Eastern Caribbean Currency Union (ECCU)[1]

During 2007, the eight economies of the Eastern Caribbean Currency Union (ECCU)[2] are expected to grow by 4.3% (weighted average). However, this figure hides huge differences among countries, from the booming economy of Anguilla, expanding by 11.9%, to the recessive phase in Montserrat, whose output dropped by 2.7%. Hurricane Dean, which hit in August, caused serious damage. A major economic policy concern continued to be the high levels of public debt in most countries, with four posting debt-to-GDP ratios above 100%.

The countries of the ECCU can be divided into three groups according to their growth rates in 2007. The first group, the rapid-growth countries, includes Anguilla (11.9%), Saint Vincent and the Grenadines (6.6%) and Antigua and Barbuda (6.1%). In the first country, growth was led by the tourism sector, especially the luxury segment. In the other two, the dynamic performance was driven by tourism-related construction. The second group, countries with moderate growth, includes Saint Kitts and Nevis (3.5%), Grenada (3.1%) and Saint Lucia (2.2%). The third group comprises the stagnant and recessive countries, Dominica (0.3%) and Montserrat (-2.7%). In this latter group, growth performance was highly influenced by natural disasters: Hurricane Dean in the former country, and volcanic activity in the latter.

The states of the ECCU continued to show high levels of public debt. Particularly worrisome is the case of Saint Kitts and Nevis, whose debt-to-GDP ratio exceeds 175%, placing it among the world's most indebted countries. Although no new external debt has been contracted for the last three to four years, public debt has continued to grow owing to the issuance of domestic debt. The latter currently accounts for almost two thirds of total debt in Saint Kitts and Nevis, more than half in Antigua and Barbuda, and around one third in Saint Lucia and Saint Vincent and the Grenadines.

In July 2006 the Eastern Caribbean Central Bank (ECCB) set the target for a debt-to-GDP ratio below 60% by 2020. This implies a significant fiscal adjustment on the part of the highly indebted countries. Given the downwards rigidity of public spending owing to the high share of debt service, salaries and wages, and other functioning outlays in public spending, most of this adjustment should be done by increasing tax revenue. In that light, Dominica introduced VAT in March 2006 and Antigua and Barbuda in January 2007. Likewise, most countries have changed the methodology for estimating the property tax base from annual rental value to market value, which should have a positive impact on the tax take.

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1 The *Preliminary Overview of the Economies of Latin America and the Caribbean* usually contains a chapter entitled "Member countries of the Organization of Eastern Caribbean States (OECS)". The source for these data is the Eastern Caribbean Central Bank, which is the monetary authority of the Eastern Caribbean Currency Union. All the OECS members except the British Virgin Islands are members of this Union. As the statistical information refers to the member countries of the Union and not of OECS —in other words, it does not include the British Virgin Islands— from this year onward, the chapter will be entitled "Member Countries of the Eastern Caribbean Currency Union".

Monetary policy focused on supporting the currency, which has since July 1976 been pegged to the United States dollar at a rate of 2.7 Eastern Caribbean dollars (EC$) to one United States dollar. Interest rates remained fairly constant, with the discount rate kept at 6.5%, whereas nominal deposit and lending rates were 4.2% and 10.2%, respectively.[2] As regards monetary aggregates, M1 expanded by 8.9% in the year to June as compared to 8.2% recorded in 2006. Meanwhile, domestic credit to the private sector grew by 21% during the first quarter year on year, three percentage points more than in 2006, reflecting more dynamic demand during the Cricket World Cup. Annual inflation is estimated at 3.5%. The convergence of the inflation rate in ECCU with United States levels is crucial, given its peg to the dollar. Any increase in domestic prices above United States inflation would mean a real exchange rate appreciation and thus a loss of competitiveness that would harm export activities as well as import-competing sectors.

Tourism is the main economic sector and the most important foreign exchange earner in ECCU countries. In 2007, numbers of stopover visitors decreased in most of the countries, with the exceptions of Anguilla and Grenada, where they grew by 22.2% (January-March, year on year) and 16.5% (January-May, year on year), respectively. On the contrary, in Saint Lucia —the main tourism destination of the subregion— stopover arrivals decreased by 9.2% in the January-May period year on year. This is explained by the disruption of normal tourism activities generated by the Cricket World Cup, hosted in the subregion during the first quarter, together with the decrease in inter-islands flights owing to the informal merger of airlines LIAT and Caribbean Star, which eroded competition and increased fares sharply. In addition, the introduction of passport requirements by the United States government for its own nationals also negatively affected the tourism sector. Cruise-ship passenger numbers are expected to increase, based on preliminary figures up to June 2007 which recorded a 13.2% increase over the same period in 2006.

Activity in the construction sector is expected to decline owing to the completion of major infrastructure projects related to the Cricket World Cup. As a result, value added in this sector is projected to grow by 5.9% compared with 11.9% in 2006. The manufacturing sector is expected to increase by 0.6 percentage points over 2006, driven by expansions in Saint Kitts and Nevis and Grenada.

EASTERN CARIBBEAN CURRENCY UNION (ECCU): MAIN ECONOMIC INDICATORS

	2005	2006	2007 [a]
	Annual growth rates		
Gross domestic product	5.8	7.1	4.3 [b]
Consumer prices	4.6	1.4	3.5 [c]
Money (M1)	10.1	8.2	8.9 [d]
	Annual average percentages		
Overall public sector balance / GDP	2.6	-4.6	...
Nominal deposit rate	3.2	3.3	4.2 [e]
Nominal lending rate	10.2	9.9	10.2 [e]
	Millions of dollars		
Exports of goods and services	1 893	2 281	...
Imports of goods and services	2 546	3 230	...
Current account	-705	-948	...
Capital and financial account	632	1 122	...
Overall balance	-16	92	...

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary estimates.
[b] Weighted average.
[c] Simple average.
[d] Twelve-month variation to June 2007.
[e] Twelve-month average to April 2007.

Hurricane Dean had a strong impact on Dominica, where more than 90% of production (banana crops) was destroyed. In Saint Lucia, the damage was less intense but still considerable. Although the Windward Islands Crop Insurance scheme will compensate most producers for their losses, financial distress will nonetheless be important as it will take at least one year to have a new harvest. More importantly, the future of the Caribbean banana industry is uncertain, as the European Union is evaluating its preferential banana quotas allocated to Africa-Caribbean-Pacific (ACP) countries. These have been challenged within the World Trade Organization (WTO) by Ecuador, Colombia and the United States.

The external sector deteriorated in 2007 owing to less dynamic exports in agriculture and lower-than-expected demand for tourism services. Together with high import volumes associated with large construction projects and high international oil and food prices, this led to an increase in the current account deficit. A main source of foreign capital continued to be FDI in the tourism sector, especially in Anguilla, Saint Kitts and Nevis and Saint Lucia. In addition, official grants for reconstruction in Dominica and Saint Kitts and Nevis rose in the third and fourth quarters in the aftermath

2 Interest rates in the currency union are set at the discretion of commercial banks, except for the minimum interest rate for savings, which is set by the ECCB.

of Hurricane Dean. All in all, the balance of payments is likely to register a small surplus, but lower than in 2006 (US$ 92 million).

There are a number of economic policy concerns in the near future. One is the worsening conditions in the United States economy. This could have a negative impact in tourist arrivals from that country.[3] Second, without any preferential treatment in the European Union, the ECCU banana industry will be severely challenged by competitors such as Ecuador and some Central American countries. Third, public finance will be very restricted given the magnitude of debt service in most countries. Furthermore, to achieve the goal of reducing debt-to-GDP ratios to below 60% by 2020 most governments would need huge primary surpluses without jeopardizing economic growth. Finally, the ECCU economies will continue to be vulnerable to natural disasters such as hurricanes, earthquakes and volcanic activity. In this regard, the Caribbean Catastrophe Risk Insurance Facility established in the wake of Hurricane Dean could play an important role in mitigating the effects of such events and provide funding for reconstruction.

[3] However, the net effect is uncertain as difficulties in the United States economy are behind the significant depreciation of the dollar against the euro and the pound. This should foster tourist arrivals from Europe.