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**PRELIMINARY OVERVIEW OF  
CARIBBEAN<sup>1</sup> ECONOMIES  
2005**

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<sup>1</sup> This document focuses on the member States of the Organisation of Eastern Caribbean States, The Bahamas, Barbados, Belize, Guyana, Jamaica, Suriname and Trinidad and Tobago.

## Table of Contents

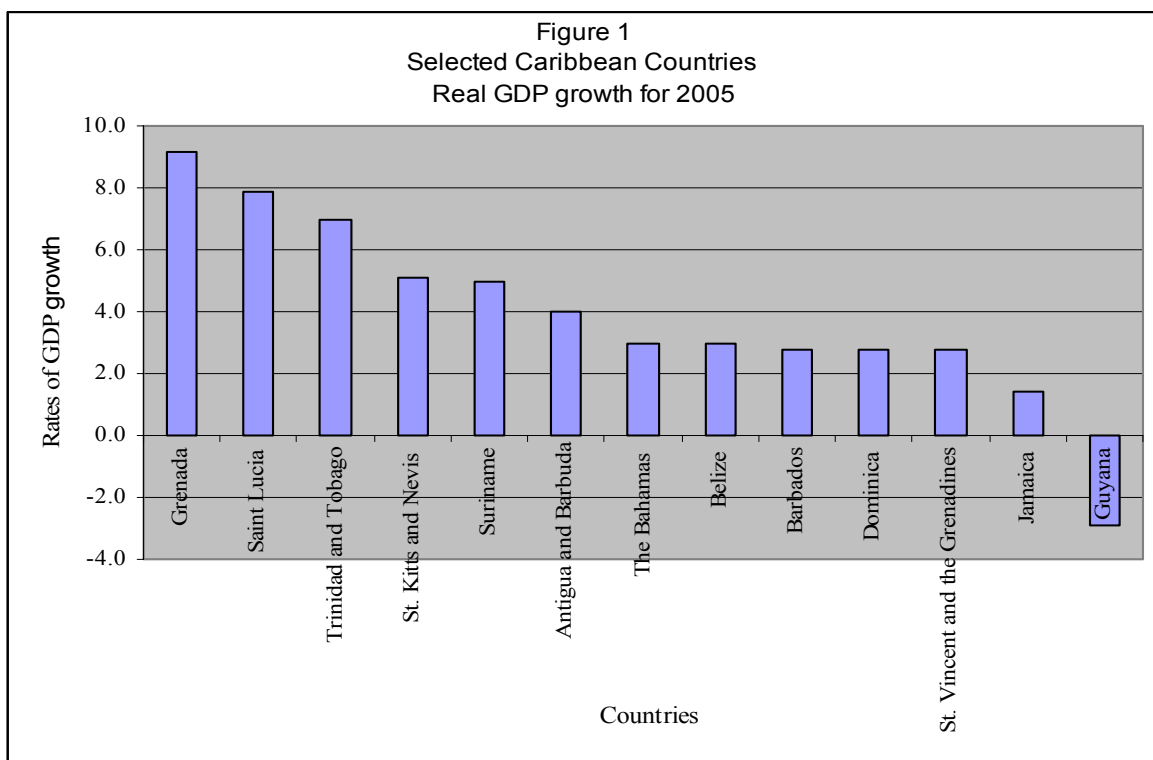
I. REGIONAL OVERVIEW .....	1
1. The economic performance in 2005 .....	2
2. The external sector .....	7
3. Monetary and exchange rate policies.....	9
4. The fiscal performance .....	12
5. Public debt .....	15
6. Inflation and unemployment .....	17
7. The state of regional integration .....	17
8. Trade negotiations.....	18
II. COUNTRY REPORTS .....	21
The Organisation of Eastern Caribbean States (OECS) .....	22
The Bahamas.....	26
Barbados .....	29
Belize .....	33
Guyana .....	37
Jamaica.....	40
Suriname .....	44
Trinidad and Tobago.....	48
Statistical Annexes.....	52

## **I. REGIONAL OVERVIEW**

## 1. The economic performance in 2005

In 2005, the majority of Caribbean countries registered a decline in their rate of economic growth with respect to the previous year (See Table 1 below).

The highest rates of growth were recorded by Grenada, Saint Lucia, and Trinidad and Tobago (9.2 per cent, 7.9 per cent and 7.0 per cent, respectively) followed by St Kitts and Nevis and Suriname (5 per cent for both). Five other countries registered moderate growth rates averaging between 2 per cent and 3 per cent. These include the Bahamas, Barbados, Belize, Dominica, and St. Vincent and the Grenadines. Finally Jamaica recorded stagnant growth while Guyana witnessed a contraction of its economic activity (1.4 per cent and -2.9 per cent, respectively).



The growth performance was mainly supported by the continued strength of external demand and low interest rates that prevailed throughout most of the year. It also responded, albeit to a lesser extent, to the expansion of internal demand.

Global demand contributed to the increase in the export price of some of the major traditional and non-traditional agriculture and mining export commodities benefiting those economies with a strong natural resource base. Jointly with other factors, it also underpinned the significant growth in tourism receipts visible for most economies of the region.

**Table 1**  
**Caribbean economies**  
**GDP growth, inflation and current account**  
**2003-2005**

	GDP growth			Inflation			Current account as percentage of GDP		
	2003	2004	2005	2003	2004	2005	2003	2004	2005
Antigua and Barbuda	5.5	5.2	4.0	3.5	2.1	...	-13.9	-10.8	-20.4
The Bahamas	1.9	2.8	3.0	2.4	0.9	1.8	-8.0	-5.3	-11.2
Barbados	3.7	4.8	2.8	1.6	1.4	3.2	-8.0	-10.5	-10.4
Belize	9.1	4.6	3.0	2.6	3.1	3.5	-10.5	-14.4	-11.1
Dominica	1.0	3.6	2.8	2.8	0.9	...	-14.4	-20.8	-21.4
Grenada	5.7	-3.0	9.2	1.1	2.5	...	-35.5	-13.5	-41.3
Guyana	-0.6	1.6	-2.9	4.9	5.5	6.0	-11.4	-9.3	-24.8
Jamaica	2.3	0.9	1.4	14.1	13.7	16.0	-8.7	-6.0	-9.3
St. Kitts and Nevis	0.6	6.4	5.1	3.1	1.7	...	-31.5	-23.1	-30.5
Saint Lucia	3.7	3.6	7.9	0.5	3.5	...	-20.4	-17.2	-13.5
St. Vincent and the Grenadines	3.6	5.4	2.8	2.2	1.7	...	-21.1	-25.9	-31.6
Suriname	5.4	7.8	5.0	13.1	9.1	16.6	-12.2	-8.5	-14.3
Trinidad and Tobago	13.2	6.2	7.0	3.8	4.0	5.3	9.4	16.4	17.4
<b>Average</b>	<b>4.2</b>	<b>3.8</b>	<b>3.9</b>	<b>4.3</b>	<b>3.9</b>	<b>7.5</b>	<b>-14.3</b>	<b>-11.5</b>	<b>-17.1</b>
<b>Standard Deviation</b>	<b>3.7</b>	<b>2.8</b>	<b>3.1</b>	<b>4.3</b>	<b>3.7</b>	<b>6.2</b>	<b>11.3</b>	<b>10.6</b>	<b>14.3</b>

Note: ... denotes not available.  
Source: IMF (2005); ECLAC (2005) and on the basis of official data.

Low interest rates allowed some economies (Antigua and Barbuda, Grenada, and Trinidad and Tobago) to refinance and reschedule external debt commitments, and provided fiscal relief by lessening interest rate payments obligations (Jamaica).

The expansion of internal demand was also a determining factor of the growth trajectory of Caribbean economies and made visible by the increase in the rate of growth of the construction sector. The increase in domestic expenditure was particularly important in the cases of Saint Lucia, Suriname and Trinidad and Tobago. In Saint Lucia the growth impulse was underpinned by the construction due to the World Cricket Cup (2007) preparations, which involve important public capital outlays. Trinidad and Tobago adopted an expansive fiscal stance facilitated by higher than expected oil prices.

The growth prospects were however overshadowed for most Caribbean countries by the increase in oil prices, adverse climatic conditions, and more specifically natural disasters. The hike in international interest rates that occurred in the latter part of the year was also a contributing factor.

During 2005, oil prices increased 68 per cent mostly due to increased constraints to production and refining capacity as projected demand was scaled down. Reductions in supply are explained by the adverse effects of Hurricanes Katrina and Rita on the Gulf of Mexico, which accounts for 30 per cent of the United States output of oil and natural gas.

The rise in oil prices had adverse effects on the fiscal and external accounts and on prices of net Caribbean oil importers curtailing aggregate output and leading countries to eventually apply restrictive measures in order to redress these imbalances. The increase in the energy bill was the main contributor to import growth and to the widening of the trade and current account imbalances. It also imposed a significant fiscal cost on some economies due to higher utility bills (the Bahamas) and because the pass through into domestic prices of the increase in oil prices was not systematically applied (for example as in the cases of Belize and Grenada). Finally, it translated into higher prices and most important greater inflationary expectations.

Contrarily energy prices generated windfall gains for oil producing countries such as Trinidad and Tobago. In this particular case, the favourable movement of oil prices allowed the government to strengthen its fiscal and balance of payments accounts, adopt expansionary measures and increase output (see Box 1 below).

**Box 1**  
**The impact of the increase in international oil prices on Caribbean economies and the policy response**

The increase in the international price of oil has generated windfall gains for oil producing countries such as Trinidad and Tobago. Contrarily it has imposed significant constraints and losses for the rest of the Caribbean countries, which are net oil importers.

*The impact on oil producing countries: the Case of Trinidad and Tobago*

In the case of Trinidad and Tobago, the rise in oil prices allowed the country to solidify its current account position and strengthen the state of the government's finances. The movement in oil prices increased export receipts and the current account and fiscal surpluses.

The bulk of the fiscal surplus was allocated to the Revenue Stabilization Fund (RSF). The RSF was created in 1999. It is a counter cyclical tool aimed to stabilize fiscal revenue in the face of oil price swings. In 2005, the Trinidad Government announced the creation of a new fund termed the Heritage Stabilization Fund (HSF). The HSF establishes that resources will be allocated to the new fund when fiscal revenues from oil and gas exceed budgeted revenues by at least 10 per cent. In addition withdrawals from the fund can be allocated to serve the more traditional counter cyclical role or be placed in strategic investments. The HSF follows the Norwegian model.

At the same time favourable price conditions of its main mineral resource permitted the Government of Trinidad and Tobago to undertake an expansive fiscal stance as the monetization of the oil revenues financed the non-energy domestic deficit. The budget for FY 2005/2006 contemplates, among other measures, increases in capital expenditure, subsidies and preferential loans for housing, agriculture, reduction in tax rates and increases in exemptions.

In the short run the expansive character of the fiscal stance has increased aggregate demand and the liquidity of the economy forcing the monetary authorities to engage in sterilization operations. However, the increase in expenditure can sustain higher levels of production due to the current and planned expansions of capacity in the oil sector.

At the regional level the windfalls associated with oil prices have allowed the government to establish a petroleum fund in FY 2004/2005 of US\$48 million to provide support to CARICOM countries in the areas of poverty alleviation and disaster rehabilitation.

**Box 1**  
**(continued)**

*The impact on net importing countries and their policy response*

The impact of the increase in the international price of oil hardened the foreign exchange constraint for net Caribbean importing countries. In September 2005, 13 Caribbean countries signed an Energy Co-operation agreement known as Petro Caribe. The agreement supersedes the Caracas Energy Agreement (1999) and its objective is the creation of a common energy policy guided by one regional company (PetroAmerica). The Petro Caribe Initiative will soften the impact of the price hike on the import bill of net importing Caribbean countries. More specifically the agreement is deferred payments arrangements and contains the following financing provisions prefaced on the movement of oil prices in the world market.

Caribbean countries will be able to finance 30 per cent of the oil purchases at an interest rate of 2 per cent over a 15-year period when the price of oil is below or equal to US\$40 dollars per barrel. When the price exceeds US\$40 dollars per barrel countries, these will be able to purchase a greater proportion of their oil (up to 40 per cent) at lower interest rates (1 per cent) and with a longer time frame for interest rate payments (over 25 years with a moratorium of two years on all repayments). If the price of barrel reaches US\$100, Caribbean countries are allowed to finance up to 50 per cent of their oil purchases under the same conditions.

In addition to the hardening of the foreign exchange constraint, net importer Caribbean countries were faced with the decision of whether to increase consumer prices in line with international conditions. Although the response was varied at the general level the pass through was limited. As an example Grenada increased retail oil prices by 15 per cent or close to 30 per cent of the increase in petroleum prices. Similarly in Belize fuel retail prices were increased by 16 per cent but for a longer period (December 2003 to June 2005).

While this created conditions of repressed inflation and postponed the problem it provided some short run relief as the authorities did not undertake major adjustments with concomitant losses in output and employment. However, this policy contributed to erode tax revenues.

The effects of adverse climatic conditions were felt in most economies of the region and reflected in the contraction of agricultural output at the aggregate level. Natural disasters affected Grenada, Guyana and Jamaica, in particular, in the month of February. Guyana was hit by flooding which had a damaging effect on its agricultural production. The damage of the floods was estimated at 12 per cent of GDP and caused a –1.2 per cent reduction in GDP growth.

Grenada and Jamaica were affected by Hurricanes Emily and Dennis. The damages were estimated at 8 per cent of GDP in both cases. In the case of Jamaica the effects of the hurricanes dampened its growth trajectory. In the case of Grenada, however, the destructive effects were not visible in the economy's rate of growth as the government pursued an aggressive policy of capital expenditures to revamp demand and growth.



The increase in international interest rates in the latter part of the year mostly due to inflation fears as a result of the world oil situation, created a widening wedge between the investment returns in assets denominated in domestic currency and those denominated in foreign currency. This, in conjunction with higher inflationary expectations and increased external imbalances, led investors to a process of asset substitution, which created pressures in the balance of payments and foreign exchange markets. Most governments that came under pressure were forced to intervene through contractive measures to ease the foreign currency constraint and defend the exchange rate parities (Barbados, Belize and Jamaica).

## **2. The external sector**

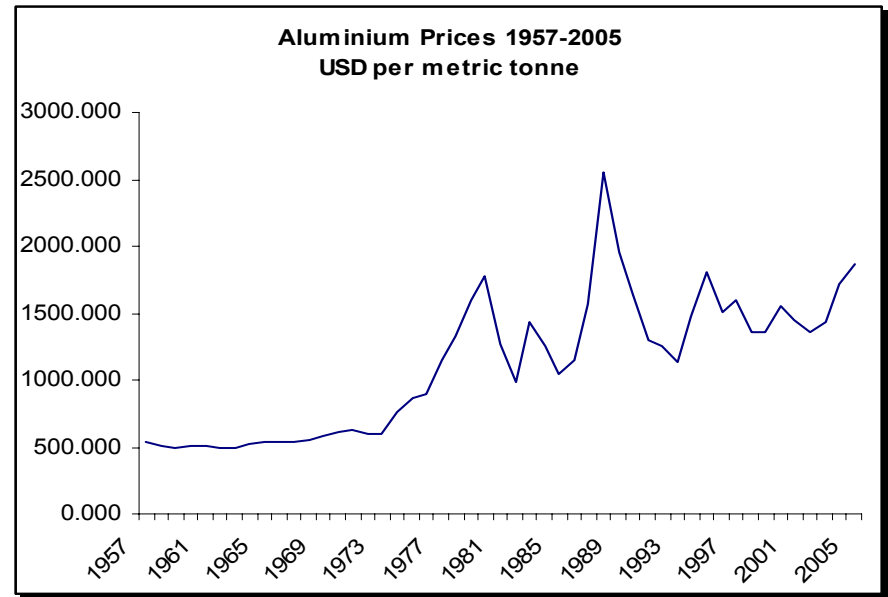
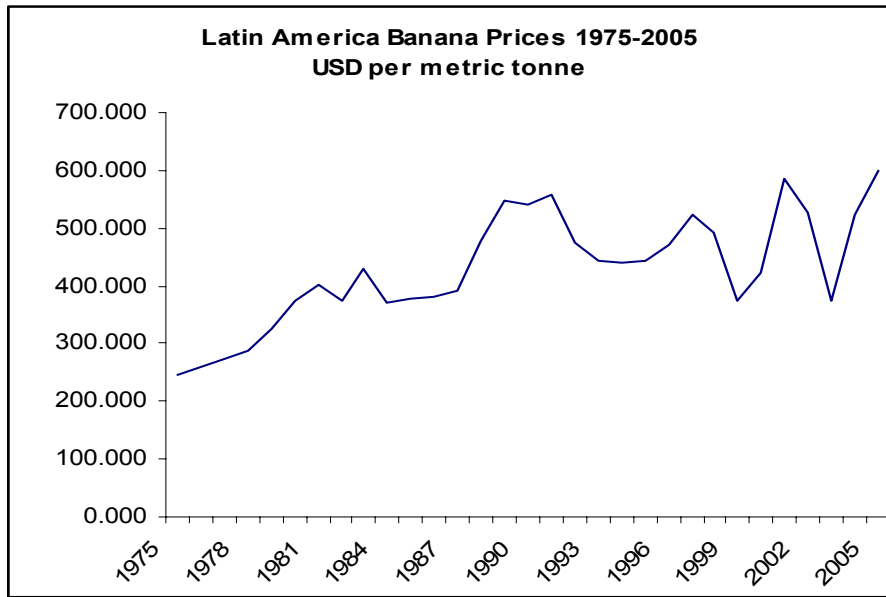
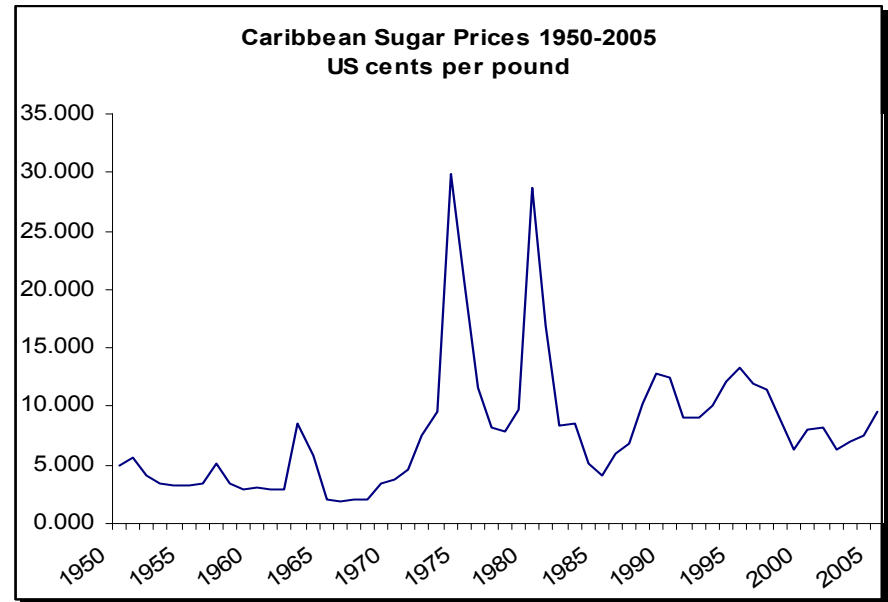
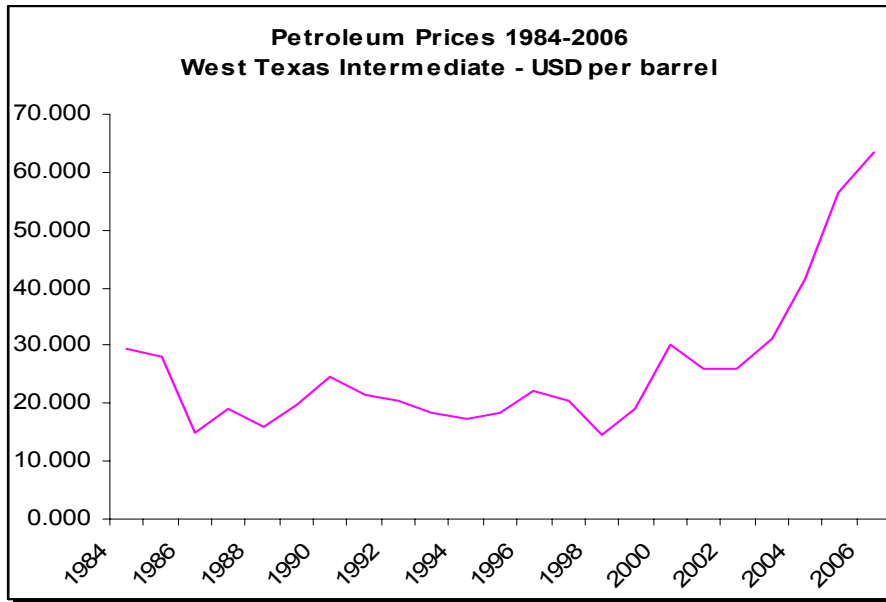
During 2005 the current account widened for most economies. On average for Caribbean countries the current account deficit as percentage of GDP increased from 12 per cent in 2004 to 17 per cent in 2005. The deterioration in the current account is mainly explained by the increase in commodity import growth, which offset the growth of exports of goods and services.

The performance of commodity exports benefited from the increased international price for most fuel and non-fuel commodities including alumina, sugar and bananas (see Figure 2) due to the growth in demand. Countries, however, were not always able to meet the increased demand nor to take advantage of the favourable price conditions.

The Organisation of Eastern Caribbean States (OECS) witnessed a decline in the export of bananas in volume due to adverse climatic conditions, infestation and technical difficulties. Grenada, Guyana and Jamaica export capacity was severely damaged by the destructive effects of natural disasters. For their part, Barbados, Belize and Trinidad and Tobago registered strong increases in commodity exports; more specifically in food and beverage and chemical exports in the case of Barbados; agricultural and fisheries in the case of Belize and petroleum and natural gas in the case of Trinidad and Tobago.

The inadequate performance of commodity exports was amply compensated by the dynamism of export services and in particular of tourism. Tourism performance benefited from favourable external conditions and also from domestic policies to develop and enhance the tourism infrastructure. The strong external demand, the rise in consumer confidence, the depreciation of the US dollar vis-à-vis the Euro, the expansion in airlift and hotel capacity are some of the key explanatory factors. Among Caribbean countries, Belize and the OECS registered the most vigorous expansion in tourism receipts.

Figure 2: Commodity prices



The increase in the energy bill due to the rise in oil prices was the main contributor to import growth. Increased domestic import demand for building materials as a result of the expansion of the construction sector and higher world prices also contributed to this result. Finally the growth of international purchases is also explained by the effects of Hurricanes Katrina and Rita on the prices of imported food and the rise in the cost of transportation.

The external financing gap was narrowed in part by external debt operations (Belize, Jamaica), official grants and aid (OECS, Jamaica), and foreign direct investment flows mainly oriented to the tourism sector (OECS, Bahamas, Barbados).

### **3. Monetary and exchange rate policies**

The monetary stance was for the most part conservative. In the face of growing actual and expected external imbalances, the central banks of the region put in place measures to rein in import demand growth and avoid an unwarranted reduction in foreign exchange reserves. These measures also responded to the growing disparity between foreign and domestic rates of interest, which provide an incentive to hold liquid resources in assets denominated in foreign currency.

Measures included interest rate hikes, reserve requirement changes and the use of reserves. The choice of instrument depended on different circumstances, practices and financial developments of the countries in question.

Barbados and Trinidad and Tobago opted for the first alternative. Barbados increased the minimum deposit interest rate four times during the year in order to encourage savings and discourage expenditure and capital outflows. Trinidad and Tobago increased its key rate (the Repo Rate) four times during the year.

Trinidad and Tobago complemented its interest rate policy with interventions in the foreign exchange market to meet increased demand for United States dollars due to the expansion of import demand and capital outflows due to foreign acquisitions. The Central Bank of Trinidad and Tobago sold an equivalent of US\$104 million in the foreign exchange market.

A similar policy stance was followed by The Bahamas and Jamaica. The Central Bank of The Bahamas sold foreign exchange to the public sector to meet, in part, its electricity bill which increased due to higher fuel prices and to the commercial banking system to satisfy the growth in the demand for credit in foreign currency.

In the case of Jamaica, unfavourable external events in the second half of the year translated in a decline in foreign exchange receipts and heightened inflation expectations. Agents reacted by substituting foreign for domestic currency denominated assets leading to a depreciation in the nominal rate of exchange. The Bank of Jamaica intervened mostly in the foreign exchange market to prop up the external value of the currency and restore investors' confidence in the currency.

**Table 2**  
**Monetary policy in the Caribbean for 2005**

Country	Interest rate changes	Domestic reserve requirements	International Reserves
The Bahamas	None	None	The Bahamas used its international reserves to buy imports and intervene in the foreign exchange market.  The stock of international reserves declined from 667 to 620 million dollars.
Barbados	Change in the minimum deposit rate from 2.25 per cent in April to 4.75 per cent in November.	None	None
Belize	None	Increase in commercial banks reserve requirement by 1 per cent in May.	None
Guyana			
Jamaica	None	None	Jamaica intervened in the foreign exchange market in the second half of 2005 foreign exchange market to stabilize exchange rate movements and restore investor's confidence.  The stock of net international reserves declined from 2,422 to 2,189 between July and November (equivalent to 21 and 19 weeks of goods and services imports).
OECS	None	None	None
Suriname		Increase in reserve requirements for deposits in international currency from 22.5 per cent to 33.3 per cent	
Trinidad and Tobago	Increase in the Repo rate from five per cent in March to six per cent in October.		The Central Bank intervened in the foreign exchange market with the aim of meeting increased demand for foreign exchange.  Notwithstanding, net official reserves increased from US\$ 3 to 4 billion.

Source: On the basis of official information

Changes in reserve requirements was implemented by Belize. Belize adopted the use of quantitative restrictions and increased the minimum reserve requirement by 1 per cent in May 2005. The country also decided to reduce bank liquidity by channelling the receipts of the Social Security Board to the Central Bank of Belize.

Finally the Eastern Caribbean Central Bank (ECCB) did not intervene in the money market. This responded to the fact that that in a currency union the supply tends to adapt to the demand for money.

For the most part countries, that operated on an interest rate basis were not fully successful in achieving their targets. Barbados and Trinidad and Tobago's interest rate increases failed to transmit this stance to the commercial banking system and to reduce the liquidity in the economy.

The increase in interest rates in the case of Barbados provided an incentive for banks to reduce their holdings of treasury bills and their cash reserves. However, even following a three-time interest rate increase in the case of Barbados in the months of January, April and June, domestic credit continued to grow at a significant pace. In the case of Trinidad and Tobago the lack of effectiveness of the interest rate instrument was recognised by the need to implement other measures to tone down the liquidity build-up in the economy.

Contrarily countries using their foreign exchange reserves and quantitative targets (Bahamas, Belize and Jamaica) managed to achieve their goals.

The Bahamas met the foreign exchange demand and reduced its net cash free reserves which in conjunction with greater credit demand led to a rise in lending rates by the banking system. Belize's policy measures resulted in a reduction in private sector credit growth although interest rates did not respond to the tightening of liquidity conditions. In Jamaica the decline in the stock of net international reserves more than offset the expansion in net domestic assets as a result of interest payments on the Central Bank's papers and translated in a contraction in the monetary base. Movements in the money supplies and commercial bank interest rates followed suit.

The conduct of monetary policy and its effects showed that commercial banks' interest rates are sticky and do not respond or respond with a marked lag to changes in the main policy instruments of the monetary authorities whether it be changes in interest rate or reserve requirements. Under these conditions the use of quantitative instruments proved to be an effective monetary management tool.

In addition, the behaviour of monetary variables highlighted the fact that price signals such as the Repo Rate (Trinidad) or the deposit minimum rate (Barbados) do not necessarily cause the intended effects on liquidity and prices. In this sense, the monetary authorities should consider the use of alternative instruments. However, interest rates have an important fiscal impact. In general the treasury bills and the key central bank rates tend to move in tandem and monetary policy objectives are closely linked to those of the fiscal authorities.

Finally, the evidence showed that the use of international reserves is an expedient instrument to restrict credit and abate unwarranted movement in foreign exchange markets. Nonetheless, their use has a significant opportunity cost and a definite limit. In addition, the policy of accumulation of external reserves forces economies into a contractionary monetary stance with the concomitant losses in output and employment.

#### **4. The fiscal performance**

The fiscal performance was characterized by three stylized facts across countries. First, revenues increased in most cases. Second, most countries tried, albeit not always successfully, to contain the expansion of current expenditure. Third, capital expenditures expanded in the case of most countries. Finally, some countries undertook partial fiscal reforms to boost their tax intake and reduce current account pressures while others passed tax reforms to stimulate economic activity (see Table 3 below for a summary of fiscal measures undertaken in 2005).

The positive revenue performance was visible in the evolution of indirect taxation and more precisely in the expansion of international trade and transactions. Such was the case of the OECS member States, Belize, the Bahamas and Barbados. For Trinidad and Tobago the expansion of revenue is attributable to the rise in international oil prices. The Bahamas remained committed to increase its revenue through the improvement of the efficiency of its tax administration. Guyana and Jamaica represent the exception to this trend as both countries experienced decline or contractions in revenue due to the disruptive effects of natural disasters on productive and distributive activities.

The containment of current expenditures was achieved in part by reducing the wage bill such as in the case of Antigua and Barbuda and Dominica, which announced a 20 per cent wage cut for civil servants. Belize announced a reduction in central government employment of 1.5 per cent and froze public wages and salaries as part of its fiscal May package. Other countries such as St. Kitts and Nevis managed to reduce expenditures by the closing of the sugar industry. For their part the Bahamas, Guyana, St. Vincent and the Grenadines increased their current expenditures. Bahamas and St. Vincent and the Grenadines outlays were partly determined by wage increases. In the case of Guyana this responded to the fiscal effects of natural disasters.

Capital expenditures, which rose for most economies reflected the preparations ahead of the Cricket World Cup (2007), which in the cases of Saint Lucia and St. Vincent and the Grenadines are expected to increase by roughly 50 per cent. Also capital expenditures responded to an expansion outlays associated with rehabilitation and recovery operations, as in the case of Dominica, Guyana, Jamaica and Grenada.

**Table 3: Selected Fiscal Measures in 2005**

Countries	Revenue		Expenditure	
	Direct taxes	Indirect taxes	Current	Capital
Antigua and Barbuda	Reintroduction of the income tax.	Five per cent retail sales tax and a seven per cent excise tax.	20 per cent cut in public employment.	
The Bahamas		Implementation of a customs information management system. Increase in tariff exemptions for construction and tourism sectors.	Increase in public sector wages.	
Barbados	Reduction in its tax rate from 40 per cent to 37.5 per cent on taxable income above BD\$24, 200. Increase in personal allowance from \$17,500 to \$20,000.			
Belize		Increase in sales tax rates and in excise taxes on beer, alcoholic beverages, soft drinks and tobacco.	Reduction in central government employment by 1.5 per cent. Freeze on wages and salaries.	Reduction in capital expenditures.
Dominica			Twenty per cent cut in public employment.	Natural disaster rehabilitation efforts.
Grenada	Special levy on income for a five-year period.	Increase by 15 per cent in petroleum retail prices. Increase in excise taxes on alcohol and tobacco.	Natural disaster rehabilitation efforts.	Natural disaster rehabilitation efforts.
Guyana			Natural disaster rehabilitation efforts.	Natural disaster rehabilitation efforts.

**Table 3: Selected Fiscal Measures in 2005 (Continued)**

<b>Table 3: Selected Fiscal Measures in 2005 (Continued)</b>				
Jamaica	Removal of property tax caps.	Increase in excise duty in cigarettes.  Increase the tax rate and base of the General Consumption Tax.	Natural disaster rehabilitation efforts.  Memorandum of understanding between the government and the Confederation of trade unions.	Natural disaster rehabilitation efforts..
St. Kitts and Nevis			Closure of the sugar industry	Closure of the sugar industry
Saint Lucia	Reduction in the corporate tax rate.			Increase by 50 per cent due to World Cup Cricket preparations.
St. Vincent and the Grenadines	Introduction of a business tax credit for small entrepreneurs, and increased the threshold of the standard deduction in the income tax		Increase in public sector wages.	Increase by 50 per cent due to World Cup Cricket preparations.
Suriname				
Trinidad and Tobago	Reform to the system of oil taxation.  Increase in personal allowance.  Unification of personal income taxes to 25 per cent.  Reduction in the corporate tax rate from 30 per cent to 25 per cent.		Subsidies to restructure the agricultural sector.  Subsidies for the construction sector.	Expenditure on strategic investments.
Source: On the basis of official information				



In 2005, a set of countries passed tax measures to strengthen their fiscal positions. Antigua and Barbuda approved a tax package (including the reintroduction of the income tax, a 5 per cent retail sales tax and a 7 per cent excise tax) in order to further reduce the budget deficit and the debt stock. Grenada also attempted to raise its tax revenue by introducing a special levy on income for five years and by improving the efficiency of its public administration. Belize decreed increases in sales tax rates and excise taxes. Finally Jamaica raised the standard general consumption tax rate to 16.5 per cent and the widening of its tax base by the significant reduction in the number of zero-rated items.

Other countries approved tax measures to stimulate economic activity. The Bahamas increased the level of its tariff exemptions in an effort to stimulate activity in the construction and the tourism sectors. Barbados reduced its tax rate from 40 per cent to 37.5 per cent on taxable income above BD\$24,200 Saint Lucia and St. Vincent and the Grenadines introduced measures to lessen the tax burden. Saint Lucia reduced the corporate tax rate. St. Vincent and the Grenadines introduced a business tax credit for small entrepreneurs, and increased the threshold of the standard deduction in the income tax.

## **5. Public debt**

Caribbean countries have some of the highest public sector debt ratios among market emerging economies. At the end of 2004, St. Kitts and Nevis, Guyana, Jamaica, Grenada, Dominica and Belize ranked among the 10 highest indebted market emerging economies.

With the exception of St. Kitts and Nevis and Belize, Caribbean countries with very high indebtedness ratios proceeded to restructure their debt obligations or put in place fiscal measures with the aim of reducing their debt stocks.

While St. Kitts and Nevis did not take any specific measure affecting its public debt, Belize increased its debt stock by placing in March 2005 two bonds in international capital markets worth US\$137 million. However, due to its low levels of credit worthiness, the country was forced to incur charges and financing fees equivalent to 1 per cent of GDP.

Highly Indebted Poor Countries (HIPC) countries such as Guyana and economies that have been hard hit by natural disasters such as Dominica and Grenada have addressed the debt issue by requesting debt relief from the creditors.

Guyana is one the beneficiaries of a recent initiative undertaken by the G-8 (London, 11 June 2005) to cancel the debt owed by 18 HIPC to the World Bank, the International Monetary Fund (IMF) and the African Development Bank.

The initial debt stock write-off for Guyana is equal to US\$337 million owed to both the International Development Association (IDA) and the IMF (US\$249 and US\$88 million, respectively). This represents a reduction of 33 per cent and 35 per cent of the value of the total and multilateral debt stock, respectively, at the end of December 2004. This is equivalent to a decline in the debt stock from 140 per cent to 96 per cent of GDP.

The G-8 agreement will also result in a decline in debt service payments of US\$61 million (US\$49 and US\$12 million in principal and interest) between 2005 and 2010 (see Table 3 above). This is equivalent to 1.2 per cent of GDP on average per year.

Estimates show that between 2004 and 2010 the ratio of external debt service to exports will decrease from 8 per cent to 4 per cent. In the same period the ratio of external debt service to government revenue will decrease from 17 per cent to 13 per cent (assuming that Guyana does not incur new debt obligations).

The G-8 debt write-off will not significantly improve the fiscal outcome for 2005. The fiscal position will deteriorate relative to 2004 even when taking into account the effects of the debt relief on expenditures. Estimations carried out on the basis of IMF and official data indicate that the deficit of the non-financial public sector will increase from -8 per cent of GDP in 2004 to -14 per cent of GDP in 2005 taking into consideration grants (-14.8 per cent to -21 per cent without grants)

Grenada suspended payments on its external debt obligations at the end of 2004 due to the devastation caused by Hurricanes Ivan and Emily in September 2004 and 2005 (200 per cent and 12 per cent of GDP). In September 2005, the authorities announced an offer to exchange new issued bonds denominated in foreign and local currency for the bulk of its external and domestic bonds, commercial loans and guaranteed debt. The new bonds offered have a 19-year maturity period and interest rates that will increase from 0.85 per cent to 8 per cent on an annual basis.

Antigua and Barbuda renegotiated the terms and conditions of its high interest paying debt to domestic banks. The Antiguan Government also managed to normalise gradually its relation with external creditors and to secure a significant debt write off. As a result of the measures pursued by the government, the debt stock, which had been slashed by 50 per cent in 2004 experienced further reduction in 2005. Finally in an effort to improve its debt management and to avoid continued increases in its debt stock, the government re-instituted the National Debt Co-ordinating Committee.

Trinidad and Tobago took advantage of the favourable external environment to its oil industry to reduce its debt stock from 48 per cent to 41 per cent of GDP. The government refinanced its debt obligations denominated in domestic currency by issuing low yield bonds with a value of TT\$800 million and a maturity of 10 years. The government also repaid existing loans.

For its part Jamaica faced its debt problem by targeting a balanced fiscal result prefaced mainly on expenditure control. This depended on authorities and trade unions' compliance with the Memorandum of Understanding (MOU) as well as on the continued decline in interest rates. The MOU is an agreement signed between the government and the Jamaica Confederation of Trade Unions seeking to reduce the wage bill through a two-year policy of public employment and wage restraint effective 1 April 2004 until 31 March 2006.

## **6. Inflation and unemployment**

The rate of inflation increased for most economies. The evolution of prices responded to supply side considerations. These include the increase in the prices of the major import commodities, in particular, oil and construction materials, supply constraints in the agricultural sector, as well as, changes in tax regimes and rises in administered prices.

Jamaica and Suriname registered double digit inflation rates (16 per cent and 17 per cent, respectively) which were the highest for the region. Suriname recorded the greatest rise in prices propelled by the decision of the authorities to suppress, in the month of September for fiscal reasons, the subsidy applied to petroleum prices. Jamaica for its part inherited a double-digit rate from 2003 due to a sharp depreciation in the exchange rate and has not been able to reduce it given the prevailing cost conditions.

To the extent that some countries have not implemented a full pass through from the rise in oil price to consumer prices, the increase in inflation is not commensurate with the international conditions and remains at a repressed stage.

## **7. The state of regional integration**

During 2005 Caribbean Community (CARICOM) countries progressed in the implementation of the CARICOM Single Market and Economy (CSME). The CSME seeks to achieve the articulation of the markets for factors, goods and services in the production and distribution spheres in order to achieve international efficiency and competitiveness. To this end its explicit objectives include the free movement of goods, services, capital and persons; more intensive coordination of macroeconomic policies and economic relations; and the harmonization of laws governing trade and other economic activities within the common market area.

Capital mobility is complementary to labour mobility. Capital mobility is a reality, at least partially, within CARICOM. It may even be asserted that capital mobility is a phenomenon that has occurred with independence of the advancement and progressive implementation of the CSME.

The CSME provisions, as they stand, contemplate only the mobility of certain categories of skilled labour. CARICOM nationals have the right to live and work in any member State without work permits. These categories of skilled labour include university graduates, artistes, sports persons, musicians and media workers.

The provisions for the CSME integration framework are contained in the Revised Treaty of Chaguaramas 2001). The Treaty recognizes the differences in size and development and differentiates between less developed countries (LDCs) and more developed countries (MDCs) (Barbados, Guyana, Jamaica and Trinidad and Tobago) among CARICOM members.

The Revised Treaty of Chaguaramas includes a series of special provisions for the LDCs, which are found in the regime for disadvantaged countries, regions and sectors and in the regime for less developed countries (see Table 4 below). These comprise the establishment of a development fund “for the purpose of providing financial or technical assistance to

disadvantaged countries, regions and sectors.” These provisions are meant to assist these “towards becoming economically viable and competitive by appropriate interventions of a transitional or temporary nature” and to “redress to the extent of the possible any negative impact of the establishment of the CSME.”

<b>Disadvantaged</b>			
	<b>Country</b>	<b>Region</b>	<b>Sector</b>
Size	Less Developed Countries		
Policy implementation	Adverse impact of the operation of the CSME	Economic dislocation from the operation of the CSME	Economic Dislocation from the operation of the CSME
External factors	Natural disasters	Natural disasters	Natural disasters
Development condition	Temporary low levels of development HIPC Status	Temporary low levels of development	

The development fund was officially established in December 2005. In January 2006, six countries (Barbados, Belize, Guyana, Suriname and Trinidad and Tobago) became the first full members of the CSME. The smallest States of the Caribbean, the OECS, are scheduled to join the CSME in the first quarter of 2006.

## **8. Trade negotiations**

During 2005 CARIFORUM economies (CARICOM countries and the Dominican Republic) concluded the second phase of the Economic Partnership Agreements (EPAs) negotiations with the European Union (EU) under the Cotonou Agreement. The Cotonou Agreement was signed between African, Caribbean and Pacific (ACP) countries in 2000.

With the Cotonou Agreement, ACP countries agreed to turn their non-reciprocal trading arrangement into fully reciprocal regional integration areas in the form of EPAs. ACP countries launched negotiations for EPAs in September 2002. The Caribbean region and the EU started the EPA negotiations in April 2004.

The EPAs timetable includes four phases: Phase I of the negotiations which was completed in September 2004 established the objectives of the EPAs. The EPAs are instruments whose objective is to: (i) facilitate the sustainable development and structural transformation of Caribbean economies; and to (ii) strengthen the regional integration process with CARIFORUM.

In accordance, the EPA negotiations are based on four principles. First, the EPAs “support are built upon the regional integration process.” Second, EPAs should promote and be consistent with development objectives and priorities. Third, the EPAs should include special and differential treatment provisions to address the constraints to growth and development

imposed on CARIFORUM countries by their small size. Finally, the EPAs should improve market access possibilities for CARIFORUM exports.

Phase II of the negotiations were completed in September 2005. They had two objectives: “(i) the definition of the economic space assuming commitments under an EPA; (ii) the identification of the regional priorities of CARIFORUM and secure support by Europe to assist with their implementation” (Ibid).

Phase II was termed a “qualified success.” It accomplished the identification of the respective economic spaces that will assume commitments under EPAs. During Phase II the priority areas to be supported by an EPA were also identified. However, tangible support by the European Union to assist with their implementation has not been secured.

Phase III will delineate the bi-regional market access commitments of both parts. More precisely the objectives are threefold: “i) to establish an agreement on the structure of EPA; ii) to consolidate the outcome of the discussion on the priority issues for CARIFORUM regional integration; iii) to define the approach to trade liberalization to be adopted in the negotiations.”

The Phase III negotiations, which will focus on four areas, market access, services and investment, trade-related issues, and legal and institutional issues, will begin *de facto* after the World Trade Organisation (WTO) Hong Kong ministerial meeting (December 2005). The Hong Kong ministerial meeting is bound to provide guidance on developmental issues, such as special and differential treatment, which are fundamental to the EPA negotiating process.

At the same time CARICOM economies also continued their ongoing agricultural negotiations with the EU. These have focused mainly on two products, sugar and bananas. In the case of sugar the EU drafted a proposal reform package (July 2004) whose aim is the reduction in the preferential price for sugar.

The June 2005 package proposal imposes further cuts on the price of sugar. The sugar price would decline by 39 per cent. In addition the current proposal includes the following measures: ‘(i) the EU regime will be prolonged until the end of the years 2014/2015 without a review of price and quota levels in 2008. The quota levels may change thereafter (ii) the proposal does not contemplate any compulsory quota cuts; (iii) a restructuring scheme providing a high degressive per-tone restructuring aid for factory closures and quota renunciation, plus a top-up payment to ensure sugar beet growers the possibility of receiving the full, final direct payment, in the event that they abandon production when the factory with which they have sugar beet delivery rights closes under the restructuring scheme.’<sup>1</sup>

More recently in November the European Union decided to move ahead with a 36 per cent price reduction over the next four years beginning in 2006/2007. Among other measures, the EU also decided: (i) to compensate farmers at an average of 64.2 per cent of the loss due to the price cut; (ii) that countries giving up at least 50 per cent of their quota will receive a payment of 30 per cent for the loss in income up to five years; (iii) the new regime will last until 2014/2015;

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<sup>1</sup> The Commission of European Communities, Reforming the European Union’s sugar policy. Update of impact assessment [SEC(2003) 1022]. Brussels, 22.6.2005. SEC(2005) 808.

(iv) the abolition of the current intervention price system and its replacement by a reference price; (v) to implement a voluntary restructuring scheme lasting four years for EU sugar factories; (vi) the creation of a diversification fund for EU member States where the quota is reduced by a minimum amount.

In the case of bananas the EU decided with due notification to the WTO to replace the existing system of tariff-quotas with a tariff only regime of 230 Euros per metric tons to be applied to bananas from Most Favoured Nation (MFN) countries. Bananas producing countries rejected the tariff and called for WTO arbitration. The decision to move to tariff only regime has not been satisfactory to MFN or ACP countries.

For the European Union the main issue is whether or not the tariff equivalent reduces the market access level provided to MFN countries. MFN countries have argued that the tariff only regime as currently proposed maintains the discrimination against Latin American banana producers. ACP countries on their part have highlighted the difficulty in determining the tariff equivalent of a tariff quota regime. Furthermore, they have argued that the 230 EU per metric ton seriously understates the level of protection provided under the tariff quota regime. Finally, they have noted that there is a margin between the highest level of tariff that the EU could have proposed and the actual level of tariff proposed while at the same time preserving market access for MFN countries.

## **II. COUNTRY REPORTS**

## The Organisation of Eastern Caribbean States (OECS)<sup>2</sup>

### 1. Main trends

The member States of the OECS maintained a rising growth trend (4.1 per cent and 5.6 per cent in 2004 and 2005). Economic activity was spearheaded by construction, tourism and transport.

In spite of the dynamism in economic activity, the OECS fiscal deficit at the aggregate level increased mainly due to rising capital expenditures on activities related to the Cricket World Cup (2007). The fiscal performance was varied at the country level. Some economies took deliberate measures to strengthen their fiscal position from the revenue and expenditure sides. Others adopted an expansive fiscal stance.

The monetary policy did not register any marked changes. The ECCB continued to operate with levels of liquidity well above its statutory requirements. The banking system registered an increase in net foreign assets in consonance with the performance of the foreign earning sector of economic activity.

On the external front the current account deficit widened and offset part of the surplus of the financial and capital account. The current account deficit reflected among other factors rising oil prices and lower volumes of traditional exports products. The surplus on the financial and capital account responded to higher foreign direct investment inflows.

For 2006, the OECS member States are projected to grow by 7 per cent led by construction (21 per cent), tourism (10 per cent), transport (9 per cent) and the recovery in agriculture (3 per cent).

### 2. Economic policy

#### 2.1 *Fiscal policy*

The fiscal deficit of the OECS member States expanded. This performance responded to an increase in capital expenditures that managed to offset the improvement in revenue performance for some of the economies.

Capital expenditures reflected the preparations ahead of the Cricket World Cup (2007), which, in the case of Saint Lucia and St. Vincent and the Grenadines, are expected to increase by roughly 50 per cent. Outlays associated with rehabilitation and recovery operations, as in the case of Dominica and Grenada, also contributed to this result.

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<sup>2</sup> The members and associate members of the OECS are Anguilla, Antigua and Barbuda, British Virgin Islands, Dominica, Grenada, Montserrat, St Kitts and Nevis, Saint Lucia and Saint Vincent and the Grenadines. The analyses in this section refer to all members except the British Virgin Islands.



Most governments contained the expansion in current expenditures. Antigua and Barbuda announced a 20 per cent wage cut for civil servants, while St. Kitts and Nevis decided to close its sugar industry. Dominica is also planning to introduce a 20 per cent wage cut for public employees. Grenada and St. Vincent and the Grenadines opted to expand the wage bill and increased by 8 per cent.

On the revenue side, some OECS member States attempted to strengthen their tax collection. Antigua and Barbuda approved a tax package (including the reintroduction of the income tax, a 5 per cent retail sales tax and a 7 per cent excise tax) in order to further reduce the budget deficit and the debt stock. Grenada also attempted to raise its tax revenue by introducing a special levy on income for five years and improving the efficiency of its public administration.

Contrarily other member States, Saint Lucia and St. Vincent and the Grenadines, introduced measures to lessen the tax burden. Saint Lucia reduced the corporate tax rate. St. Vincent and the Grenadines introduced a business tax credit for small entrepreneurs, and increased the threshold of the standard deduction in the income tax.

The debt situation of the OECS remains a source of concern. Some economies, such as Antigua and Barbuda and Grenada, introduced measures to restructure and reduce their external debt. Others, such as St. Kitts and Nevis, which has one the highest debt to GDP ratios in the OECS, did not take any specific steps to reduce its debt.

Antigua and Barbuda renegotiated the terms and conditions of its high interest paying debt to domestic banks. The Antiguan Government also managed to gradually normalize its relation with external creditors and to secure a significant debt write-off. As a result of the measures pursued by the government, the debt stock, which had been slashed by 50 per cent in 2004 experienced further reduction in 2005.

For its part, Grenada announced, in September 2005, an offer to exchange new issued bonds denominated in foreign and local currency for the bulk of its external and domestic bonds, commercial loans and guaranteed debt. The new bonds offered have a 19-year maturity period and interest rates that will increase from 0.85 per cent to 8 per cent on an annual basis.

## *2.2 Monetary and exchange rate policies*

The economies that make up the OECS formed a monetary union in 1983. Their single currency, the Eastern Caribbean dollar (EC\$), is linked to the United States dollar (US\$) at a fixed rate of EC\$ 2.71. The union's monetary authority, the ECCB, acts as a virtual currency board and is required by its statutes to maintain reserves equivalent to 60 per cent of its monetary liabilities. Ever since the monetary union's inception, the ECCB has maintained a neutral stance and has changed its benchmark interest rate only slightly.

The monetary union has two features that account for this neutral behaviour. On the one hand, the management of external assets and liabilities has enabled the monetary authority to keep its reserves at a level well in excess of the statutory requirement; and on the other, the

commercial banking system complies strictly with its obligation to maintain a balance between assets and liabilities.

During 2005, the OECS member States registered an increase in their net foreign assets prefaced mainly on foreign direct investment flows. At the same time net domestic assets expanded in line with the dynamism of the some of the main sectors of economic activity. In consonance with movements in the asset side, monetary liabilities expanded (19 per cent) reflecting mainly the accumulation in balances in other OECS member States and to a lesser extent the growth of deposits.

In line with the increase in liquidity and the overall improvement in economic performance, credit grew by 9 per cent. Among productive activities, tourism, construction and, to a lesser extent, agriculture accounted for the bulk in commercial bank lending.

### **3. Evolution of main variables**

#### *3.1 Economic activity*

Economic growth in the OECS was led by construction, transport and tourism (22 per cent, 8 per cent and 5 per cent, respectively). Grenada and Saint Lucia registered the highest growth rates (9 per cent and 8 per cent, respectively). Dominica and St. Vincent and the Grenadines registered the lowest rates of growth (3 per cent and 3 per cent).

Agriculture registered a contraction due to the decline in banana production in the Windward Islands, adverse climatic conditions and disease. The virtual stoppage of production in Grenada as a consequence of the devastating effects of Hurricane Ivan, and the decline of sugar production in St. Kitts and Nevis were important contributing factors to the overall performance.

The manufacturing sector recovered and experienced modest growth (2.3 per cent). The overall performance was affected by the increase in costs due to the rise in the international price of oil, firm closures and the contraction in agriculture. At the country level, St. Vincent and the Grenadines witnessed the highest growth rate (4.5 per cent) while Grenada posted a negative rate of expansion (-6 per cent) due to the effects of Hurricane Ivan and Emily.

Construction expanded significantly (22 per cent) due to the start of preparations for the Cricket World Cup (2007), reconstruction and rehabilitation activities associated with natural disasters, ongoing governmental and private infrastructure projects and related to tourism activities.

The performance of tourism activity (5 per cent) responded to continued improved economic performance in the major country developed markets, favourable prices for European tourists as a result of the depreciation of the United States dollar relative to the Euro and the increase in airlift capacity. In spite of these favourable circumstances cruise-ship tourism witnessed a decline due to the reduced number of ship calls and constraints in domestic berthing capacity.

### 3.2 *Prices, wages and employment*

The rate of inflation increased due to the rise in the international price of oil, increased administered prices and the depreciation in the United States dollar relative to other major currencies.

The rate of unemployment moved in consonance with the improved level of economic activity.

### 3.3 *Evolution of the external sector*

The overall balance result worsened (3.34 per cent and 0.84 per cent of GDP in 2004 and 2005) due to the expansion in the current account deficit (17 per cent and 23 per cent of GDP in 2004 and 2005), which more than offset the increased surplus in the financial and capital account (19 per cent and 23 per cent of GDP in 2004 and 2005).

The current account deficit reflected the deterioration of the terms of trade brought about by the increased in the international price of oil, the increase in the demand for building materials due to the construction boom, and the decline in banana production and of agricultural crops. The services account outturn responded mainly to the performance of the travel category and to a lesser extent to that of transport.

The evolution of the income account (8 per cent of GDP for 2004 and 2005) was determined by interest payments on government transactions. For its part current transfers declined (7 per cent and 5 per cent of GDP for 2004 and 2005).

The financial and capital account surplus (19 per cent and 23 per cent of GDP for 2004 and 2005) was driven by foreign direct investment mainly in equity invested in the tourism sector.

## The Bahamas

### 1. Main trends

The economy expanded by 3 per cent in 2005 due to the dynamism of the construction sector sustained by improved tourism performance. Construction reflected the startup activities of new buildings and rehabilitation expenditures related to natural disasters. Tourism recovered from the destructive effects brought about by the natural disasters that hit the island in September 2004.

The moderate expansion in economic activity in conjunction with tax revenue enhancing measures translated to a decline in the central government's deficit (3 per cent and 2.5 per cent in FY2003 and FY2004). The government is aiming to increase the fiscal deficit for FY2005 to 2.9 per cent of GDP.

The improved prospects for the Bahamian economy stimulated strong foreign direct investment and other capital inflows. These fell short of the required finance to close the external gap driven mainly by the import bill. The resulting contraction in the international reserves led to a tightening of liquidity conditions. The contraction of supply of finance jointly with the increased demand for personal loans forced the commercial banks to raise interest rates.

On a different front, the government has progressed with a plan of reforms aimed at solidifying market mechanisms through privatizations, reforms of government institutions and greater outward orientation.

### 2. Economic policy

The economic policy of the Bahamas aimed to reduce the budget deficit and confront, in a sustainable way, the balance of payments imbalance.

#### *2.1 Fiscal policy*

For FY2004 the central government managed to reduce its budget deficit (3 per cent and 2.5 per cent in FY2003 and 2004) mainly as a result of measures to improve the efficiency of the tax administration, the sale of a hotel property and the reception of post hurricane relief aid.

The FY2005 budget is targeting a fiscal deficit of 2.9 per cent of GDP. Recurrent expenditure is forecasted to be 5.5 per cent greater than the projected outcome of FY2004, mainly due to increased pay and benefit expenditure to public servants and related groups. Salaries represent more than 70 per cent of government expenditure.

For their part the evolution of revenues is forecasted to depend on international trade and transaction taxes. Particularly important is the expected rise in stamp taxes prefaced on revenue enhancing measures such as the implementation of the customs information management system.

Overall, preliminary figures for the first quarter of FY2005 point to a reduction in the fiscal deficit relative to the same period in FY2004.

The deficit was financed from domestic sources. As a result the public debt increased (46 per cent and 49 per cent of GDP for 2004 and 2005).

## *2.2 Monetary and exchange rate policy*

Since August 2004, the Central Bank's monetary stance has been more accommodating due to a slight relaxing of lending restrictions.

During 2005, the liquidity conditions of the economy tightened. On the one hand, the demand for credit and in particular for consumer loans increased underpinned by the good performance of the economy. The sectoral breakdown of private sector credit shows that personal loans, which represented 72 per cent of the total, grew 4.5 per cent. Other important components of the demand for credit include residential mortgages and consumer credit. For its part credit to the public sector contracted 10.5 per cent relative to 09/04.

On the other hand, imports increased as a result of the rise in the international price of oil. This included the increase in payments for the fuel used by the Bahamas Electricity Company.

Both factors reduced the domestic and foreign liquidity in the banking system. The net free cash reserves declined by B\$6.5 million while the international net reserves saw a decline of B\$43 million or 13 per cent (for the period January-September 2005). Both factors translated into a contraction in the narrow money supply (-2.1 per cent in September 2005 versus 1.2 per cent for 2004).

Commercial banks responded by raising the average banking spread. Lending rates rose by 66 basis points to 10.69 per cent while the lending rate increased by 2 basis points to reach 3.11 per cent.

## **3. Evolution of the main variables**

### *3.1 Economic activity*

The construction sector saw increased activity during 2005 relative to 2004, in part stemming from heightened activity due to the 2004 hurricane season: the total number of residential (commercial) mortgage commitments increased by 104 per cent (68 per cent) during the first half of 2005 relative to that of 2004, the value of which increased 146 per cent (106 per cent). This positive trend continued due to the 2005 hurricane season, which saw the passage of several hurricanes, in particular Hurricane Wilma and also due to improved growth prospects of the economy.

The tourism sector exhibited weaker performance relative to the previous year. In the first nine months of the year total visitor arrivals declined (-3.1 per cent and 12 per cent in 2005 and 2004). Air arrivals grew by 1.7 per cent while sea arrivals contracted by 5.1 per cent. Grand

Bahama performed worse, with air and sea arrivals down 26 per cent YTD August 2005; this can be in part explained by the reduction in hotel capacity as a result of the damage caused by natural disasters in 2004.

### *3.2 Prices, wages and employment*

The rate of inflation expanded (0.9 per cent and 1.8 per cent in 2004 and 2005, respectively) as a result of the increase in the international price of oil and building materials and higher wages. At the level of its components the evidence available for the third quarter of 2005 shows that most components of the retail price index increased. Medical care and health registered the highest increase and other goods and services recorded the lowest increase 1.2 per cent. Transport and communication, which captures part of the increase in the fuel prices, rose 3.1 per cent.

### *3.3 The evolution of the external sector*

The overall balance-of-payments outcome was negative as the current account deficit (5 per cent and 11 per cent of GDP for 2004 and 2005) more than offset the increase in the surplus in the capital and financial account (6 per cent and 10.7 per cent of GDP for 2004 and 2005). As a result the stock of net international reserves decreased.

The current account deficit widened due mainly to the growth in merchandise imports and to the decline in remittances. The increase in imports responded to the rise in the international price of oil and building materials. Import growth also reflected the reconstruction efforts of the 2004 Hurricane season. For their part exports of goods reflected the decline in crawfish exports and miscellaneous fish, which overshadowed the rise in conch export earnings.

The surplus in the services balance remained at the level of the previous year due to the marginal decline in tourism activity. Unilateral transfers witnessed a decline as a result of the normalization of economic and social activities more than one year after the passage of the natural disasters that affected the Bahamas in 2004.

The capital and financial account increased its surplus to greater inflows of foreign direct investment and other capital inflows. Foreign direct investment inflows responded to the dynamism of the tourism and construction sectors and to the favorable growth expectations of the economy. In particular contributing to this improvement was funding associated with the Cable Beach project

## Barbados

### 1. Main trends

Following fairly dynamic growth of 4.8 per cent in 2004, economic activity slowed in 2005 to 2.8 per cent. Growth in 2005 was bolstered by activity in construction, transport and communication, wholesale and retail trade and to a lesser extent by manufacturing and agriculture.

In spite of the more sluggish demand, inflation picked up in 2005 (1.4 per cent and 3.2 per cent in 2004 and 2005, respectively) propelled by higher fuel prices.

The fiscal deficit remained at the level of the previous year (2.3 per cent of GDP). The fiscal result reflected increases in tax collections in spite of the reduction in personal tax rates and allowances as well as the expansion of capital expenditures due to the preparations for the Cricket World Cup (2007).

During the year existing excess liquidity in the economy prompted the Central Bank to tighten monetary conditions. The monetary authorities raised the minimum interest rate on deposits four times during the year in an effort to attract savings, curb spending and thus reduce the external sector imbalance.

Partly as a result of these measures the current account deficit of the balance of payments remained at the level of the previous year (10 per cent of GDP). However, the surplus in the capital and financial account was insufficient to finance the current account disequilibrium and the economy experienced a loss of international reserves.

In 2006, growth is projected to increase to 3.3 per cent; inflation should moderate to 2.4 per cent and the balance of payments to improve with an overall deficit of 1.2 per cent of GDP.

### 2. Economic policy

During 2005, economic policy focused on the management of aggregate demand to rein in spending and control import growth in order to improve the external position of the country. Economic policy was underpinned by tax increases and contractionary monetary measures.

#### *2.1 Fiscal policy*

For 2005 as a whole, the overall fiscal deficit remained stable within the vicinity of 2.3 per cent of GDP. The fiscal performance reflected increases in tax revenues and capital expenditures.

The behaviour of tax revenues reflected the increase in indirect tax receipts which, jointly with the expansion in the intake from the international business and financial services sectors, offset the decline in personal tax income. In 2005, the government imposed an environmental

levy on used cars, increased the excise tax on larger cars and implemented a three per cent levy on extraregional imports. At the same time the government reduced the highest personal tax rate from 40 per cent to 37.5 per cent and increased personal allowances.

On the expenditure side, the government was able to contain the growth in salaries and wages. The existing three-year public sector contract stipulates an increase of 3 per cent for FY2005/2006, which is below the rate of inflation.

However, transfers and subsidies grew propelled by transfers to the Barbados Tourism Authority and the University of the West Indies (UWI). In the same vein, capital expenditure posted robust growth of almost 12 per cent, associated with outlays on the Cricket World Cup stadium and road works that were fast-forwarded for the World Cup. The deficit was financed on the domestic market to limit the impact of international interest and exchange rate fluctuations.

The deficit was financed from domestic sources. The current public debt stock, which is roughly 85 per cent of GDP has raised concerns and led in August to a downgrading of Barbados long-term foreign, local currency ratings and short-term sovereign credit risk. Notwithstanding, Barbados has raised the ceiling for total loan guarantees to public-owned companies. It also has approved an increase in the level of indebtedness of the Barbados Water Authority.

In 2006, the fiscal deficit is projected to rise marginally to 2.7 per cent of GDP. Growth in total expenditure (2.2 per cent) is expected to outstrip growth in total revenue (0.8 per cent) as disbursements continue for cricket World Cup and roads and other infrastructure works.

### *2.1 Monetary and exchange rate policy*

During the year the monetary authorities adopted a contractive stance in order to curb spending and strengthen the external position of the economy. To this end the Central Bank increased the minimum rate on deposits four times during the year (January, April, June and September) from 2.25 per cent to 4.25 per cent. Available data for the first nine months of the year show that deposits grew 6.4 per cent in 2005 relative to 4.8 per cent in 2004. For their part deposits of official institutions grew by BBS\$159 million.

In the same vein commercial banks absorbed liquidity by reducing their holdings of Treasury bills. The increase in treasury bills brought up their yield, (the average three-month Treasury bill rate shifted upwards to 5.28 per cent from 2.76 per cent for September last year) increasing the servicing cost of the government's debt.

Notwithstanding the contraction in the supply of liquidity, credit demand remained strong. However, interest rates exhibited a marked stickiness. In the first nine months of 2005, credit demand in the non-financial private sector expanded by 13.7 per cent (5.7 per cent in 2004). Viewed from a more detailed perspective, lending to personal, financial and commercial sectors registered the highest growth rates (17 per cent, 34 per cent and 19 per cent for the same period, respectively).



All in all in keeping with the monetary stance and the reduction in the rate of growth of the economy the movements in money supply reflected these developments broad money increased by around 7 per cent (to 85.3 per cent of GDP) in 2005 following robust growth of 17 per cent last year.

### **3. Evolution of the principal variables**

#### *3.1 Economic Activity*

In 2005 economic growth slowed in 2005 to 2.8 per cent and thus closer to its trend level. This follows an above average recovery last year. The impetus for growth in 2005 came from the construction, transport and communication and commercial sectors.

The agricultural sector benefited from the positive outlook of the sugar industry (11 per cent) bolstered by favourable external and climatic conditions. Contrarily non-sugar agriculture declined.

The performance of construction (7 per cent) is explained by the demand for residential housing, the Cricket World Cup (2007) preparations and road works.

The manufacturing sector improved its performance due the pull-effects of the construction sector and increased output in beverages, chemicals and tobacco.

Wholesale and retail activity and transport and communication (2.7 per cent and 4.4 per cent) were buoyed by dynamic consumer demand, especially for mobile telephones and the dynamism of the construction sector.

Unfortunately, tourism activity declined by over 4 per cent compared with growth of over 12 per cent during the first three quarters of 2004. Visitor arrivals from Canada, a price sensitive market and also the United Kingdom were down on average by about 9 per cent. For the whole of 2005, tourism is projected to decline by about 3 per cent, suggesting some improvement in the last quarter.

#### *3.2 Prices, wages and employment*

Inflation picked up significantly compared with the similar period last year, propelled by high fuel prices (1.4 per cent and 3.2 per cent in 2004 and 2005, respectively). Higher prices of construction materials and imported food (due to the effects of Hurricanes Katrina and Rita on the United States agricultural output) were additional contributing factors.

With continued GDP growth, unemployment fell to 8.9 per cent, from 9.6 per cent in the first half of 2004.

### 3.3 *The evolution of the external sector*

During 2005 the external position of the Barbadian economy deteriorated. The surplus registered by the capital and financial accounts did not manage to offset the current account deficit which remained at the level of the previous year (10 per cent of GDP) As a result the country registered a decline in international reserves.

The current account result reflected the improvement in exports of food, beverages, and chemicals, which managed, notwithstanding the decline in tourism receipts, to partly offset the increase in imports. The latter responded to higher prices for oil, construction materials and imported food items.

The performance of tourism responded in part to a reduction in airline capacity, the effects of Hurricanes Rita and Katrina on the United States, and the preference of international cruise liner for shorter cruises due to the energy costs. The available evidence indicates that receipts in both long-stay and cruise ship arrivals declined.

The surplus in the capital and financial account responded to higher levels of foreign direct investment in the tourism sector as short-term capital inflows decreased.

## Belize

### 1. Main trends

Economic performance in 2005 is expected to reach 3 per cent, down from 4.6 per cent registered in 2004. Relatively strong growth performance in the first half of the year (4.4 per cent), led by healthy increases in fishing, wholesale and tourism, was counteracted by a slowdown in the second half. Agriculture was negatively affected by a drought, leading to a decline in sugar and banana production. Tourism expanded, yet at considerably lower rates than in the past.

During the year the government's major concern was the avoidance of a balance of payments crisis as a result of the high and unsustainable levels of indebtedness and to maintain the exchange rate parity. To this end, the government implemented both fiscal and monetary measures to rein in the growth in spending.

On the fiscal side the government passed a reform to reduce its deficit, from 8 per cent of GDP in FY2004/2005 to a range of 3 per cent to 4 per cent of GDP in FY2005/2006. The fiscal reform includes increases in a series of taxes to boost revenue coupled with a wage freeze and completion of projects to contain the growth in expenditure.<sup>3</sup>

At the same time the monetary authorities increased commercial bank's reserve requirement ratio in an effort to curb liquidity and absorption.

Partly as a result of these measures and due to higher prices for major export commodities and tourism inflows the deficit in the current account contracted notwithstanding the growth of imports due to the increase in the international price of oil. The deficit was financed by external debt. In order to mitigate the adverse effects of the increase in the international price of oil which were felt also in the rate of inflation (4 per cent), the government signed in the month of September a final agreement on the Petro Caribe initiative with Venezuela (See Regional Overview). In the realm of other areas Belize concluded a 'partial scope agreement' with Guatemala, covering principally goods. This will come into effect in April 2006.

### 2. Economic policy

Economic policy was aimed at the reduction of the current account deficit which has been the main source behind the increase in the stock of external debt in recent years (roughly 90 per cent in GDP in 2005). To this end the government adopted austere fiscal and monetary policies.

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<sup>3</sup> FY denotes fiscal year. The fiscal year runs from April to March. All figures, unless otherwise noted, are denoted in Belizean dollars. The official rate of the Belizean dollar to the US dollar is held at BZ\$2: US\$1.

## 2.1 *Fiscal policy*

The fiscal deficit widened in FY2004/2005, overshooting the expected deficit of 3 per cent considerably (reaching 8.7 per cent). In FY2005/2006 the government sought to reduce the fiscal deficit to 3 per cent of GDP and passed a series of measures to increase tax revenues and reduce expenditures.

In May, the government increased the sales tax rates, and the excise taxes on alcoholic and non-alcoholic beverages. At the same time it reduced public employment by 1.5 per cent and implemented a wage freeze and proceeded to finalize several capital projects. The effects of these measures have been deemed insufficient to comply with the government's objectives and the forecasted deficit for FY2005/2006 has been increased to 3.6 per cent of GDP.

The latest available figures for the first seven months of the FY2005/2006 show an increase in current revenue and little change in total expenditure. The latter is explained by a rise in current expenditure that was offset by a decline in capital expenditure. The level of expenditure and revenue will also be affected by the re-nationalization of Belize Water Services, which was financed through a loan from Taiwan.

During the year, Belize maintained a similar level of external indebtedness to that of the previous year (90 per cent of GDP). The country issued two bonds in international capital markets totalling 137 million US\$ (14 per cent of GDP) which allowed to finance the external debt. Due to the high level of risk of Belize, fees and charges corresponding to the placement of bonds reached 1 per cent of GDP.

## 2.2 *Monetary and exchange rate policy*

Monetary policy was tightened during 2005 whereby the reserve requirement was increased by 1 per cent in December 2004 and May 2005. In addition the authorities channelled the deposits of the Belize Social Security Board from the commercial banking system to the Central Bank.

The consequent decline in commercial bank liquidity (since the beginning of 2005 statutory liquidity levels fell by BZ\$25 millions) was reflected in the slowdown in credit growth to the private sector (8 per cent and 3 per cent in 2004 and 2005). Credit to the primary sector contracted (1.4 per cent) due to repayments in marine and various agricultural subsectors; credit to secondary and tertiary sector expanded marginally (2.2 per cent and 1.4 per cent, respectively). The commercial banking system responded by increasing the deposit rate and lowering the lending rate. This allowed the banks to build up its liquidity while at the same time providing a stimulus to loan demand.

Despite the decline in net domestic credit, a large increase in net foreign assets allowed the money supply to expand in line with the rates registered in the previous year (8 per cent). These inflows of foreign exchange were a result of increased loan disbursements and funds from the sale of Belize Telecommunications Ltd (BTL) shares.

During the year the monetary authorities also unified the exchange rate system. In July the multiple exchange rate system operational in Belize since 2002 was restricted with the closure of ‘cambios’ licensed to sell at rates up to BZ\$2.15:US\$1.

### **3. Evolution of the main variables**

#### *3.1 Economic activity*

GDP increased by 3 per cent, owing largely to increases in fishing, wholesale and tourism (hotels and restaurants).

The agriculture sector contracted due to a decline in sugar and molasses production resulting from a decline in sugar deliveries due to drought. Banana production also declined due to unfavourable weather.

The contraction of these two sectors was too large to be compensated for by other positive developments in the sector. Citrus saw significant increases, with the largest crop yet in 2004/2005 at 7.8 million boxes in total due to improved fertilization and control of pests. For their part, marine exports increased 9 per cent, with expanded shrimp production.

Tourism continued its upward trend, albeit at a considerably lower rate than that registered in previous years. In the period covering January to October total stayovers rose (3 per cent) while cruise ship arrivals declined (-1.0 per cent). This is a reaction to the effects of the 2005 hurricane season on the southern United States.

#### *3.2 Prices, wages and employment*

The consumer price index increased (3.1 per cent and 3.5 per cent in 2004 and 2005) with increases measured in all subcomponents. The behaviour of prices was determined by the increased costs of energy and imported food and by the tax measures implemented by the government as a part of the May package. The authorities have not allowed internal prices to fully reflect the sharp increases in the international price of oil.

At the component level, food, beverages and tobacco increased most (6.3 per cent higher) due to an increase in the cost of imports from the United States and in response to higher transportation costs (5.9 per cent) and utility costs (4.5 per cent) due to increases costs of electricity imports from Mexico.

Unemployment fell 0.6 percentage points to 11.0 per cent over the 12 months to April 2005.

#### *3.3 The evolution of the external sector*

The global balance was positive (4 per cent of GDP) as the current account deficit was more than offset by the increase in the surplus in the capital and financial accounts. As a result the economy improved its international reserve standing.

The current account deficit narrowed (-14 per cent and -11 per cent of GDP for 2004 and 2005, respectively) as the growth of exports of goods and services partially offset that of imports. The performance of exports improved mainly due to the increase in the international price of some of Belize major export commodities. The expansion of imports was determined by the energy bill and most importantly by the rise in the purchases of capital goods (23 per cent between January and October 2004 and 2005).

The surplus on the capital and financial accounts reflected the placement of bonds in the international capital markets and increased privatization receipts.

## Guyana

### 1. Main trends

Economic growth declined in 2005 relative to 2004. Real GDP is projected to decline by 2.9 per cent in contrast to the marginal growth registered 1.6 per cent last year. Economic activity was down due to the adverse effects of the February floods on agriculture and, in particular, on sugar and rice. The total damage of the floods was estimated at 12 per cent of GDP. The most affected sectors included housing, agriculture and transport.

The shortage of domestic food supplies after the flood jointly with higher oil prices pushed up the rate of inflation to 6 per cent.

The Central Government's deficit increased markedly due to the effects of the recovery and rehabilitation operations and the interruption of income flows associated with the natural disaster, the increase in the price of oil, and the rise of expenditures related to the Skeldon Sugar factory. The deficit was financed with official assistance aid.

Monetary conditions remained stable throughout the year as reflected in moderate money growth and a marginal depreciation of the nominal exchange rate. Efforts to stimulate economic activity through a decline in interest rates managed to stimulate the demand for credit.

For its part, the overall balance of payments improved. The current account worsened to over 25 per cent of GDP (9 per cent in 2004), but was more than offset by net capital inflows and official aid flows related to debt relief.

In June 2005 the G-8 group of developed countries decided to cancel the debt owed by 18 HIPC to the World Bank, the IMF and the African Development Bank. Guyana is one of the beneficiaries of this initiative. The G-8 agreement will reduce the debt stock of Guyana and reduce debt service payments by 1.2 per cent of GDP over the next 10 years (see regional overview).

In 2006, real GDP is projected to recover with growth of about 4 per cent bolstered by construction and recovery in agriculture. The overall budget deficit is projected to decline marginally to 13 per cent of GDP.

### 2. Economic policy

#### 2.1 *Fiscal policy*

The fiscal deficit increased (5 per cent and 13 per cent in 2004 and 2005) as a result of a reduction in tax revenues coupled with an expansion in capital expenditures. Revenues were affected by the interruption in the production and distribution processes caused by the floods. This effect was however mitigated by the G-8 debt write-off, which represented a decrease in debt obligation payments of 0.5 per cent of GDP.

The rise in capital expenditure responded to repairs and maintenance following the floods to facilitate the recovery process and to curtail the fall-out in economic activity. The outlays on the Cricket World Cup stadium and on the Skeldon sugar factory were also an important contributing factor. The expenditure on the sugar factory is part of an effort to modernize and render competitive the sugar sector which remains in terms of output and employment the backbone of the economy.

The available data shows that central government debt increased from G\$64,438 million in June 2004 to G\$69,203 as at June 2005. Future external debt and debt service is set to decline with the recent the Organization for Economic Cooperation and Development (OECD) debt relief.

## *2.2 Monetary and exchange rate policy*

Monetary policy was aimed at the management of excess liquidity in the banking system to ensure price stability, improved credit to the private sector and exchange rate stability.

As at the end of September 2005, broad money recorded a substantial increase of over 27 per cent, in contrast to a decline of over 7 per cent for the similar period in 2004. Growth in broad money was buttressed by the increase in savings deposits.

On the asset side of the monetary accounts, domestic credit expanded by almost 30 per cent, for the first three quarters of the year, relative to growth of roughly 9 per cent last year. This led to a reduction banking sector liquidity and credit to the private sector increased by over 6 per cent to G\$50,869 million. A welcomed outcome was the 10.6 per cent growth in credit to agriculture as producers sought to restore production after the floods.

The expansion in credit was brought about in part by the decline in interest rates. These fell on average for the period September 2004 to September 2005. The weighted prime lending rate declined from 16.84 per cent to 16.38 per cent, while the commercial bank's lending rate fell from 14.08 per cent to 8.81 per cent.

The net foreign assets of the banking system declined slightly by less than 1 per cent after strong accumulation (20.7 per cent) in 2004. Growth in commercial banks net foreign assets to purchase foreign sovereign bonds was offset by the decumulation of the Bank of Guyana's foreign assets. The exchange rate depreciated marginally in the first eight months of the year of 2005 as the strong foreign exchange demand was met by existing foreign exchange reserves. In August 2004, the bilateral exchange rate with the United States averaged 199.8 and it increased to 200 one year later.



### **3. Evolution of the main variables**

#### *3.1 Economic Activity*

Real GDP contracted by 2.9 per cent in contrast to marginal growth of 1.6 per cent last year mainly as a result of the effects of the floods on the major sectors of the economy. Among the productive sectors, agriculture concentrated a significant part of the damage.

The contraction in agriculture (15 per cent) affected in particular the sugar and rice subsectors. For the first half of the year, sugar output stood at 86,906 tonnes, only 27.2 per cent of the projected target for the year. For 2005 as a whole, sugar production is expected to decline significantly by over 20 per cent compared to a 7.6 per cent growth in 2004. The flood inundated a number of important sugar fields and reduced the sucrose content of harvested canes; this was compounded by strikes and worker absenteeism.

Contrarily the mining sector which was the least affected by the floods recorded important gains. Bauxite output is projected to pick up by almost 13 per cent (to 1,729,277 metric tonnes) as a result of increased capacity use and favourable external conditions.

The expansion of the construction sector reflected the growth of public investment in infrastructure projects. Manufacturing and forestry also improved their performance. The evolution of manufacturing reflected higher levels of productivity. The behaviour of forestry responded in part to increased levels of investment in the sector and was visible in the expansion of logs and round wood production.

#### *3.2 Prices, wages and employment*

Inflation is expected to rise from 5.5 per cent in 2004 to 6 per cent in 2005. Impetus for higher prices have stemmed from higher fuel prices, domestic food shortages in the aftermath of the flood and the growth in the money supply.

#### *3.3 The evolution of the external sector*

The overall balance of payments registered a surplus of (US\$3.1 million), driven by robust net capital inflows, which more than offset the increase in the current account deficit (9 per cent and 25 per cent of GDP in 2004 and 2005). The evolution of the current account responded on the one hand to the contraction in rice and sugar exports as a consequence of the floods. On the other, imports posted strong growth driven by consumption, intermediate and capital goods and more particularly by the increased cost of fuel and building materials.

## Jamaica

### 1. Main trends

Jamaica's performance improved with respect to the previous year (0.9 per cent and 1.4 per cent in 2004 and 2005) but was severely dampened by external shocks, including two hurricanes (Dennis and Emily) and higher international oil prices. Mining and construction were the main contributors to economic growth.

The external shocks and low growth negatively affected the fiscal accounts challenging the objective of a balanced budget by the end of FY2006<sup>4</sup>. Nonetheless the government remains committed to a substantial reduction in the budget deficit as the means to reduce the stock of debt.

The management of monetary policy, whose focus was placed on lowering interest rates to spur growth and lessen interest rate payments on the debt, was challenged by the reduction in foreign exchange receipts due to the decline in net export earnings and most important in net private capital flows. The latter responded to a higher interest rate differential between the United States and Jamaican dollar denominated assets and higher than expected inflation (16 per cent on point-to-point basis). The Bank of Jamaica intervened in the foreign exchange market to stabilize exchange rate movements and restore investor confidence.

For 2006, Jamaica is projected to grow at 3 per cent led by the expected recovery in agriculture, mining and, to a lesser extent, tourism. A balanced budget and the reduction in interest rates will remain the key policy objectives. It is expected that the Petro Caribe initiative will lessen, partially, the pressure of rising oil prices on the external accounts and alleviate the foreign exchange constraint by converting 40 per cent of the oil import bill into short-term loans. Also Jamaica and Venezuela signed a bilateral Memorandum of Understanding to improve the capacity of the Petrojam refinery.

### 2. Economic policy

The main objective of economic policy is to reduce the debt stock, which is deemed to be unsustainable. To this end the government committed itself to achieve a balanced budget for FY 2006 on the basis of wage controls and reduction in interest rates. The external shocks have however challenged the achievement of this objective.

#### *2.1 Fiscal policy*

For FY2006, the authorities had planned to achieve a balanced fiscal result prefaced mainly on expenditure control and to a lesser extent on the increase in tax revenues. The former goal depended mainly on authorities and trade unions' compliance with the Memorandum of

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<sup>4</sup> FY2006 denotes the fiscal year running from the 1 April 2005 to the 31 March 2006.

Understanding as well as on the continued decline in interest rates. The increase in tax revenues depended on the change in the general consumption tax rate and the widening of the tax base.

In spite of fiscal compliant monetary and labour policies, the government will not achieve the announced fiscal target due to the effects of external shocks mainly on revenue collection and to a lesser extent on expenditure. The low level of activity has been a contributing factor in the revenue shortfall.

In the first two quarters of the fiscal year (April-September) revenue collection fell by 8.8 per cent below target. In response, the government curtailed current and capital expenditures and managed to stay under the planned budgeted amount by -4 per cent. However, the effect of expenditures associated with disaster relief, rehabilitation and reconstruction activities will be fully felt in the upcoming months.

The government plans to end the year with a deficit of close to 1 per cent of GDP, which is not expected to question the credible commitment of the authorities to a balanced budget. This target is essential for the reduction in the stock of debt, which stands at 136 per cent of GDP and whose management absorbs more than 60 per cent of government expenditure. Once the balanced budget is reached the government is planning to run a surplus in order to create a contingency fund to address the potential effects of unforeseen events.

## *2.2 Monetary and exchange rate policies*

Monetary policy was expansionary in the first eight months of the year and switched thereafter to a more conservative stance.

Guided by a favourable environment the Bank of Jamaica lowered its interest rates on its tenors with a view to enhance private sector credit growth and the expansion of economic activity. Lower interest rates also had a favourable impact on the state of public finances by lowering interest payments on domestic denominated debt.

Unfavourable external events in the latter part of the year translated in a decline in foreign exchange receipts and heightened inflation expectations. Agents reacted by substituting foreign for domestic currency denominated assets leading to a depreciation in the nominal rate of exchange (J\$61.63 and J\$62.89 for October 2004 and 2005 for the bilateral exchange rate between the Jamaican and the United States dollar).

The Bank of Jamaica adopted a cautious stance and intervened mostly in the foreign exchange market to prop up the external value of the currency (and to a lesser extent in the domestic market through open market operations). As a result the stock of foreign reserves declined (2.2 and 2.1 million in June and September 2005) while the spectrum of interest rates managed to remain on a similar plateau (12.75 for Treasury Bills since May 2005).

The decline in the stock of net international reserves more than offset the expansion in net domestic assets as a result of interest payments on the Central Bank's papers and translated in a contraction in the monetary base. Movements in the money supplies followed suit (23 per cent

and 5 per cent for 12 month growth rates for September 2004 and 2005 for M1 including foreign currency deposits).

For its part commercial banks lending activity expanded (14 per cent for 2005). The credit expansion responded to declining real rates of interest as a consequence of rising inflation and to the required financing for construction and refurbishment of the tourism industry affected by the natural disasters.

### **3. Evolution of main variables**

#### *3.1 Economic activity*

The rate of growth increased with respect to the previous year. The path of economic expansion was led by construction activity, mining and, to a lesser extent, tourism.

The performance of agriculture (-11 per cent) reflected unfavourable climatic conditions. The sector was negatively affected by a drought in the first four months of the year and also suffered the destructive impact of Hurricanes Dennis and Emily in the month of July. Agriculture is projected to recover and grow by 7 per cent in 2006.

The behaviour of manufacturing (0.6 per cent) was affected by the poor performance of agriculture, high production costs and by low levels of competitiveness. The sector is expected to grow by 2 per cent in 2006.

The mining sector recovered (5.0 per cent) in relation to the previous year. The recovery, partly hampered by flood rains associated with Hurricanes Dennis and labour disputes, responded to the increase in the average capacity utilization of alumina and bauxite plants. The sector's performance also benefited from foreign direct investment flows. Mining is expected to grow by 6 per cent in 2006.

Construction sector activity (eight per cent) was influenced by the dynamism of residential and non-residential construction. The most important determinants included increased housing starts due to improved access to loans, recovery and reconstruction activities following Hurricanes Dennis and Emily, and higher cement production. The sector is expected to remain on its growth curve reaching five per cent in 2006.

Tourism (2 per cent) witnessed a decline in the number of stopover and cruise arrivals as a result of greater price competition from other destinations and the interruptions in tourism services caused by natural disasters. The sector is projected to grow by 3 per cent in 2006.

#### *3.2 Prices, wages and employment*

The rate of inflation remained at the two-digit level (16 per cent). Its level was determined by a concatenation of factors. These included increased transportation fares, fuel prices, utility rates, tuition fees, and the contraction in supply as a result of the impact of Hurricanes Dennis and Emily. The increase in the general consumption was also a contributing

factor to the overall hike in prices. The highest monthly rates of inflation were recorded in the months of May and especially September (2.2 per cent and 2.6 per cent, respectively).

Higher inflation resulted in lower real wages forcing the government to amend the Memorandum of Understanding between the Government and the Jamaica Confederation of Unions. The amendment (September 2005) provides for the payments of allowances to public sector employees as well as the option to reschedule their loan repayments.

The rate of unemployment (12 per cent in April 2005) reflected mainly a seasonal pattern of employment in some sectors as well as the effects of external shocks on some of the main productive sectors. Community, social and professional services, wholesale and retail, hotels and restaurants, agriculture, and construction account for the largest shares in the labour force (27 per cent, 24 per cent, 17 per cent, and 10 per cent, respectively).

### *3.3 Evolution of the external sector*

The result of the global balance deteriorated leading to a decline in international reserves (9 per cent and 2 per cent of GDP for 2004 and 2005). This resulted from the expansion in the current account deficit (6ix per cent and -9 per cent of GDP in 2004 and 2005) and the reduction in the financial and capital account surplus due to the decline in net private capital inflows.

The current account deficit is explained by the growth in merchandise imports and the decline in exports of goods and services. The evolution of imports (44 per cent and 45 per cent of GDP) responded to increased oil prices. The performance of exports of goods and services was negatively affected by the destructive effects of the natural disasters that affected the country in the latter part of the year.

The capital and financial account result responded to a higher international interest rate differential and heightened inflationary expectations. Both of these factors detracted foreign investment while at the same time stimulated local investors to switch from domestic to foreign currency denominated assets.

## Suriname

### 1. Main trends

The Surinamese economy moderated its rate of expansion following the strong upsurge of the previous year (7.8 per cent and 5.2 per cent in 2004 and 2005). The construction and mining sectors were the main contributors to economic growth.

The good performance of the economy jointly with the hike in petroleum and administered prices bolstered tax revenues and allowed the government to record a surplus in its fiscal accounts. At the same time, as a result of the tax measures the inflation rate increased substantially from 9 per cent to 17 per cent.

In a context of strong growth and rising inflation the monetary authorities opted to defend the exchange rate parity by imposing measures to contain the increase in the demand for foreign currency.

For its part the balance of payments recorded a negative result due mostly to the rise in imports, in particular of petroleum products, and notwithstanding the increase in foreign direct investment flows in the mining sector.

During the year, the incumbent President Venetian was re-elected as a result of the inclusion of a greater number of political parties within the governing political coalition. The newly re-elected authorities have announced their intentions of maintaining the present course in the management of economic policy. However, they have indicated the undertaking of an expansionary fiscal policy in 2006 as a result of higher planned capital expenditures.

### 2. Economic policy

During 2005, the government strengthened the state of its public finances while at the same time implemented measures to protect the exchange rate parity of the domestic currency.

#### *2.1 Fiscal policy*

The central government registered a small surplus (0.8 per cent of GDP) as the increase in revenues managed to offset that of expenditures.

The evolution of revenues responded to the strong growth of the economy and in particular of imports, the sharp increase in fuel prices decreed by the government in September as well as the increase in electricity fixed tariff rates (August), in the price of transportation (59 per cent in September) and gas (28 per cent in October).

As in the case of most governments in the region, the pass through from international to domestic fuel prices was limited. The taxation of petroleum products includes four components: an import duty, a turnover tax, a road levy and a variable petroleum consumption tax. The petroleum consumption tax is the difference between the pump price and the landed cost plus a mark-up meant to finance transportation and distribution. The government followed a policy of

fixing the difference between the pump price and landed costs and subsidised oil companies allowing them to cover the landed cost and mark-up.

The sharp increase in the price of oil reduced the difference between the pump price and the landed cost and mark-up and thus reduced the tax revenue from the petroleum tax while at the same time increasing subsidy payments.

The behaviour of total expenditures reflected mainly the increase in capital outlays. The latter responded to the expansion of infrastructure projects. Current expenditures contracted as the rise in the purchase of goods and services and wages was more than offset by the contraction in current transfers.

For 2006, the government plans to adopt an expansive fiscal stance and the fiscal result will turn negative and expand to 6 per cent of GDP. This will result from a substantial increase mainly in capital expenditures and to a lesser extent in current expenditures.

## *2.2 Monetary and exchange rate policies*

Monetary policy was directed at maintaining the stability of the pegged exchange rate regime.

The increase in inflation coupled with a higher interest rate differential between assets denominated in domestic currency and those denominated in foreign currency led to an increase in the demand for foreign currency. The anticipation of capital losses induced a process of substitution between foreign and domestic currency.

The Central Bank opted to curb the demand for foreign currency and mitigate the reduction in foreign net assets and at the same time stimulate the demand for domestic currency. To this end it increased legal reserve requirements for foreign currency deposits for commercial banks from 22.5 per cent to 33.3 per cent while at the same time did not change the legal reserve requirement for domestic deposits (30 per cent). The adoption of this measure stimulated the supply for loans in domestic currency relative to those denominated in foreign currency.

The monetary stance was reinforced by the amendment of the Central Bank Act (May 2005) which imposed additional restrictions on Central Bank lending to the government avoiding thus future monetization of budget deficits.

All in all the said measures managed to rein in the demand for foreign currency and the nominal exchange rate fluctuated marginally. It depreciated marginally from 2.75 to 2.80 Surinamese dollars per United States dollar in March and reverted its tendency to record a slight appreciation to 2.78 in May.

### **3. Evolution of main variables**

#### *3.1 Economic activity*

The economy registered strong growth albeit at a lower pace than that of the previous year (7.8 per cent and 5.2 per cent in 2004 and 2005). The rate of economic expansion was led by construction and mining sectors.

The construction sector (11 per cent) was bolstered by the dynamism of the economy and the increase in capital expenditures. The recent measure allowing commercial banks to use part of their legal reserve requirement to finance real estate loans is also a contributing factor.

The performance of the mining sector (9.8 per cent) reflected, in the case of gold and petroleum products, lower costs as a result of improved methods of production, the creation of additional capacity and petroleum, and the stimulus provided by the increase in the international price of most metal and fuel products. For its part alumina production was hampered by technical difficulties notwithstanding favourable external demand conditions.

Agriculture (2.0 per cent) recovered as a result of the implementation of improved technical methods and favourable climatic conditions. The main State-owned rice company is subject to a process of privatization which should be completed in 2006 and seek to increase the efficiency and productive potential of the subsector.

#### *3.2 Prices, wages and employment*

The rate of inflation increased sharply reaching double digits (9 per cent and 17 per cent between January-August 2004 and 2005) mainly as result of the hike in oil prices. The increase in utility rates, bus fares and gas as well as the rise in the international price of construction materials were important contributing factors.

During the year, nominal wages were not adjusted to reflect the price increase and as a result their purchasing power deteriorated.

For its part available labour data show that unemployment registered a decline in Paramaribo and Wanica from 9 per cent to 8 per cent in line with the growth prospects of the economy.

#### *3.3 Evolution of the external sector*

The available data shows that the global balance was negative. The current account deficit widened (US\$138 and 235 million in 2004 and 2005, respectively) due to the significant surge in imports relative to exports. This is explained in turn by the higher energy bill and the rise in the international price of building materials.



The capital and financial account also posted a negative result in spite of the rise in foreign direct investment in the mining sector. This is reflected in the decline of the stock of net foreign assets held by the commercial banking system.

## Trinidad and Tobago

### 1. Main trends

The economy of Trinidad and Tobago continued its impressive growth performance of 2004. The current energy boom has contributed significantly to growth of output, revenue and foreign exchange inflows. Unlike previous booms (1970s and 1980s), which were based mainly on high prices the current boom is based on a combination of high prices, recently discovered large reserves of oil and natural gas and expansion in the liquefied natural gas subsector. Diversification within the energy sector has reduced the heavy dependence on the oil subsector. However, economic sustainability, especially the sustainability of fiscal policy, in the event of decline in oil prices and/or the exhaustion of energy reserves depends on growth and development of the non-energy sector.

The government registered a surplus for FY2004/2005<sup>5</sup> and is expecting a positive result for FY2005/2006. The government fiscal activities benefited from the upward trend in oil prices. The government has introduced a series of tax measures for the FY2005/2006 including the reform of the oil tax system, the reduction in the corporate rate and a flat tax rate for personal income. In addition it contemplates several measures to provide tax relief for middle-income earners as well as to stimulate productive sectors.

For their part the monetary authorities adopted a contractive stance to reduce the existing levels of liquidity. The Central Bank opted to increase the Repo Rate on several occasions and complemented this measure by interventions in the foreign exchange market.

The balance of payments registered a positive result as the surplus in the current account more than offset the deficit in the financial and capital account. As a result the stock of international reserves increased. The performance of the current account is attributed mainly to the expansion in energy products.

### 2. Economic policy

During 2005, economic policy combined an expansive fiscal stance with a restrictive monetary policy. The government profited from the existing favorable conditions to implement a series of new tax measures and reforms and stimulate the development of the economy. For their part the monetary authorities confronted a situation of excess liquidity with increases in interest rates and interventions in the foreign exchange market.

#### 2.1 *Fiscal policy*

The central government posted a surplus for FY2004/2005 equivalent to \$300 million as a result of the higher than expected increase in the price of oil. The bulk of the surplus was transferred to the revenue stabilization fund. The fiscal performance also allowed the government to reduce its debt stock from 48 per cent to 41 per cent of GDP. As a result, the long-term foreign and local currency sovereign rating was upgraded.

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<sup>5</sup> The fiscal year runs from October to September.

For FY2005/2006 the government expects to reap windfall gains associated with the continued upward trend in international petroleum prices and adopted as a result an expansionary fiscal stance. Total revenue is budgeted to reach TT\$34,129 million while expenditures are projected at TT\$34,199 million. The estimates are prefaced on a price of oil of US\$45 per barrel in the case of revenues and on a price of oil US\$35 per barrel for revenues.

Oil revenues are projected to increase from TT\$11.1 billion in FY2004/2005 to TT\$18 billion in FY2005/2006. Part of the increase in oil revenues is attributed to the introduction a new tax regime for petroleum products. Contrarily, non-oil revenue is expected to decline during FY2005/2006 as a result of the reduction in income and corporate taxes announced in the 2006 budget. It should increase over the longer term in line with enhanced revenue from the energy sector.

The FY2005/2006 contemplates the reduction in the tax corporate rate to 25 per cent excluding petrochemical and energy companies whose tax rates will remain at 35 per cent and 55 per cent. Regarding the income tax rate the government plans to introduce a flat tax of 25 per cent, which will replace the personal income tax rates of 25 per cent and 30 per cent. These measures are aimed at providing tax relief (estimated at 1.7 TT\$ billion on a net basis) for middle-income earners.

The government is also contemplating reducing excise duties on petroleum products and at the same time increasing the wholesale price for gasoline. This measure seeks to improve efficiency in the distribution and sale of petroleum products.

Public expenditure is estimated to increase to 27 per cent GDP in FY2005/2006 largely as a result of increased spending on wages and salaries (19 per cent) and on transfers and subsidies (34 per cent). The non-energy deficit is therefore expected to increase from 8 per cent GDP in FY2004/2005 to 15 per cent GDP in FY2005/2006. Increased public expenditure is still based on revenue intake from the energy sector although it is expected that reform of the non-energy tax regime would provide a more sustainable source of revenue. Government expenditure has been focused on large public sector construction projects (new government buildings and upgrade to existing buildings) as well as on low cost (affordable) housing development. Through its expenditure measures the government also plans to stimulate manufacturing production and set the basis for a turnaround in agriculture.

## *2.2 Monetary and exchange rate policy*

Monetary policy shifted from its accommodating stance in response to inflationary pressures experienced from the start of 2005. The Repo rate was increased by 25 basis points to 5.25 per cent in March 2005 and further to 5.50 per cent in July, 5.75 per cent in September and 6.00 per cent in November 2005. In line with this increase was the rise in commercial bank prime lending rates from 8.75 per cent at the end of 2004 to 9.50 per cent. The monetary authorities also postponed the planned reduction in the reserve requirement by 2 per cent as a part of a policy that seeks to gradually reduce the costs of financial intermediation.

Liquidity has remained high due mainly to increases in fiscal spending. Credit expansion and the rise in imports have also been contributing to current liquidity pressures. Private sector credit grew by four percentage points (to 15.7 per cent) over the year ending August 2005. Commercial bank credit to consumers experienced the largest increase (26.4 per cent) followed by real estate mortgage (40.5 per cent) and credit to business (8.5 per cent).

The Central Bank increased its open market operations to manage the increase in liquidity. Net sales of securities increased from an average of US\$14 million per month in fiscal 2004 to US\$41.4 million per month in fiscal 2005. Nevertheless, the continued buildup of liquidity is challenging the Central Bank to seek novel ways of absorbing liquidity. Increases in the Repo Rate have had limited effect on key market rates such as the inter-bank rate and actual commercial bank lending rates. Although the Repo rate has been increased four times for the year the inter-bank rate has fluctuated within a narrow band of 4.12 per cent to 4.31 per cent.

Sales of foreign exchange (US\$87 million) by the Central Bank during the first 10 months of 2005 reflected an 80 per cent increase in demand over the previous period. Total sales for 2005 are projected to increase to US\$104 million. Increased demand for foreign exchange has been driven by the increase in imports, capital account transactions and fiscal spending. Capital outflows in relation to foreign acquisitions and sovereign and other bond placements totaled US\$498 million in 2005.

Despite the pressures in the foreign exchange market the exchange rate has remained stable and broadly competitive. Nevertheless, the trade weighted real effective exchange rate has appreciated since 2004.

### **3. Evolution of the main variables**

#### *3.1 Economic Activity*

GDP growth expanded from 6.2 per cent in 2004 to 7 per cent for 2005 and is projected to rise further to 8 per cent in 2006. This growth is due largely to the prevailing high prices for oil and gas on the international market and the increase in output and value added in the energy sector.

The production in the energy sector is expected to rise as a result of increased use of productive capacity. Part of this will result from the commissioning of new plants in the petrochemical sector and also from the start up of Train IV which will increase gas utilization and significantly increase gas output.

The non-energy sector also improved its contribution to growth by an estimated 5.6 per cent compared with 3 per cent in 2004. Construction has been the main driver of growth (8.1 per cent) in this sector as a result of ongoing, and the start-up, of infrastructure projects.

Although agriculture continued to decline (-0.5 per cent) its performance was an improvement over 2003 (-18.2 per cent) and 2004 (-21.1 per cent). It partly reflects the

normalization activities following the closure of operations of Caroni Limited (1975) and also adverse climatic conditions as well as technical and labour related difficulties.

The performance of the manufacturing sector responded to the growth in food beverages and tobacco, poultry and chemicals. The rise in the expansion of the chemical subsector responded to the rise in the demand for cement in line with the expansion of the construction sector.

### *3.2 Prices, wages and employment*

The economy has been subject to inflationary pressures since the beginning of 2005. The annual average rate of inflation increased from 4 per cent in 2004 to 5.3 per cent in 2005 slightly overshooting the upper limit (5 per cent) of the Central Bank's inflation target.

Food prices were the main contributor to the rise in the inflation rate. They increased from an average of 13 per cent in 2004 to an average of 23 per cent in 2005. The reduction in import duties on a number of food items, aimed at lowering food prices, is still awaiting approval from the CARICOM Secretariat. The increase in the price of construction materials (from 6.4 per cent in 2004 to 11.3 per cent in 2005) also contributed to the rise in inflation.

For its part employment increased due to growth in construction and expansion in the energy sector, which resulted in job creation of 5,500 and 2,600 jobs, respectively. However 5,400 jobs were lost in agriculture and manufacturing. The net additional jobs (2,700) and the decline in the labour force (4,400) resulted in a fall in the unemployment rate to 8 per cent. The rate is expected to fall below 8 per cent during FY2005/2006.

### *3.3 The evolution of the external sector*

During 2005, the overall result of the balance of payments was positive as the current account surplus managed to offset the deficit registered in the capital and financial account. As a result the stock of international reserves expanded.

The current account of the balance of payments improved (16 per cent and 17 per cent of GDP for 2004 and 2005) mainly as a result of increases in the price and volume of petroleum products. Non-energy exports also improved albeit at a lower pace. The performance of non-energy exports reflects the fact that the Trinidadian economy has lost competitiveness relative to its major trading partners since 2004.

The evolution of imports responded to the rise in the price of imported food and building materials. Increased investment in the energy sector and the concomitant repatriation of profits by foreign owned firms, also contributed to the overall result of the current account

The current account surplus was partly offset by the rise in the deficit of the capital and financial account one the hand as a result of increased long and short-term capital outflows. On the other hand the economy registered a slowdown in foreign direct investment inflows.

## **STATISTICAL ANNEXES**