EASTERN CARIBBEAN CURRENCY UNION

1. General trends

In 2010, economic activity in the Eastern Caribbean Currency Union (ECCU) contracted by 2.4%, a more moderate decline than the 6.5% slump recorded in 2009. This protracted downturn was due to the continued negative effects of the global economic and financial crisis. With the exception of Saint Vincent and the Grenadines, where economic activity contracted further, and Dominica, which registered minimal positive growth of 0.06%, all other member countries of the ECCU slower rates of GDP contraction than in 2009. The overall fiscal deficit narrowed from 4.7% of GDP in 2009 to 1.5% of GDP as many countries curtailed capital expenditure. In fact, a number of countries implemented some degree of fiscal consolidation. The high level of public-sector debt continued to be a major challenge, especially given the small size of these economies. The total debt-to-GDP ratio was 83.9% in 2010, slightly higher than in 2009 (82.9%). Monetary policy remained virtually unchanged as there were no adjustments to the main policy rates. The current account deficit shrank in 2010 to 18.8% of GDP compared with 21.9% of GDP in 2009, reflecting a further decline in imports due to the recession throughout the ECCU area. Based on preliminary estimates, economic activity is expected to rebound by 3.2% in 2011, driven by increased tourism and construction activity, as well as utilities and other service. This growth will be spearheaded by the economies of Saint Kitts and Nevis, Saint Lucia, and Saint Vincent and the Grenadines.

Despite the prospects for positive economic activity in 2011, the economies remain vulnerable to natural disasters, as evidenced by Hurricane Tomas in the last quarter of 2010, which caused substantial damage in Saint Lucia and Saint Vincent and the Grenadines. Meanwhile the establishment by the Organization of Eastern Caribbean States of the Eastern Caribbean Economic Union will provide the economies with more space and scope for effecting economic transformation.

2. Economic policy

(a) Fiscal policy

Fiscal policy in 2010 was contractionary as most governments, guided by the Eight Point Stabilization and Growth Programme of the ECCI Monetary Council, underwent some degree of fiscal consolidation. As a result, the overall fiscal deficit diminished from 4.7% of GDP in 2009 to 1.5% of GDP in 2010. Total revenue increased by 4.3% to 27.0% of GDP as current revenue, which fell by 8% in 2009, picked up slightly (by 1.7%) to stand at 23.7% of GDP in 2010. This improvement was due to a 27.2% rise in non-tax revenue, boosted mainly by land sales concluded as part of a housing strategy. Even though total revenue was higher, tax revenue declined by 1.2%. While total tax revenue and tax revenue on incomes and profits decreased, the introduction of a value added tax in Grenada and in Saint Kitts and Nevis of 15% and 17%, respectively, contributed to a marginal 3.2% increase in tax revenue from sales of domestic goods and services. Grant receipts were up by 25%. Total expenditure contracted by nearly 7% to stand at 28.5% of GDP following declines in both current and capital expenditure (1.3% and 28.4% respectively). The substantial reduction in capital expenditure was in line with the fiscal consolidation strategy. The marginal decline in current expenditure was due to lower outlays on goods and services, interest payments, and transfers and subsidies despite a 0.9% increase in outlays on wages and salaries, which reflected retroactive payments to civil servants in Saint Lucia and Saint Vincent and the Grenadines. The primary balance shifted from a deficit of 1.7% in 2009 to a surplus of 1.5% in 2010. On an individual country basis, the overall fiscal deficit improved in all countries except Saint Kitts and Nevis and Saint Vincent and the Grenadines, which reported deficits of 4.2% of GDP and 3.5% of GDP, respectively. Dominica recorded an overall fiscal surplus of 1.4% of GDP.

In 2011, fiscal policy will continue to be guided by the Eight Point Stabilization and Growth Programme, which is designed to strengthen fiscal stability, address the challenges of the financial sector and stimulate economic activity through effective implementation of the Public Sector Investment Programme (PSIP). Projections for 2011, based on national budget estimates, indicate that Antigua and Barbuda will record an overall fiscal deficit of 1.5% of GDP for fiscal year 2011/2012, as the country enters the second year of its fiscal consolidation programme backed by the International Monetary Fund (IMF). Saint Kitts and Nevis will see an increase in its primary surplus to 8% of GDP for the fiscal year 2011/2012, as the value added tax introduced in November 2010 begins to yield higher levels of revenue, while other fiscal measures will keep a lid on expenditure. Dominica will record a smaller primary surplus of 2% of GDP for the fiscal year 2010/2011, as the country aggressively implements its PSIP. Grenada's overall fiscal deficit will widen to 6.7% of GDP, following a substantial increase in capital expenditure to spur economic growth and generate employment.

The Debt Management Advisory Services Unit, a part of the Eastern Caribbean Central Bank (ECCB) established in 2009, continued to provide technical support to member countries during 2010. Part of this support included the formulation of debt management strategies, which laid out objectives and planned for effective debt management. In 2010, total public-sector debt increased slightly to 83.9% of GDP from 82.9% of GDP in 2009 (52% external and 48% domestic). External debt increased by 7.5% to 43.8% of GDP, reflecting increased borrowing, primarily from IMF, the Caribbean Development Bank and the European Investment Bank. On the other hand, domestic debt decreased by 6% to 40.1% of GDP, primarily because of debt repayments by Antigua and Barbuda. The total debt-to-GDP ratio increased in all countries with the exception of Antigua and Barbuda, which is currently subject to an IMF Standby Arrangement. In 2011, debt will continue to increase as countries continue to borrow to support economic activity. Saint Lucia and Saint Vincent and the Grenadines benefited from IMF Rapid Credit Facilities of US$ 8.19 million and US$ 3.26 million, respectively, in the first quarter of 2011. Saint Kitts and Nevis reached an agreement in principle with the IMF on a US$ 84 million Stand-by Arrangement over 36 months in June 2011.

(b) Monetary and exchange-rate policy

The ECCU monetary policy stance remained unchanged during 2010. The focus was on maintaining the stability of the financial system and the credibility of the currency peg at EC$2.7 to the United States dollar. The central-bank-administered interest rates (the discount rate and the savings deposit rate) remained unchanged (at 6.5% and 3%, respectively). The commercial banks' average nominal deposit rate remained at 4.5%, while the nominal average lending rate increased slightly from 10.8% in 2009 to 11.2% in 2010.

Owing to sluggish economic activity, growth in broad money was minimal at 1.8% in 2010, approximately the same rate as in the previous year. M1 was down by 0.5%, reflecting declines in both the currency held by the public and demand deposits. Credit to the private sector rose by about 2% to 88.9% of GDP in 2010, a rate similar to that in 2009, but substantially lower than the growth rates of 10% in 2008 and 38% in 2007. The highest allocation of private sector credit was for household uses, namely home and land purchases, home construction and renovation, and other personal loans. The ECCU member governments became net creditors to domestic banks during 2010, reversing the trend of being net borrowers. This reversal was offset by a substantial increase in governments' external debt during the course of 2010.

In 2010, the ECCU continued to address a number of developments in the financial system which unfolded in 2009. The Bank of Antigua, which was on the brink of failure, was purchased by the Eastern Caribbean Amalgamated Bank, which began successful operations in October 2010. The National Bank of Saint Vincent and the Grenadines had been experiencing liquidity problems and was restructured as the government divested its majority shareholder status by inviting new capital to invest through the East Caribbean Financial Holdings Company Ltd. A number of countries established Financial Services Regulatory Commissions and enacted new insurance legislation to allow for better supervision of the non-bank financial sector. Some progress, though slow, has been made in tackling issues relating to the collapse of the Colonial Life Insurance Company Limited and the British American Insurance Company. The property portfolio of the latter was sold to Caribbean Alliance Insurance Company in 2010 and the British American Insurance Company Health Insurance Support Fund was launched in May 2011.

3. The main variables

(a) Economic activity

The economic and financial crisis continued to have a negative impact on the economies of the ECCU in 2010. Construction, one of the key productive sectors of the economy, contracted by 20.5%, almost the same rate as in 2009. This decrease was due to the limited availability of foreign financing, reduced inflows of foreign direct investment and a reduction of approximately 28.4% in public capital expenditure. Declines were also recorded in mining, which is closely associated with the construction sector as the main materials extracted are sand and gravel. Wholesale and retail trade, transport, storage and communication and financial intermediation also declined. The agricultural sector, which contributes about 4% to GDP, contracted by 6.3%. This sector is a significant foreign exchange earner for the economies of Dominica, Grenada, Saint Lucia, and Saint Vincent and the Grenadines. The setback in the agricultural sector was mainly due to pest infestation and drought at the beginning of the year and to Hurricane Tomas during the last quarter. Saint Lucia and Saint Vincent and the Grenadines suffered hurricane damage to their banana subsector, with production losses of 88.0% and 27.2%, respectively. In Grenada, nutmeg production slumped by 45%. On a positive note there was a slight increase (2.5%) in livestock farming. Manufacturing output contracted by 5.4% and makes up roughly 4% of GDP. The exception was Grenada, which saw growth in manufacturing output by 15% while all other countries experienced a decline.

The tourism sector, another key economic sector of ECCU, contributed roughly 9% of GDP. Activity in the tourism sector, proxied by hotels and restaurants, increased by 2.7% in 2010 compared with a contraction of 9.7% in 2009. Stay-over visitors, who comprise the higher end segment of the tourism market, increased by 3.4%, compared with a reduction of 12% of 2009. Stay-over visitors from the United States and Canada increased by 12.7% and 14.2%, respectively, while stay-over visitors from the United Kingdom and the Caribbean were down by 6.4% and 5.2%, respectively. Cruise visitors declined by nearly 6%, compared with an increase of 19% in the previous year.

(b) Prices, wages and employment

Inflation increased in 2010 (December to December) to 2.2% from 1.2% in 2009, owing mainly to escalating food prices and higher costs of fuel and electricity. The inflation rates varied between countries; the highest rates were recorded in Grenada (4.2%) and Saint Kitts and Nevis (3.9%). In Grenada, the higher prices were due to the initial effects of the introduction of the value added tax. In Antigua and Barbuda there was a slight rise in inflation from 2.4% in 2009 to 2.9% in 2010 due to the reduction in the number of zero-rated items under the Antigua and Barbuda sales tax regulations. The inflation rate averaged 2% in Dominica, Saint Lucia, and Saint Vincent and the Grenadines.

Dominica increased the minimum hourly wage rate of non-established workers from EC$ 5.00 to EC$ 5.77 per hour with effect from April 2011. This measure will guarantee that all "non-established" workers who work a minimum of 40 hours per week receive no less than EC$ 1,000 a month. In Saint Vincent and the Grenadines, public servants were granted a 3% salary increase in January 2010. The unemployment rate rose slightly in Saint Lucia from 18.1% in 2009 to 20.6% in 2010. Grenada's recent labour survey showed an unemployment rate of 29% in 2010.

(c) The external sector

The sluggish state of the ECCU economies contributed to a slight improvement in the balance-of-payments current account deficit. The deficit narrowed from 21.9% in 2009 to 18.8% in 2010 or US$ 960 million. This reduction is attributable to a fall in imports due to weaker domestic demand. This drop in imports caused the trade deficit to diminish by 3%, to US$1,674 million. Export earnings also fell by 2.3% due to lower volumes of domestic exports, principally bananas, nutmeg, soap and rice.

The surplus on the services account increased by nearly 9% to US$ 705 million or 13.4% of GDP, thanks to a 5.4% rise in travel receipts as stay-over tourist demand increased by 3.4%. Meanwhile, the capital and financial account surplus narrowed by 16.5% to stand at US$ 1.09 billion or 20.7% of GDP (including errors and omissions). This decline was due to a 16% drop in capital transfers to the government. Foreign direct investment also contracted by 17% to US$ 576 million, or 11% of GDP, owing to a reduction in equity inflows into the tourism sector. The balance on the current and capital and financial accounts contributed to an overall balance-of-payments surplus of 2% of GDP, slightly lower than the amount recorded for 2009 (3% of GDP). Net international reserves amounted to US$ 925 million, covering 3.7 months of imports.

In 2011, the balance-of-payments current account deficit will increase to approximately 19.2% of GDP as economic activity picks up and international prices of commodities trend upwards.