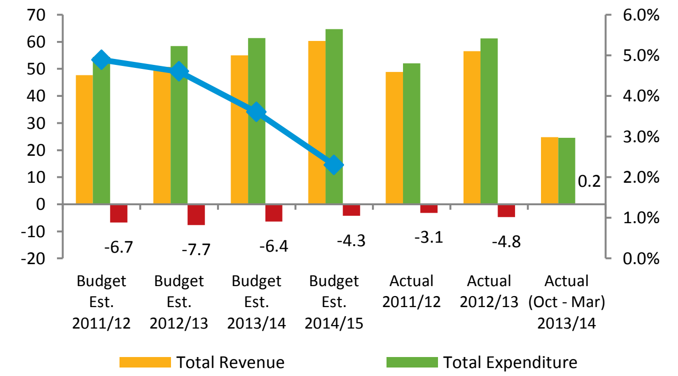
	2009	2010	2011	2012E	2013P
(Annual percentage changes, unless otherwise indicated)					
Real Sector					
Real GDP	3.5	4.5	4.2	4.8	4.7
Nominal GDP	-3.1	13.2	25.8	11.94	5.3
Inflation (end of period)	1.3	10.3	15.3	3.4	0.6
Exchange Rates (end of period)	2.75	2.75	3.35	3.35	3.35
(In percent of GDP, unless otherwise indicated, on a calendar year basis)					
External Sector					
Exports of goods and services	68.2	54.3	64.5	63.1	n.a
Imports of goods and services	60.7	62.7	73	68.8	n.a
Current Account	-1.1	1	0.4	-0.2	-2.1
Gross International Reserves (USD Mill)	763	785	987	1,209	775
Savings and Investment					
Private Sector Balance	1.9	9.6	4.7	-0.6	-2.0
Public Sector Balance	-2.4	-3.1	0.9	0.5	0.0
Savings	3.3	1.8	6.9	6.3	5.6
Investment	5.7	4.9	6	5.8	5.7
Central Government					
Revenue and Grants	36.4	25.8	26	25	24.1
Total Expenditure	35.3	28.2	25.2	24.5	24.1
Primary Balance	-1.2	-2.3	1.8	1.4	0.9
Overall Balance	-3	-3.6	0.9	-4.0	-3.9
Consolidate NFPS balance	-3	-3.6	0.9	0.5	n.a
Debt Indicators					
Total Public Sector Debt	18.5	21.6	19.1	21.5	28.0
Public Sector Debt over Revenues	61.5	81	73.3	74.4	75.2
External Debt (end of period)	8.3	8.7	7.6	11.5	14.0
Domestic Debt (end of period)	10.2	12.9	10.8	10	14.0
External debt as percent of exports of goods and services	15.8	14.5	17.3	18.9	22.2

Source: Based on IMF Article IV Country Report and Central Bank of Suriname

Recent Developments

The Minister of Finance of Trinidad and Tobago presented the Budget for FY 2014/15 to Parliament on September 8, 2014. The budget titled "Empowering our People through Sustained Economic Growth and Prosperity" represents the final fiscal package for the present administration before the general election in 2015. It largely emphasizes social welfare policies and some measures to further develop areas of potential growth.

Figure 1. Central Government Revenues and Expenditures (TT$ billions)



Source: Ministry of Finance and the Economy of Trinidad and Tobago.

Total expenditures and revenues are budgeted to be higher with a smaller fiscal deficit in FY 2014/15, compared with FY 2013/14.[1] Fiscal expenditure in FY 2014/15 is estimated at TT$64.66 billion, 5.3 percent higher than in FY 2013/14. The allocation of government expenditure has remained similar to the previous year, with education and training accounting for the largest share (16 percent of total expenditure), while national security and health will receive 11 and 9 percent, respectively. Government revenues are estimated at TT$60.35 billion, an increase of 9.7 percent from the previous fiscal year. The energy sector is expected to contribute 35 percent of total revenues, down from 43 percent in the previous fiscal year. The budgeted revenues is based on an assumed West Texas Intermediate crude oil price of US$ 80.00 per barrel and gas price of US$ 2.75 per mmbtu (million British thermal unit), similar to assumptions made in FY 2013/14. However, the price of oil has declined from an average US$93 per barrel in September, to US$77 per barrel for the first three weeks of November. While this has raised some concerns about the government's revenue stream, the Minister of Finance has indicated that higher than expected gas prices which make a larger contribution to the budgeted revenues is partially offsetting the effects of lower oil prices. Going forward, the government has indicated awareness of this and would be ready to make adjustments if the price of oil remains below the budgeted level for an extended period or if similar declines are observed in gas prices. Consistent with the government's commitment to reducing the fiscal deficit to zero by 2016, the projected deficit in FY 2014/15 is budgeted at 2.3 percent of GDP, down from 3.6 percent of GDP in the 2013/14 budget. The government indicated that much of the deficit will be financed from the local market. The budget did not introduce any new taxes but announced a tax amnesty for tax penalties and interest for late filing of returns and late payment of income, corporation and value-added taxes, business levy and environmental levy for years of income up to 2013. This tax amnesty is the third in the past 8 years. The most recent was announced in FY 2010/11, which yielded approximately TT$1.8 billion in additional revenues.

[1] The fiscal year refers to the period 1 October through 30 September.

Highlights

The Government of Trinidad and Tobago presented the 2014/15 budget to Parliament on September 8, 2014. The budget projects revenues at TT$ 60 billion while the estimated expenditure is TT$ 64 billion. The fiscal deficit is estimated to be 2.3 percent of GDP, down from 3.6 percent in fiscal year 2013/2014.

The budget has further enhanced the social safety net by expanding the benefits of existing programs and introducing new initiatives. However, the authorities plan to improve the effectiveness and efficiency of current safety schemes.

The economy has moved three places up the Global Competitiveness Ranking in 2014 to position 89.

Social Sector Spending and Fuel Subsidies

The government's estimated expenditure on transfers and subsidies are expected to decline marginally from 54 percent of total expenditure in FY 2013/14 to 53 percent in FY 2014/15. As part of the government's social safety net, the budget announced increases to social welfare grants, personal allowances and pensions offered to disabled persons, senior citizens and public officers. In addition, it proposes to establish a new program that will provide financial assistance of TT$500 (US$80) per month for any child born to disadvantaged parents in the next fiscal year. The Minister of Finance also indicated that the Government will engage the World Bank to undertake a detailed review of social programs to ensure that they become more efficient and effective in meeting their objectives. As one means of reducing the fuel subsidy that averages about TT$4 billion annually, the budget announced that by the first quarter of 2016, 35 compressed natural gas (CNG) fuelling stations will be launched, which will provide an alternative fuel option for the motoring public. In addition, the importation of Hybrid and Electric Powered Vehicles not older than 2 years would be exempted from value-added tax and motor vehicle tax for a period of 5 years.

Other Important Measures Outlined in the Budget

1. Increase in the rebate on local labor in the film, fashion, and music subsectors.
2. Introduction of legislative changes that will create a climate for FDI in the maritime sector.
3. Increase in the floor of the Heritage and Stabilization Fund from US$1 billion in 2010 to US$4 billion, which increases the amount below which withdrawals cannot be made.
4. Increase in the minimum wage from TT$12.50 to TT$15 dollars per hour.
5. Introduction of a tax-deductible savings bond.
6. Increases in housing allowances.
7. Measures to boost agricultural production: the budget has provided rebates on establishing and refurbishing approved facilities for agro processing of approved commodities.
8. The Agricultural Development Bank will be provided with an allocation of TT$75 million.
9. Introduction of an innovation fund capitalized with TT$50 million.

Fiscal Performance in 2013

The fiscal deficit that was projected for FY 2013/14 is likely to be much lower than expected. The central government fiscal outturn at the end of June 2014 was a surplus of TT$1.96 billion, despite a budgeted deficit ofTT$6.34 billion. This outcome occurred as actual revenues exceeded forecasted revenues, while actual expenditures fell short of budget projections. The sources of additional revenues, according to the Ministry of Finance, were higher-than-expected receipts from taxes while the main factors influencing the lower level of Government spending were a decline in expenditure on other goods and services and transfers and subsidies.

Energy Sector Developments

The macroeconomic fundamentals of Trinidad and Tobago's economy have remained strong, and the economy is expected to grow by 2.1 percent in 2015. Investments in the energy sector will average over US$3 billion per year for the next 3 years with a major focus on the upstream sector. This is partly related to the fiscal incentives provided in the past four budgets, which aimed to improve the competitiveness of the energy sector.

Prospects for growth in the downstream energy sector also look promising in the medium term. Work on the country's first downstream plant in the past 6 years is expected to commence in 2015 and would provide a significant boost to companies in the downstream energy services sector. Apart from this, the new natural gas master plan should be completed by the end of this year along with public consultations on the Government's national energy policy. These two policy frameworks would address issues relating to the sustainability of the energy industry in the medium and long term.

Pockets of foreign exchange shortages still persists despite frequent injections of U.S. dollars in the financial system by the Central Bank. The chronic shortages of U.S. dollars that the private sector experienced in the past has abated in the second half of 2014 as the Central Bank continues to make timely interventions. For the year 2014 (up to the first week of November), the Central Bank has sold US$ 1.5 billion to the financial system, which accounted for 25 percent of the total supply to the market. Some of the main factors that have contributed to the lingering tightness in the system have been attributed to lower conversions by the public and improved consumption demand as economic prospects improve.

Excess liquidity in the banking system declined to below TT$5 billion in July 2014 from about TT$8.5 billion in May 2014. This was largely due to the issuance of a TT$1 billion liquidity absorption bond by the Central Bank, ongoing open market operations and indirectly through the Central Bank's support to the foreign exchange market. In the context of continuing low interest rates, private sector credit granted by banks increased in June 2014. The growth of business sector lending continued for the fifth consecutive month in June 2014. Meanwhile, consumer lending remained strong, growing at around 7.5 per cent in May 2014. With excess liquidity in the banking system still high, monetary policy will have to continue contending with a structural liquidity overhang for the foreseeable future.

High-Frequency Macroeconomic Indicators				
	Last data	Period	Prior data	Period
Annual GDP growth (%)	2.1	Q4 2013	-0.5	Q3 2013
Exports (12-month growth)	-3.9	Q4 2013	-1.9	Q3 2013
Imports (12-month growth)	32.5	Q4 2013	-8.6	Q3 2013
Private sector credit growth (%)	5.8	Mar-14	3.2	Sep-13
Inflation	3.3	Apr-14	4.5	Mar-14
Exchange rate (end of period)	6.5	May-14	6.5	Apr-14
Natural gas production (% yoy change)	-2.4	Q1 2014	2.7	Q4 2013
Unemployment rate (%)	3.7	Mar-13	4.7	Dec-12

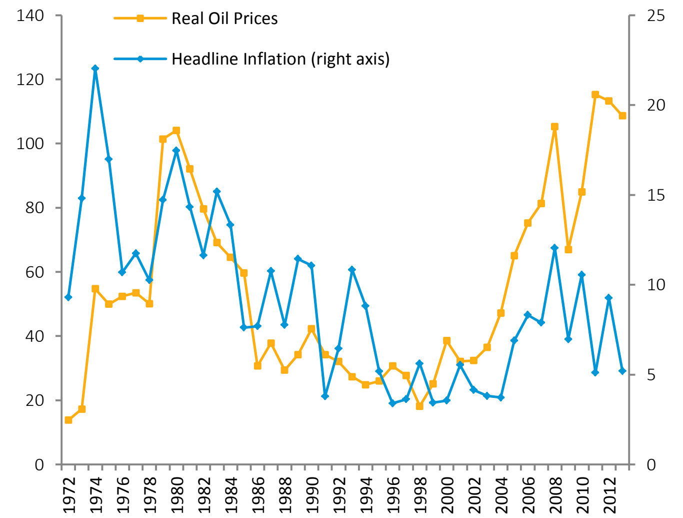
Source: Ministry of Finance and the Economy of Trinidad and Tobago

TRINIDAD AND TOBAGO MANAGING FOOD PRICE VOLATILITY

Introduction

Trinidad and Tobago is a small open economy that is highly vulnerable to external shocks. As an oil-exporting economy, sharp increases in oil prices are largely associated with increases in Government expenditures, which tend to stimulate aggregate demand and exert upward pressure on domestic prices. The rate of inflation in the Trinidad and Tobago economy has a tendency to follow a pro-cyclical path—rising in times of economic boom and falling during recessionary periods (see Figure 1). For example, during the period 1973–82, the economy experienced its first oil boom resulting in an upward movement of the inflation rate from 9.3 percent in 1972 to a high of 22 percent in 1974. The oil boom, which aggravated excess liquidity in the economy, along with higher import prices contributed significantly to the inflationary episode. The recessionary period thereafter was characterized by a fall in crude oil prices and Government revenues, along with tighter fiscal and monetary policies, which resulted in a slowdown in the headline inflation rate to 6.4 percent in 1992. Headline inflation declined considerably during the period 1993–2000, averaging about 4.8 percent. However, inflation increased thereafter from 5.4 percent in 2001 to 9.26 percent in 2012.

Figure 2. Pro-cyclicality of Inflation in Trinidad and Tobago



Source: Central Bank of Trinidad and Tobago.

Strong Relation between Headline and Food Inflation

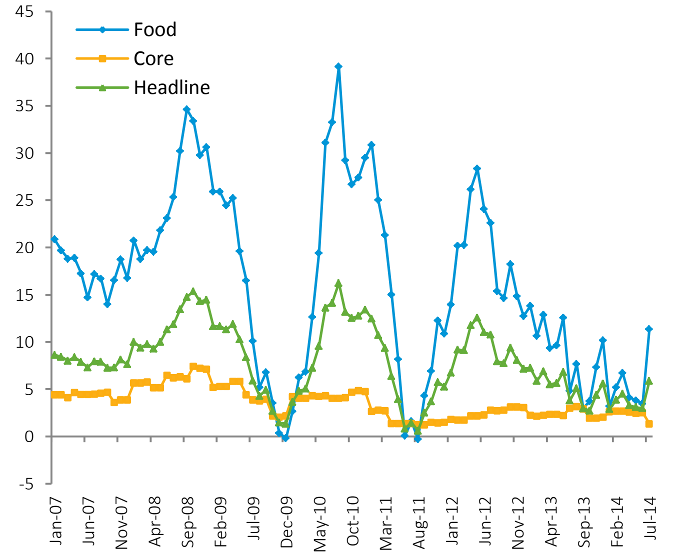
Food price inflation is the main driver of headline inflation in Trinidad and Tobago. The retail price index is used to measure the rate of inflation in Trinidad and Tobago. The index was last rebased in 2003 while the Household and Budgetary Survey from which the basket of goods is derived and used to determine the RPI was revised in 2008/09. In recent times, headline inflation has generally exhibited a downward trend, declining from 12.6 percent in May 2012 to 3.0 percent in May 2014, thereafter increasing to 5.9 percent in July 2014. Core inflation has remained low, in single digits over the past 5 years. Food inflation has been the main driver of headline inflation and accounts for a large part of its volatility (see Table 1 and Figure 3). The other categories of inflation generally have a weaker influence on headline inflation. Moreover, Primus, Jagessar, Cox and Mahabir (2011) showed that the contribution of food inflation to headline inflation averaged 50 to 80 percent over the period 1994–2010.

Table 1.Retail Price Index (year-on-year %)

	2007	2008	2009	2010	2011	2012	2013
Clothing	2.2	2.7	-0.5	-0.9	0.6	2.9	0.4
Food	17.4	25.9	12.6	22.2	10.4	19.1	8.7
Housing	4.3	5.5	4.5	0.3	1.3	2.4	0.1
Transportation	5.3	6.2	6.1	4.9	2.2	2.7	5.3
Health	0.0	0.0	0.0	0.0	0.0	0.1	0.0
Communication	12.1	13.8	6.4	2.7	2.2	2.8	4.9
Education	4.3	6.2	4.1	4.3	1.7	2.5	2.4
All Items	7.9	12.1	7.0	10.6	5.1	9.3	5.2

Source: Central Bank of Trinidad and Tobago.

Figure 3, Headline, Food, and Core Inflation (year-on-year %)



Source: Central Bank of Trinidad and Tobago.

What Drives Food Price Inflation?

Food inflation is influenced by both international and domestic conditions. Domestic food prices contribute to two thirds of the weight in the food sub-index, while one third of the weight comprises imports. Jagessar and Mahabir (2011) examined the transmission of changes in international prices of four commodities (rice, wheat, milk, and soya beans) to domestic prices. They found that the transmission of changes in international prices to domestic prices is likely to have an effect in the second month after the change. Moreover, the effect of these changes was estimated to last for a duration of 5 to 9 periods (months).

In the past 5 years, Trinidad and Tobago has experienced three major bouts of high food prices. First, there was the 2008 global food crisis, which saw food prices increase to record levels. The second occurred in the third quarter of 2010, when food price inflation neared 40 percent by August 2010 as a result of a severe drought that affected the domestic supply of staple agricultural commodities, particularly fruits and vegetables. The third occurred during the first half of 2012. Food price inflation increased from 13.96 percent in January 2012 to 28.3 percent in May 2012. This episode was largely attributed to weather-induced supply shortages.

The deagriculturalization of the Trinidad and Tobago economy over the past decades could partly explain some of the supply constraints that influence domestic food production and prices. The size of the agriculture sector has declined significantly both in terms of its productive capacity and output. The number of persons employed in the agriculture sector has persistently declined from 47,000 in 1991 to 22,000 in 2012—a decline of more than 50 percent. Moreover, its share in total employment has declined from about 12 percent in 1991 to 3.7 percent in 2012. These changes have resulted in a falloff in agricultural output where the share of the agriculture sector in GDP declined from 2.57 percent in 1991 to 0.62 percent in 2012. The contraction in agriculture output would have also contributed to a rise in the food imports, which has grown from TT$1.1 billion in 1991 to about TT$6.4 billion in 2012. Food imports as a share of GDP declined from 4.8 percent in 1991 to 2.7 percent in 2006 before increasing again to 4.3 percent 2012 (see Table 3).

Food Production Is Key to Smoothen Food Prices in the Long Term…But the Agriculture Sector Faces Many Challenges

The agricultural sector faces numerous constraints that further impede its ability to sufficiently meet domestic demand and reduce the volatility in food prices. The Inter-American Institute for Cooperation on Agriculture has identified three major sets of challenges facing the sector. First, the economy must confront and address infrastructure and legal bottlenecks which impede domestic supply and contribute to low productivity levels and escalating production costs in the sector. The increasing incidences of praedial larceny can also discourage investments in the sector. Second, farmers face difficulties in obtaining land tenure and land for agricultural purposes. Third, labor shortages and the inability of the sector to attract younger workers is becoming a major challenge for producers.

Table 3: Agricultural activity and Food Imports in Trinidad and Tobago

	Employment in Agriculture (000's)	Persons with Jobs (000's)	% share	Agriculture, value added (% of GDP)	Food Imports (TT$Mn)	Food Imports/GDP
1991	47	401	11.73	2.57	1102	4.84
1995	46	432	10.63	2.42	1592	5.02
2000	36	503	7.23	1.41	1726	3.36
2001	40	514	7.8	1.34	2152	3.91
2002	36	525	6.88	1.46	1998	3.55
2003	31	534	5.88	0.99	2340	3.31
2004	26	562	4.62	0.95	2640	3.25
2005	25	574	4.36	0.49	3220	3.20
2006	26	586	4.39	0.57	3166	2.73
2007	22	588	3.81	0.39	3904	2.85
2008	23	598	3.85	0.38	4955	2.83
2009	23	588	3.89	0.62	4409	3.64
2010	22	582	3.69	0.65	4603	3.51
2011	22	585	3.71	0.55	5548(p)	3.68
2012	22	597	3.73	0.62	6381(p)	4.27

Source: World Development Indicators, World Integrated Trade Solution database and Central Statistical Office, Trinidad and Tobago.
Note: p=preliminary data
Food Imports = The commodities in the Standard International Trade Classification sections 0 (food and live animals), 1 (beverages and tobacco), and 4 (animal and vegetable oils and fats) and SITC division 22 (oil seeds, oil nuts, and oil kernels).

Food Production and Food Security in Trinidad and Tobago

The government of Trinidad and Tobago, having recognized the challenge that food prices pose to consumers and the need to ensure food security, has developed a National Food Production Action Plan for the period 2012–15, which seeks to reduce the food import bill, reduce food inflation, create sustainable long-term productive employment, contribute to economic diversification, and increase food security.

As part of the National Food Production Action Plan, the Ministry of Food Production launched the Caroni GREEN (Growers Responsible for Evolving and Enriching the Environment) Initiative (CGI) on June 5, 2013. The CGI is a program aimed at boosting local food production on a phased basis over a 2 year period by providing farmers without land tenure an opportunity to utilize idle agricultural land leased to former Caroni 1975 workers. This initiative makes use of 5,800 acres of unused agriculture land mainly consisting of 2-acre plots. Some noticeable benefits have already been observed from this venture as the Central Bank in its latest monetary policy report has noted that the increase in domestic output from the CGI coupled with favorable weather conditions have contributed to a decline in food price inflation.

Over the past couple of years, the Government has also strengthened its food security policies. First, it is establishing a Food Security Facility with Guyana to purchase lands for rice cultivation. Within the growth poles, some areas of Tobago will be set aside for cultivation. Moreover, more than 4,200 acres of land were set aside for the distribution of state lands to farmers, and loans to farmers from the Agricultural Development Bank are set to increase. This can reduce the risk of further price spikes induced by droughts from the small amount of land cultivated for fresh food.

In the 2014/15 budget, the government outlined several measures to support domestic food production and reduce food price inflation. These include the following:

1. An increase in all fines related to praedial larceny by 50.0 percent.
2. The cost of establishing approved facilities for agro processing of approved commodities will be subject to a rebate of 50.0 percent up to a maximum of $100,000.
3. The cost of refurbishing approved facilities for agro processing of approved commodities will be subject to a rebate of 50.0 percent up to a maximum of $50,000.
4. 40.0 percent of the cost of Hazard Analysis and Critical Control Points for agro processors will be refunded up to a maximum of $150,000.
5. An allocation of $75.0 million to the Agricultural Development Bank.

Monetary Policy and Inflation

Maintaining a low and stable inflation is one of the Central Bank's primary mandates. In recent times, the Central Bank has maintained an accommodative policy stance to support economic growth; however, with prospects of more demand pressures, it has indicated that it will focus more on inflation containment going forward. In its latest July 2014 monetary policy report, the Central Bank indicated that it will continue to use available instruments and other liquidity absorption methods to further contain liquidity in the system and reduce potential underlying inflationary pressures.

Over the next 2 years, with prospects of a full recovery of the energy sector, continued growth in credit demand and assuming fuel subsidies are gradually dismantled (as announced), some inflationary pressure may accumulate. The Central Bank has indicated keen awareness of this and considers that there is still plenty of slack on the upside of policy interest rates, given the current negative domestic real interest rate.

Conclusion

As in any small open economy, Trinidad and Tobago highly depends on imported commodities; therefore, changes in international food prices can create inflationary pressures and volatility, although temporary. The Government has outlined measures to increase domestic food production and address some of the supply-side bottlenecks in the agriculture sector. These programs and initiatives, once materialized, can help to smooth out the volatility in food prices in the long term. However, in the short to medium term, the economy remains vulnerable to shocks in international food prices and adverse weather conditions.

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Trinidad and Tobago: Selected Indicators

	2009	2010	2011	2012	2013 (P)
(Annual percentage changes, unless otherwise indicated)					
Real Sector					
Real GDP	-4.4	0.2	-2.6	1.2	1.6
Nominal GDP	-31.3	7.4	13.6	2.1	7.4
Inflation (end of period)	1.3	13.4	5.3	7.2	5.6
External Sector					
Exports of goods and services*	-50.5	21.9	33.0	-13.1	-1.6
of which: oil and natural gas*	-51.8	18.8	34.7	-16.8	-18.2
Imports of goods and services*	-27.1	-6.8	46.2	-4.7	-2.1
Current account (percentage of GDP)	8.5	20.2	12.3	3.9	10.0
FDI (percentage of GDP)	3.7	2.7	3.3	3.2	3.8
(In percentage of GDP, unless otherwise indicated, on a fiscal year basis)					
Central Government**					
Revenue and grants	29.0	34.1	32.6	32.3	32.4
of which: energy revenues	14.3	17.6	18.8	17.4	16.3
Current expenditure	27.7	28.9	28.6	29.1	29.9
Capital expenditure and net lending	6.3	5.0	4.8	4.6	5.1
Primary balance	-2.3	2.7	1.2	0.8	-0.7
Overall balance	-5.0	0.1	-0.8	-1.4	-2.6
Consolidate NFPS balance (incl. CLICO)	-9.0	-3.9	0.0	-0.3	-1.2
Debt Indicators					
Public sector debt^	30.6	35.5	33.4	38.7	41.2
Public sector debt over revenues	105.5	104.1	102.5	122.8	111.5
External public debt (end of period)	7.7	6.7	6.4	6.7	5.7
External debt service as percentage of exports of goods and services	3.70	1.10	0.80	0.90	0.9

Notes: * refers to annual change in value (USD Million); ** 2013 refers to October 2012-September 2013; ^ Non Financial Public Sector Debt. Excludes debt issued for sterilization and since 2012 it includes debt increase due to issue to CLICO debt holders. FDI= foreign direct investment; NFPS= Non-Financial Public Sector. (P) Provisional numbers for 2013.

Source: Central Bank of Trinidad and Tobago, International Monetary Fund 2013 Article IV Press Release, IMF World Economic Outlook, April 2013.

OECS Overview

Overall, OECS countries remain in a challenging position. The region was strongly affected by the world economic downturn and recovery has been slow. Based on IMF forecasts, the situation is expected to continue improving but varies among countries. The weak fiscal situation, high level of debt and weak growth forecasts pose the most important challenges to the region. The main drivers of growth remain construction and tourism, while the contribution of agriculture varied depending on climatic conditions. At the same time, the financial sector remains stable (see below for summaries of individual countries).

According to the Eastern Caribbean Central Bank's (ECCB) Economic and Financial Review for Q1 2014 (EFR), preliminary estimates indicate that the currency union overall expanded, based on growth in the construction; mining and quarrying; hotels and restaurants; wholesale and retail trade; and transport, storage, and communication sectors. Overall, the agriculture sector is estimated to have remained flat, while manufacturing contracted.

Construction, driven by foreign direct investment and domestic private spending, is estimated to have risen, while capital spending in the public sector fell by 5.6 percent to XCD193.0 million in Q1 2014 year-on-year, driven mainly by declines in Saint Lucia and Grenada.

Tourism sector performance is estimated to have improved based on an 8.8 percent year-on-year increase in total visitor arrivals to 1.6 million, driven by 3.3 percent year-on-year growth in stopover arrivals from the United States, United Kingdom, and Canada. Cruise passenger arrivals, which account for roughly 75 percent of total arrivals to the region, expanded by 10 percent year-on-year to 1.2 million, according to the EFR.

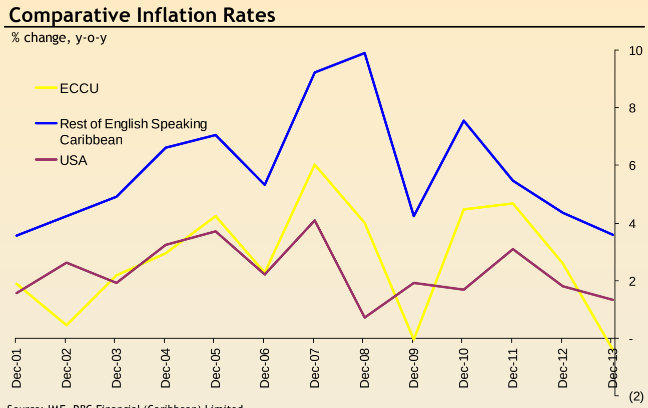
Although output of cocoa, hot peppers, and nutmeg is estimated to have grown for the period under review, the 17.1 percent overall decline in banana production meant the agriculture sector overall contracted.

Inflation reached 1 percent in Q1 2014 year-on-year versus deflation of 0.5 percent recorded in Q1 2013, as a result of broad-based price increases across most subindices and across most territories.

The overall fiscal balance swung into deficit, compared with Q1 2013, driving up total public sector debt by 0.4 percent year-on-year to just under XCD13 billion. Only St. Kitts and Nevis, Montserrat, and Anguilla saw no increases in their debt stock.

The proportion of ECCB Foreign Reserve Assets held under Article 24 (2) of the ECCB Agreement as a Percentage of Demand Liabilities is 95.35 percent as at July 31, 2014,

Special Update: Inflation



Source: IMF, RBC Financial (Caribbean) Limited

Inflation in the Eastern Caribbean has historically been lower than in the rest of the English-speaking Caribbean, based largely on the quasi-currency board arrangement for the Eastern Caribbean dollar (XCD), which has been pegged at XCD2.70 to the USD since July 1976.

Under the quasi–currency board arrangement, the ECCB must hold foreign exchange equivalent to at least 60 percent of its demand liabilities (mainly currency in circulation and commercial banks' non–interest-earning reserves). It targets 80 percent reserve coverage in terms of operations and close to 100 percent in practice.

The principal source of monetary expansion by the ECCB has been the accumulation of foreign exchange reserves, which has directly contributed to slower rates of expansion of the XCD money supply, and by extension, lower inflation rates which more closely mirror that of the United States than the rest of the English-speaking Caribbean.

The benefits of the quasi-currency board arrangement according to the IMF are reflected in low inflation and relatively low nominal interest rates enjoyed in the OECS/ECCU, which are below-average rates elsewhere in the Caribbean and in other developing economies.

indicating that the EC dollar is almost fully backed by US dollars.

Antigua and Barbuda

Preliminary estimates suggest that the economy contracted in Q1 2014. On the basis of available indicators, The Economic and Financial Review (EFR) of the Eastern Caribbean Central Bank (ECCB) estimates that the construction; financial intermediation; wholesale and retail trade; transport, storage, and communication; and public administration sectors contracted. At the same time, the hotels and restaurants sector expanded in Q1 2014 as a result of a 4.3 percent year-on-year growth in the number of stopover arrivals. Stopover arrivals from Canada declined by 5.5 percent year-on-year whereas US and UK visitors increased by 5.9 percent and 11.9 percent, respectively. However, with fewer cruise ship calls, cruise passenger arrivals dropped 5.2 percent year-on-year in Q1 2014.

Marginal deflation of 0.04 percent year-on-year was recorded, driven by weak demand and softer fuel, electricity, food, and commodity import prices.

The overall fiscal surplus narrowed based on a smaller current account surplus at XCD2.4 million, reflecting 18.2 percent higher recurrent expenditure. Interest payments grew by XCD16.2 million or 87.4 percent year-on-year, and total debt service increased by XCD12.8 million to XCD72.8 million in Q1 2014 based mainly on repayment of a stand-by loan from the International Monetary Fund (IMF). Total public sector debt stood at XCD3, 093.8 million in March 2014, having expanded by 31.4 percent or XCD9.7 million during Q1 2014, driven by central government borrowing.

Total domestic credit contracted by 0.1 percent year-on-year or XCD2.3 million to XCD2.67 billion in March 2014, as credit to the private sector declined by 0.6 percent and to the public sector by 1.2 percent year-on-year.

Dominica

Dominica's economy is estimated to have expanded in Q1 2014, on the basis of preliminary data suggesting stronger output in agriculture, construction, and tourism; the manufacturing sector, however, was mixed. Banana production fell by almost 14 percent year-on-year, but this was compensated by higher output for cocoa, coffee, hot peppers, and livestock.

Private construction intensified as the number and value of construction starts rose by 8.6 percent and 3.6 percent respectively, year-on-year. Public spending on construction increased, as evidenced by continued road development, work on water supply networks, the geothermal energy initiative, an abattoir for pork and poultry, an agricultural center, and a coffee plant.

Stopover visitor arrivals are estimated to have declined by 2.2 percent year-on-year, reflecting lower demand from Caribbean visitors—the largest source market for Dominica at 14.7 percent. Additional airlift was received from St. Maarten during the period under review, but this was not sufficient to improve the overall performance of the Caribbean source market because of reduced demand from its largest subcategory, the French West Indies. Stopover arrivals from Europe expanded by 11.6 percent, from the United States by 7.4 percent, and from Canada by 4.7 percent year-on-year. Cruise passenger arrivals grew 37.3 percent year-on-year, with a 24.7 percent rise in the number of cruise ship calls, year-on-year.

Deflation of 0.6 percent year-on-year was recorded based mainly on a 3.3 percent year-on-year in the housing, utilities, gas and fuels subindex, the highest weighted in the basket of consumer goods. This decline resulted mainly from lower costs for utilities including electricity as the use of more hydropower contributed to reductions in the fossil fuel surcharge.

On the basis of lower grant inflows and higher capital spending, the overall fiscal balance swung into deficit of XCD5.7 million in Q1 2014, versus a surplus of XCD3.2 million 1 year earlier. The primary surplus fell from XCD10.4 million to XCD1.7 million for the period under review. Total public sector debt outstanding grew by 1.6 percent year-on-year, mainly because of a 2.1 percent year-on-year increase in external debt.

Domestic credit contracted by XCD704.8 million or 2.4 percent year-on-year, as credit to the private sector contracted by 0.3 percent, and the government's net credit position fell 28 percent since December 2013 to XCD38.5 million.

Grenada

According to the ECCB, indications suggest that the economy contracted in Q1 2014 year-on-year. Construction, stopover arrivals and manufacturing all registered declines, which outweighed growth in agriculture and education.

Upgrades to the Sandals Resort were completed in late 2013, accounting for the majority of the relative decline in the construction sector seen in the first quarter, year-on-year.

Cruise passenger arrivals increased by 5 percent year-on-year, even though the number of cruise ship calls fell by about 10 percent year-on-year. Stopover arrivals declined by 0.6 percent year-on-year, as visits by Caribbean tourists declined by 22 percent. This outdid the increased stopover arrivals from Canada, the United Kingdom, and the United States, which were up 6 percent, 1.6 percent, and 0.3 percent year-on-year, respectively.

Agricultural output is estimated to have grown overall, reflecting increased acreage being farmed, as cocoa output rose by 35.5 percent and nutmeg by 28 percent year-on-year, outpacing the 8.5 percent decline in banana production.

Consumer prices were relatively unchanged overall, as increases in transport, and the heaviest weighted subindex—housing, utilities, gas, and fuels—of 0.1 percent year-on-year each, balanced the 0.4 percent decline in food prices.

The overall fiscal deficit narrowed by 19.8 percent to XCD37.4 million, as current revenue increased due to measures taken as part of the adjustment program. This drove the total debt stock up by less than 1 percent to XCD2.27 billion, 91.5 percent of which is central government debt.

St. Kitts and Nevis

The economy is estimated to have grown in Q1 2014 year-on-year. The agriculture sector declined, whereas construction and manufacturing expanded, according to estimates from the ECCB.

In Q1 2014, public sector capital spending reached three times the level 1 year earlier, while private capital spending also grew, driving overall growth in the construction sector.

Cruise passenger arrivals increased by 23 percent year-on-year as cruise ship calls grew by 17.6 percent. However, stopover arrivals declined by 1.6 percent year-on-year, as Caribbean tourist arrivals contracted percent7.6 percent and by 1.2 percent from the United States.

The manufacturing sector is estimated to have expanded overall, based mainly on 70 percent higher exports of tobacco products. The agriculture sector contracted as total crop production declined by 18.7 percent. This was tempered somewhat by mixed livestock production.

Deflation of 0.6 percent year-on-year in Q1 2014 was driven mainly by lower prices for transport and food and nonalcoholic beverages. The only category with price increases was the housing, utilities, gas, and fuels subindex, according to the EFR. The fiscal surplus declined by 63 percent year-on-year to XCD33.8 million, as nontax revenues (Citizenship-by-Investment fees) softened and expenditure grew. Total public sector debt outstanding declined by 0.2 percent from December 2013 to March 2014, to XCD2 billion. According to the EFR, during 2014, the total debt stock of the government is expected to be reduced further upon the completion of a debt-for-land swap between the Nevis Island Administration and the St. Kitts Nevis Anguilla National Bank.

Domestic credit contracted by 8.4 percent year-on-year as private sector credit declined by 1.3 percent, and the net deposit position of the general government expanded by 14.8 percent year-on-year.

St. Lucia

According to the EFR, the economy remained flat in Q1 2014, compared with Q1 2013. The construction sector is estimated to have contracted during the period under review, as both private and public spending may have softened.

The tourism sector is estimated to have grown; stopover arrivals increased 7.5 percent year-on-year and arrivals increased from all major source markets except the Caribbean, which saw a 9.2 percent decline year-on-year. Cruise passenger arrivals grew 7.3 percent year-on-year, as the number of cruise ship calls increased by 5.6 percent year-on-year in Q1 2014.

Banana production declined by 23.6 percent year-on-year, whereas the rest of the agriculture sector is estimated to have grown more significantly as a result of a number of initiatives.

The inflation rate reached 3.4 percent year-on-year in Q1 2014, versus deflation of 0.9 percent seen 1 year earlier. Price increases were broad based, and declines were seen only in the subindices for transport, alcoholic beverages, tobacco and narcotics, and hotels and restaurants.

The overall fiscal deficit declined by 22 percent year-on-year to XCD64.2 million as a result of 27.3 percent lower capital spending. The primary fiscal deficit also narrowed, by 38.4 percent year-on-year, to XCD31.5 million. Total public sector debt is estimated at XCD2.75 billion—an increase of XCD1.1 million over Q1 2014.

Domestic credit contracted by 2.1 percent year-on-year to XCD3.9 billion, as net credit to both private and public sector declined.

St. Vincent and the Grenadines

Preliminary indications suggest that the economy expanded in Q1 2014 year-on-year, driven by the construction and tourism sectors primarily. Significantly higher public sector capital spending was the major contributor to the uptick in the construction sector, while private construction spending also showed growth.

The tourism sector is estimated to have expanded as stopover arrivals increased 2.6 percent year-on-year, reflecting growth from the United Kingdom at 9.7 percent, the Caribbean at 3.6 percent, Canada at 0.8 percent, and other countries including Latin America at 0.7 percent. By contrast, the stopover arrivals from the USA contracted by 2.4 percent year-on-year. Cruise passenger arrivals grew 1.3 percent year-on-year, despite a 16.3 percent drop in the number of cruise ship calls.

Disinflation saw the inflation rate fall to 0.2 percent year-on-year in Q1 2014, as the housing, water, electricity, gas and other fuels subindex—which carries the heaviest weight—rose by 0.6 percent on higher electricity and fuel rate charges.

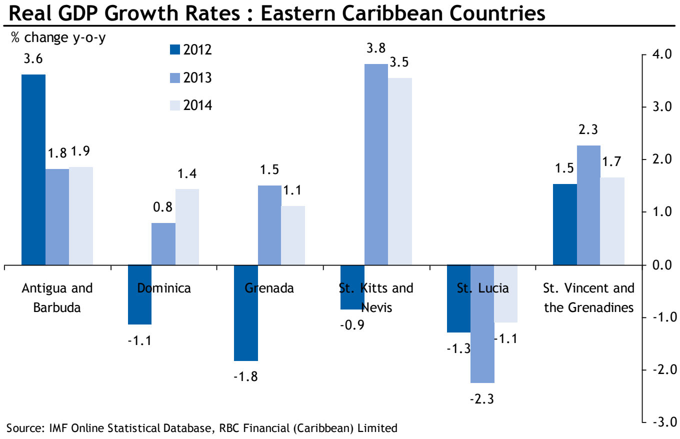
The overall fiscal deficit widened by 241.5 percent year-on-year to XCD14 million, as capital expenditure almost tripled and capital revenues declined. The primary balance swung into deficit of XCD4.7m from a surplus of XCD6.9m 1 year earlier. Total public sector debt increased by 1.7 percent during Q1 2014 to XCD1.5 billion.

Domestic credit expanded by 0.9 percent year-on-year to XCD1.0 billion, mainly because of central government borrowing, which grew by 22.4 percent year-on-year, as credit to the private sector contracted by 0.2 percent year-on-year.

The OECS and the IMF

In its October 2014 edition of the World Economic Outlook, the IMF raised its growth projections for Antigua and Barbuda, and St. Kitts and Nevis, but lowered those of the other Eastern Caribbean territories under review. Most notable is that the IMF now expects St. Lucia to contract by 1.1 percent in 2014, down from its previous projection of 0.3 percent growth announced in April 2014, as shown in Figure 1. St. Lucia could therefore be facing its third consecutive year of contraction in 2014 according to the IMF, despite showing growth in tourist arrivals.

Figure 1. Real GDP Growth Rates



Several countries experienced IMF missions. The missions noted slow but important improvements in Grenada, St. Kitts and Nevis and St. Vincent and the Grenadines as the region is only slowly recovering from the world economic downturn. St. Vincent and the Grenadines also received balance-of-payments support resulting from severe flooding and landslides in December 2013. The situation remains challenging in Antigua and Barbuda as improvement in growth are accompanied by a worsening of the fiscal position (see also mission summaries below).

There was an IMF Mission to Antigua and Barbuda in August 2014 for Article IV consultations and the second Post-Program Monitoring review, upon conclusion of which the IMF reported the following:

- After a real GDP growth of 1.8 percent in 2013, economic activity intensified in H1 2014.
- Tourism is recovering, with stayover arrivals up 7.7 percent in H1 2014, while other sectors have continued to grow.
- Inflation in July stood at 1.7 percent, year-on-year.

- The fiscal position deteriorated under the expansionary stance in the run-up to the elections. Spending in H1 2014 was up 6.6 percent year-on-year, whereas tax revenue grew by 3.4 percent.
- For the 12-month period from July 2013 to June 2014, the primary deficit widened to 1.3 percent of GDP compared with a surplus of about a 0.6 percent of GDP from July 2012 to June 2013.
- Scheduled external amortization has risen significantly this year to close to 3 percent of GDP from 1.2 percent in 2013, mainly because of repayment obligations to the IMF and Paris Club creditors.
- With few sources of financing on account of Antigua and Barbuda's already-elevated debt levels, external arrears accumulated, growing by almost 1 percent of GDP in H1 2014.
- Growth in 2014 is expected at about 2 percent with a moderate recovery in tourism.

An IMF team visited Grenada in August 2014 to conduct the first review under the Extended Credit Facility and reported the following:

- Grenada has made a strong start in implementing its program. The fiscal consolidation is on track, and all quantitative performance criteria for end-June were met.
- The economic recovery is slowly taking hold and the growth outlook remains broadly in line with the program, while inflation has been lower than expected.
- The economy continues to face significant challenges from high unemployment, a large debt overhang, and balance sheets weakened by impaired loans.
- The structural reform agenda will focus on (a) improving the business environment through amendments to the Investment Promotion Act, the tax incentive regime, and regulatory reforms to the energy sector; (b) a continued strengthening of the fiscal policy framework through the introduction of fiscal responsibility legislation, new legislative frameworks for public debt management and tax administration, and a regulatory framework for the National Transformation Fund to ensure sustainable management of the Citizenship-by-Investment receipts; (c) modernizing the public service; and (d) strengthening the financial position and oversight of statutory bodies.
- Consideration of the first review of Grenada's IMF-supported program could take place by the IMF's Executive Board in November. Upon approval, about USD3 million would be made available to Grenada.

St. Kitts and Nevis prepaid about USD17.1 million to the IMF on June 24, 2014. The early repayment represents about 23.4 percent of the USD73.1 million borrowed from the IMF under a Stand-By Arrangement, which fall due in 2014 and 2015 under the original repayment schedule. According to the IMF, this is the first time that an obligation of this magnitude has been repaid early by a Caribbean nation, reflecting the improvement in macroeconomic balances brought on by policy efforts and strong inflows under the Citizenship-by-Investment program. This early repayment will reduce the outstanding obligations of St. Kitts and Nevis to the IMF to about USD 56 million, and lower the debt to GDP ratio by about 2 percent of GDP. The outstanding balance is projected to be repaid to the IMF during 2014–18.

In July 2014, the IMF completed the ninth and final review of St. Kitts and Nevis' economic performance under a program supported by a 36-month Stand-By Arrangement, which enabled the authorities to draw an additional USD4.5 million, bringing the total resources available for immediate disbursement to USD7.9 million. The authorities have expressed the intention to continue to treat the arrangement as precautionary, according to the IMF release, which also stated the following:

- Substantial strides have been made under the home-grown IMF-supported program. Fiscal and debt sustainability have improved significantly, financial sector stability was preserved during a comprehensive debt restructuring exercise, and economic growth has rebounded strongly following a 4-year recession.
- The fiscal outturn for end-March 2014 was consistent with program objectives and the government is on track to achieve its end-year targets. Debt has fallen considerably, but it is still high and vulnerable to shocks. Completing the remaining debt-for-land swap is necessary to achieve the medium-term debt target.

IMF Executive Board approved a USD6.4 million disbursement under the Rapid Credit Facility and the Rapid Financing Instrument for St. Vincent and the Grenadines in August 2014. According to the IMF, this disbursement will help the country meet an urgent balance-of-payments need resulting from severe flooding and landslides in December 2013, which caused massive damage to infrastructure, housing, and agriculture. The IMF release stated the following:

- Emergency relief and high rehabilitation costs have

weakened the fiscal position and created an urgent balance-of-payments need at a time when the economy is striving to recover from previous natural disasters and from the global economic downturn.

- Rehabilitation and reconstruction spending is expected to widen the fiscal deficit this year. Mindful of the high and growing public debt, the authorities have reiterated their intention to rely mainly on grants and concessional resources to finance the recovery. At the same time, they will step up their efforts to mobilize budgetary resources by increasing revenue collection, containing the wage bill, and reducing transfers to state-owned enterprises.
- The authorities intend to generate a primary surplus of at least 2 percent of GDP in the medium term to ensure that the debt-to-GDP ratio is put on a declining path.

On February 6, 2013, the Executive Board of **the IMF concluded the 2012 Article IV consultation with St. Vincent and the Grenadines,** and released the staff report on August 21, 2014. Highlights are as follows:

- After 3 consecutive years of negative growth, reflecting the effect of the global financial crisis, higher commodity prices and natural disasters, real GDP grew by about 0.5 percent in 2011.
- Economic activity indicators for the first 6 months of 2012 suggest a modest pickup in tourism arrivals, manufacturing, and agricultural activity. Real GDP growth is expected to be around 0.5 percent this year, as weak construction activity partly offsets the modest upticks in manufacturing and tourism.
- Pressures on prices have eased, consistent with declining commodity prices. Year-on-year inflation reached a low of 0.9 percent in September 2012, after peaking at 4.7 percent at the end of 2011.
- The external current account deficit remains high at around 30 percent of GDP, largely reflecting higher-than-expected imports relating to foreign direct investment, fuel, and international airport construction.
- The fiscal deficit is expected to narrow by about one percentage point compared with last year to about 2.75 percent of GDP, as lower-than-projected revenues were offset by cuts in capital expenditure as a result of financing constraints. That said, spending on wages and salaries is expected to be somewhat higher given the recent announcement of a retroactive wage increase of 1.5 percent for civil service workers for 2011 and 2012. Earlier in the year, the government issued an XCD40 million 10-year bond on the Regional Government Securities Market to help finance the deficit.

OECS Selected Economic Indicators

	Population 2013 (000)	Nominal GDP 2013 (USD MM)	2013 Real GDP change (%)	Public sector debt/GDP 2013 (%)	Overall Fiscal Balance 2013 (% of GDP)	Primary Fiscal Balance 2013 (% of GDP)	Inflation 2013 y-o-y (%)
Antigua and Barbuda	87	1,201	1.8	94.3	-4.2	-1.6	1.1
Dominica	71	497	0.8	75.1	-2.7	-0.9	-1.1
Grenada	106	814	1.5	109.8	-7.1	-3.7	-1.2
St. Kitts and Nevis	58	775	3.8	103.1	12.3	15.7	0.4
St. Lucia	169	1,332	-2.3	79.6	-5.9	-2.1	-0.7
St. Vincent and the Grenadines	110	720	2.3	74.0	-6.2	-4.1	0.8
Eastern Caribbean Currency Union			1.1		-3.0		-0.4

X C D = Eastern Caribbean dollar. USD1 .00 = XCD2.70 approximately.
Source : International Monetary Fund and Eastern Caribbean Central Bank.

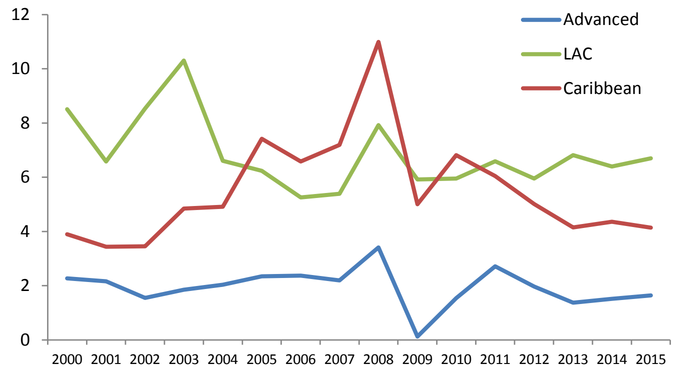
REGIONAL SUPPLEMENT: INFLATION IN THE CARIBBEAN: A DORMANT VOLCANO?

Introduction

Although inflation risks seem contained in the short term, the high vulnerability to external shocks leaves the Caribbean countries highly exposed to fluctuations in commodity prices. This section examines the degree of dependence of domestic prices on international commodity prices. Furthermore, it analyzes the determinants and risks associated with inflation for The Bahamas, Barbados, Guyana, Jamaica, Suriname, and Trinidad and Tobago (CCB region). While inflation pressures have been easing recently, in small and open countries inflation could quickly pick up and take the center stage of the countries' priorities again.

Figure 1 shows the recent dynamic of inflation in advanced and Latin American and Caribbean countries. While the rise of commodity prices up to 2007–08 affected the world inflation indexes, the increase of Caribbean prices was quite dramatic. This evidence stresses the high elasticity of consumer prices in the Caribbean region to international commodity prices.

Figure 1. Headline Inflation in the Caribbean and Other Regions (%)

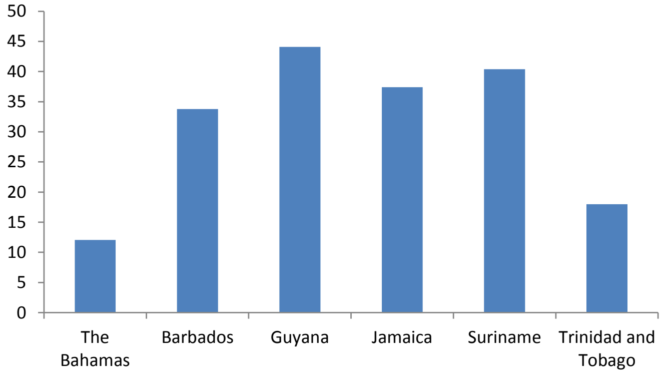


Source: World Economic Outlook, April 2014.

Moreover, the large share of commodities in final expenditure could amplify the effects of commodity price shocks in the domestic economy. Figure 2 shows the weights of food items in the consumption basket for the Caribbean countries. In particular, the median weight of food in the region is greater than 35 percent of the consumer basket, similar to the 38 percent in Asia[1] but much greater than the 16 percent in Europe and 14 percent in the United States.

Furthermore, the ability of the central banks to, at least partially, absorb external shocks depends on the credibility of monetary policy and the exchange rate regime. In some countries, flexible exchange rates could cushion the increase of international prices through an appreciation of the currency (for example, in Jamaica). However, that could not be the case in The Bahamas, Barbados, Suriname, and Trinidad and Tobago. Moreover, the lack of fiscal space as a result of high indebtedness and financial system fragility in some countries also reduces the ability to soften external shocks through countercyclical fiscal policy.

Figure 2. Weight of Food on the Consumption Basket (%)



Source: Central Bank authorities.

Understanding Inflation Risks in the Caribbean

Inflation concerns run deep in the population as price increases affect almost everyone. In general, inflation is measured by the change in the consumer price index (CPI). Although there is no general consensus on the optimal rate of inflation, many specialists would agree that high levels of inflation are harmful for the economy because they introduce uncertainties for consumers, wage earners, and businesses. Conversely, very low or even negative inflation, also called *deflation*, could negatively affect growth and macro stability, considering that deflation increases the real value of liabilities, including debt and pension obligations.

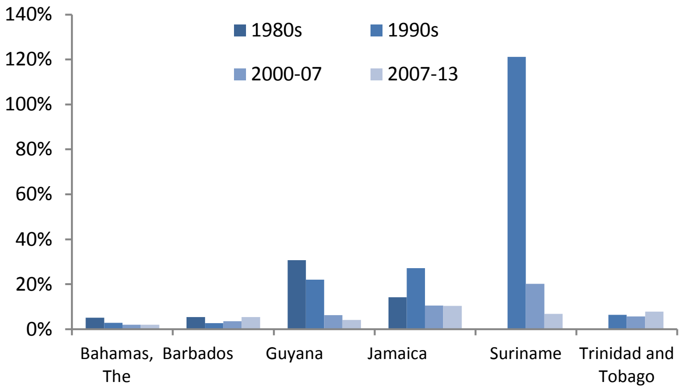
When we analyze prices behavior since 1980, we can observe that inflation in the Caribbean has been declining (see Figure 3). However, the experiences among the countries of the region have varied considerably. In particular, Suriname experienced a period of extremely high inflation during the 90s.

For the other countries, inflation pressures have remained contained, in particular for The Bahamas and Barbados. Guyana had an inflation peak from 1989 to 1991 (with a rate above 100

[1] The food weights in the CPI for Asia consider Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka, Indonesia, China, Philippines and Thailand.

percent) and Jamaica in 1991 (when inflation reached 80 percent). However, in recent years, changes in prices have remained at manageable levels.

Figure 3. Inflation in CCB Countries over Different Periods



Source: Authors' calculations based on World Economic Outlook, April 2014

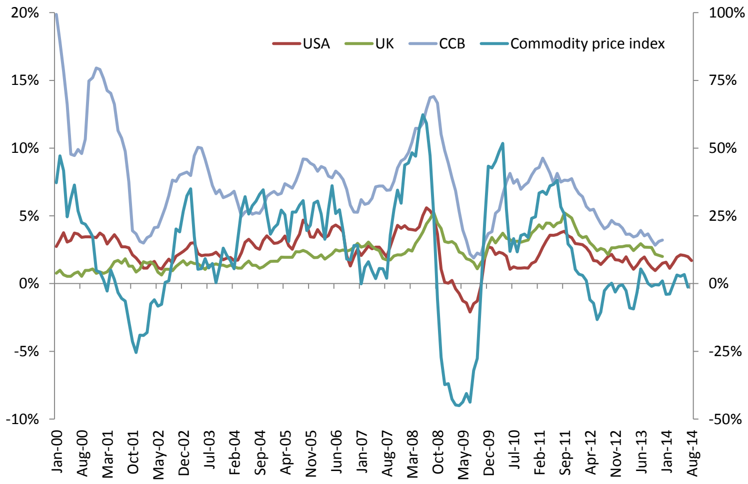
Drivers of Inflation and Pass-Through of Commodity Prices

Given the differences in monetary and exchange rate policies, economic structures and economic developments, inflation varies among the CCB countries (see individual country reports). However, some factors affect many countries at the same time. A clear example was the rapid increase in commodity prices in the second half of the 2000s that led to worldwide inflationary pressure, which was especially strong in the Caribbean (see Figure 4). Over the last 5 years, inflation pressures seem contained, but commodity prices have not reached the pre-crisis level, which could confuse good luck with structural strength.

Moreover, one of the restrictions of the Caribbean countries is their inability to credibly set a path for inflation expectations. Therefore, a temporary increase in the commodity prices could unhinge inflation expectations and spill over into underlying inflation.

When we analyze inflation risks, we have to consider that changes in the price of food and fuel may influence overall inflation directly and indirectly. For example, the increase in, the international price of fuels, has a direct (first-round) effect over the headline inflation— increasing the price of that particular item of the consumption basket. However, the increase also has an indirect (second round) effect: rising prices that use fuel as an input and increasing inflation expectation for the near future, therefore setting in motion demands for higher wages.

Figure 4. Inflation in the United States, the United Kingdom, and CCB Countries, and Commodity Index, January 2004 to December 2013



Source: Latin American and Caribbean Macro Watch Database and IMF.

First-round effects are particularly large in smaller economies but also tend to dwindle soon after the international prices shock vanishes. Therefore, exchange rate policies can be used to cushion the temporary shocks. However, second-round effects are usually more persistent, and its effects clearly depend on the ability of the monetary authority to commit on policies to set the path for expectations.

This section analyzes to what degree international price changes translate into domestic inflation rates in the Caribbean (called *pass-through*). Measuring the rate of *pass-through* is crucial for forecasting consumer prices and determining the optimal policy response to the shocks. The following exercise captures the short- and long-run effects of shocks to international commodity price indexes on domestic price indexes. Using monthly data from the early 1990s, the exercise estimates the elasticities of the local CPIs with respect to indexes of commodity prices.

What factors might affect the extent of pass-through from international commodity prices on domestic consumer prices? First, an increase of the international price of a good could be counterbalanced by an appreciation of the exchange rate. Therefore, exchange rate movements can amplify or mitigate the domestic impact of changes in world prices. As mentioned earlier, several of the countries of the CCB region have fixed exchange rates, which constrain the capacity to absorb external shocks; the rest of the countries show recent depreciations of their currencies, which could amplify the fluctuation of international prices.

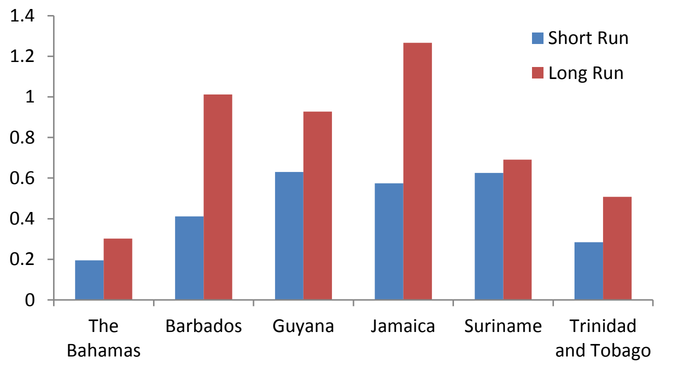
Second, price distortions such as taxes or subsidies on certain commodities, especially fuels may amplify or mitigate the pass-through. Although some of the countries of the region display direct and indirect subsidies on fuels, including Trinidad and Tobago and Suriname, the capacity of governments to use fiscal measures to alleviate the pressure from international prices is restricted by the tight fiscal position and the high level of indebtedness. An exception is Guyana, which uses varying rates on the import excises for fuel to soften the effect of fuel price variation on domestic inflation (see country report).

Finally, the impact from international to domestic prices is affected by the degree of dependence and integration of the domestic economy with the international commodity market. Economies with a relatively abundant domestic production are better able to absorb fluctuations in international prices. Most of the countries of the region are net fuel importers, and all of them import food commodities, amplifying the effect of a commodity price shock.

Figure 5 displays the short- (3 months) and long-run (12 months) impact of an increase in international food prices on the domestic consumer price index. The effect of an increase in international food prices on domestic prices is larger than the weight of food in the index. The heterogeneity of the short-run impacts among CCB is captured by Jamaica and The Bahamas, the first with one of the largest weights of food in the CPI, and the latter with the smallest. In the case of Jamaica, the short-run impact is about 50 percent larger than the weight of food in the CPI, displaying an elasticity of 60 percent. The Bahamas exhibit a short-run effect 60 percent larger than the weight of food in the CPI, with an elasticity of about 20 percent.

For all countries, the effects after 12 month are larger than after 3 month. Notably in the case of Barbados and Jamaica, the long-run effect of changes in international food prices duplicates the short-run effect. This could reflect the vulnerable macroeconomic conditions, which restricts monetary and fiscal policy to react to external shocks and makes inflation expectations more volatile.

Figure 5. Short and Long-Run Effects of a Shock in Food Price

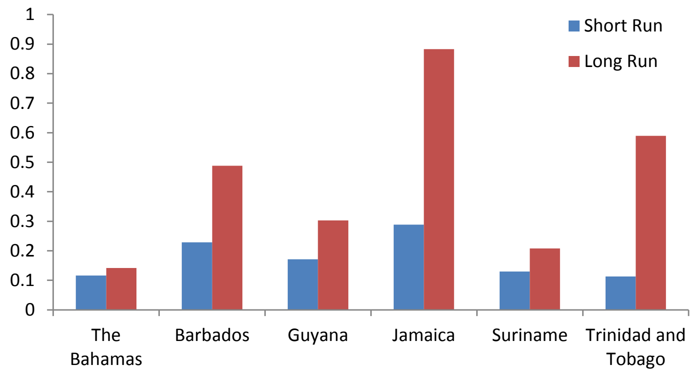


Source: Authors' calculations.

For the case of Barbados, an increase in the international food prices generates a 1-to-1 effect in the local CPI. In Jamaica, the impact is even larger, with an increase of 1 percent in the international food price translating to an increase of the local CPI by 1.26 percent. Although these figures are large by international standards, the results are in line with those posted by the International Monetary Fund (World Economic Outlook 2008).

As shown in previous studies (for example Rigobon 2008), when considering the impact of food prices, most of the effects take place in the longer run, when also derivatives of the food commodities adjust their prices. In particular, the levels of the short-run impacts are in line with the weights of the commodities determined by the CPI. The correlation between the weight of food in the CPI and the short-run impact is greater than 95 percent.

Figure 6. Short and Long-Run Effects of a Shock in Fuel Prices



Source: Authors' calculations.

With respect to the effect of fuel on the CPI (see Figure 6), results are similar to food, with the exception of Trinidad and Tobago, where the short-run effect is considerably smaller. As mentioned in the country report of Trinidad and Tobago, being an oil exporter, domestic price increases from international fuel price increases result from the economic boom rather than from the direct price increase itself.

Commodity Prices and Forecasts

So far, the end of the super cycle of commodity prices predicted since the second half of 2013 has not taken place. However, energy prices have been fairly flat since 2012, with rising prices of natural gas, and declining prices of crude oil following the surge in supply from North America. At the same time, surging supplies, weak demand and a rising US dollar have been triggering a collapse in global oil prices. With respect to food commodities, a better production outlook for most crops has been easing fears of higher food prices.

In terms of forecasts, the "Economist Intelligence Unit November 20 Crude Oil Forecast" projects declining prices for both Brent and WTI until 2016. However, upside risks remain high due geopolitical risks in the Middle East and the spread of the Ebola virus. Furthermore, global output for major grains and oilseeds is projected to surpass demand growth, reducing the upside risks, and projecting a further decline of the international prices.

Similar to oil prices, the October 2014 World Economic Outlook projects commodity prices at current levels or slightly below 2013 values during the next 5 years. As such, inflationary pressures from commodity prices are projected to remain contained (see Figure 7).

This is good news for the countries in the CCB region, given their level of exposure (and the high elasticity of the local CPIs to commodity prices). However, the region is lagging behind in terms of developing tools to influence inflation expectations

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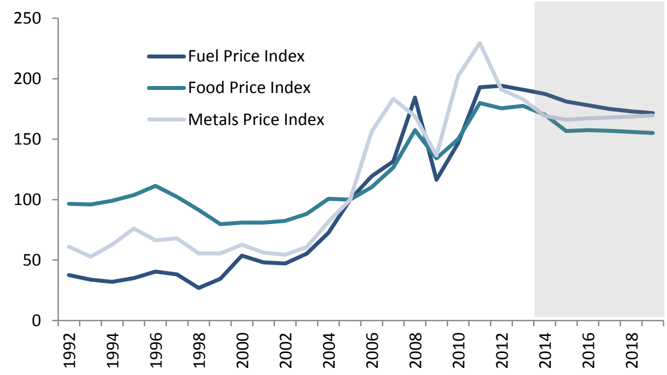
Figure 7. Commodity Prices Index and Forecast



Note: 2005 = 100.

Source: World Economic Outlook, October 2014.

Conclusion

Although inflation risks have been contained during the last few years, it remains a topic that deserves proper consideration and monitoring. In particular, commodity prices shocks from higher crude oil or food prices remain a major risk. The current US involvement in the Syria-Iraq war could push up energy prices, creating a new and serious problem for the region. In that case, inflation could erupt, adding a new concern and difficulty to policymakers.

The Caribbean Quarterly Bulletin

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