COUNTRY BRIEF

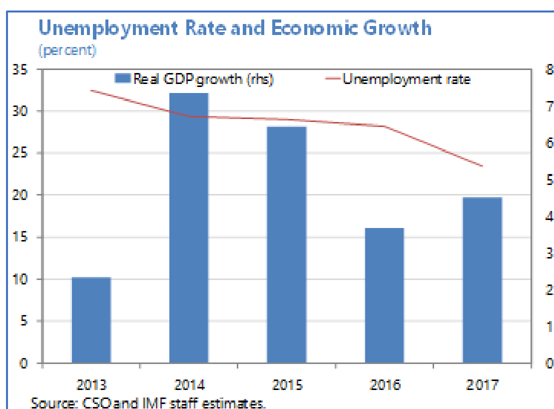
Grenada: Reaping Dividends From Recent Reforms

By Bogdan Lissovolik and Wayne Mitchell

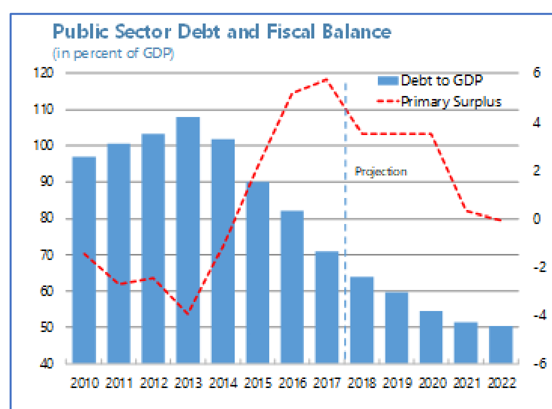
Grenada's economy made important strides in recent years during the authorities' home-grown program that was supported by the IMF. The government achieved impressive debt reduction, improved the framework for fiscal policy, strengthened the financial system, and created a better business environment. The focus now should turn toward raising potential growth and making it more broad-based, further reducing unemployment, and efficiently using hard-earned fiscal space to make the economy more prosperous and resilient to economic shocks and natural disasters.

The Grenadian economy is enjoying robust growth. GDP grew by 5 percent in 2017 and has been growing at a similar rate in early-2018, driven by strong activity in construction, tourism, and education. Weather-related weaknesses in agriculture have, however, been a headwind. Unemployment, while falling, remains high at above 20 percent. Inflation has been below 1 percent, supported by the peg to the US dollar. FDI is estimated at 8½ percent of GDP, driven by tourism and proceeds from the Citizenship-by-Investment (CBI) program.

The fiscal situation improved further in 2017, with the government overperforming the targets of the Fiscal Responsibility Law (FRL). The primary surplus increased to 5¾ percent of GDP (the FRL floor is 3.5 percent of GDP), supported by buoyant tax revenues while recurrent spending was contained. Targeted social spending was, appropriately, increased.

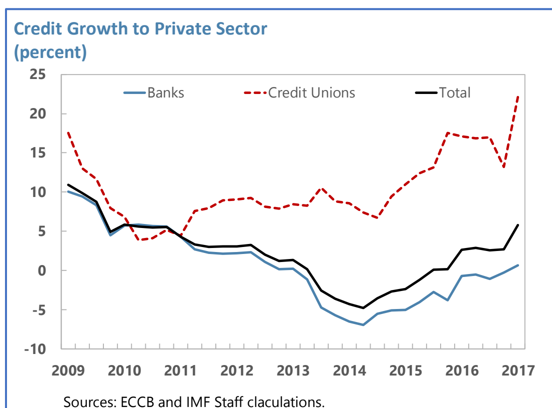


Source: CSO and IMF staff estimates.



Nevertheless, a shortfall in grant financing and slow project execution kept capital outlays low. Public debt fell to around 70 percent of GDP in 2017 (from 82 percent of GDP in 2016) reflecting the strong fiscal position and completion of debt restructuring. Progress has also been made in addressing external and domestic arrears, although negotiations with three bilateral creditors aimed at fully regularizing external arrears have yet to be concluded.

The financial sector has benefitted from the strong economy. Bank credit has recently shown signs of incipient recovery as non-performing loans continue to decrease, helped by economic growth, an increase in property prices, and relatively quick foreclosure procedures. By contrast, credit union lending (which now accounts for a quarter of total credit), grew briskly by about 20 percent. Although banks in Grenada have not had a meaningful loss of correspondent banking relationships (CBRs) there are risks that non-bank financial institutions may lose access to banks due to AML/CFT concerns.



While the outlook remains favorable, growth momentum is expected to taper over time. In 2019, growth is projected to be in the 3½-4 percent range, benefiting from supportive global economic conditions, continued strength in construction, and a tourism sector that has shown itself to be competitive within the ECCU. Thereafter, growth would ease to its potential rate of 2¾ percent while inflation stabilizes at around 2 percent. The primary fiscal surplus is expected to remain high in the near term, supporting rapid debt reduction, although once the public debt ratio falls below 55 percent of GDP (projected for 2020), the FRL would allow for a reduction in the surplus.

Risks include both domestic and external factors. On the external side, uncertainty about the growth outlook for advanced economies, potential shifts in global financial conditions, and CBI inflows, can surprise in both directions. Pressures on CBRs could affect financial intermediation and natural disasters are an ever-present risk. An adverse court judgment in the Grenlec power company case could have fiscal implications as could the realization of fiscal risks from the Petrocaribe arrangement. On the domestic side, implementation of the government's initiatives on health care and pensions, the forthcoming cycle of public wage negotiations, and the availability of financing, could all pose downside risks to the fiscal outlook if not properly managed.

Overall, despite improvements in economic performance, public debt is still relatively high, job creation has been insufficient, and institutional capacity for policy implementation needs strengthening. Accordingly, determined policy implementation is needed to capitalize on progress from recent reforms, improve the economic outlook, and mitigate risks. Progress is needed in the following areas.

On **fiscal policy,** compliance with the FRL has been key to public debt reduction,

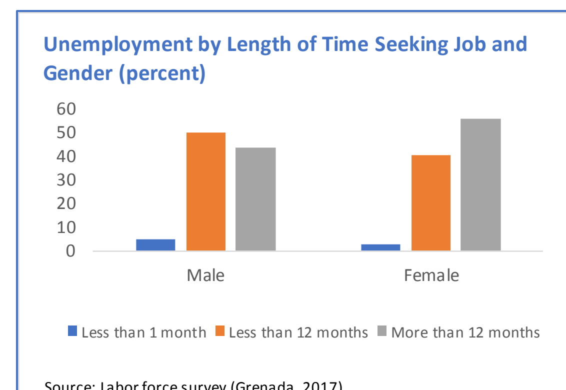
strengthening confidence and building credibility. Maintaining the FRL's rules-based framework is essential to support policy credibility. Careful preparation is needed for a responsible transition to the next phase of the FRL. When the debt falls below the target of 55 percent debt to GDP, the FRL envisages a recalibration of the rule-based parameters that would allow for a relaxation of the fiscal rules. It would be desirable that any effort to use that fiscal space be gradual and consistent with the fiscal needs and absorptive capacity. Going forward, better alignment of policies between annual budgets and the rules-based framework would improve expenditure allocation and efficiency.

Further **structural fiscal reforms** would be critical to support this process. The FRL wage bill ceiling of 9 percent of GDP should be underpinned through the implementation of the government's Public Sector Management Reform Strategy. Better institutional support for public investment management would improve the quality and focus of public investment and increase its effectiveness. Incorporating future aging costs into the fiscal framework, including due to initiatives on pensions and health care, represents a challenge. The targeting of social assistance programs to the poor and vulnerable could be improved and continued reforms of State Owned Enterprises and Statutory Bodies are needed to strengthen productivity and effectiveness and minimize fiscal risks. Public debt and cash management needs to be improved and regularization of arrears to external bilateral creditors completed.

In the **financial sector**, there is scope to upgrade financial oversight, particularly for nonbanks. The rapid growth of credit union lending warrants close monitoring with a view to assessing and pre-empting emerging financial stability risks. To this effect, there is a need to enhance monitoring and oversight capacity of the nonbank financial regulator, including by collecting more granular loan data and undertaking regular stress testing. In parallel, ECCU governments are taking steps toward harmonization of regulation of the non-bank financial sector at the regional level and an acceleration of this process would help reduce potential risks. Finally, ensuring compliance with AML/CFT regulations at all levels is critical for continued stable access to cross-border payments. In this context, non-bank financial institutions are particularly prone to risks of losing access to bank payments systems due to AML/CFT concerns. Legislation to formalize the annual registration of entities for AML/CFT purposes will be helpful in capturing such AML/CFT risks early.

While the recent recovery has been a very positive development, growth has not been sufficiently broad based, underpinned mainly by construction activity and tourism. Accordingly, on **supply side policies,** remaining bottlenecks to growth and job creation need to be addressed. There is scope to enhance links between tourism and other key sectors, including through increasing agri- and medical-tourism, as well as sustainably leverage maritime resources for tourist activities. Agriculture productivity would benefit from better land use policies, infrastructure and logistics. Addressing skills

Unemployment by Length of Time Seeking Job and Gender (percent)



Source: Labor force survey (Grenada, 2017)

gaps and increasing flexibility in hiring would help reduce employment and increase productivity. An improved business environment and increasing resilience to natural disasters would help attract investment and support employment. Finally, inclusive growth policies should be bolstered through a medium-term plan to operationalize a new Growth and Poverty Reduction Strategy and an elaboration of a 2030 Development Plan drawing on the Sustainable Development Goals.