



Sun, Sand, Sea and Debt...

The Caribbean's Limited Fiscal Space

Over the past two years, the world witnessed a truly Keynesian approach to the economic crisis, as government expenditure ballooned in a valiant effort to shore up economic activity and to prevent a protracted global recession. Arguably, expansionary fiscal policy was the primary reason for the relatively quick rebound in economic growth, since it seemed as though the crisis was unresponsive to the aggressive easing of monetary policy which was actually the first line of defense for several countries. One of the major reasons for that was waning consumer and business confidence, so that even though interest rates fell to record low levels, spending and investments were held back, simply because expectations dictated that the economic situation would get worse. For this reason, governments throughout the world were forced to boost expenditure to help anchor short term expectations and improve sentiment.

Consumer spending in the US accounts for approximately 70% of that economy, and with about 8.5 million people losing their jobs since the crisis began, the Obama administration quickly implemented policies to stem further job losses and to create new jobs. China and Japan as well as some of the European countries and the larger emerging markets also followed this approach, spending billions of dollars to resuscitate their fragile economies. Even though there may be some long term consequences of these policies in terms of higher debt and inflationary pressures, the expansionary fiscal policies seem to have taken some (short term) effect as we continue to see gradual signs of recovery in those countries.

In contrast to the outlook for the global economy, the prospect for the Caribbean region remains subdued. Table 1 shows the outlook for GDP growth for selected countries in the region.

TABLE 1: CARIBBEAN GDP PERFORMANCE AND OUTLOOK

| Country | Average 2005-2008 | 2009 (Estimated) | 2010 (Forecast) |
|---------------------|-------------------|------------------|-----------------|
| Antigua and Barbuda | 6.9% | -6.5% | -1.5% |
| Barbados | 2.7% | -3.0% | -0.5% |
| Grenada | 4.0% | -4.0% | 0.0% |
| Jamaica | 1.1% | -3.6% | -0.2% |
| St Lucia | 3.0% | -2.5% | -0.4% |
| St Kitts & Nevis | 3.6% | -2.0% | 0.0% |
| Trinidad & Tobago | 6.7% | -3.0% | 1.5% |
| US | 2.1% | -2.7% | 2.1% |

The table 1 shows that the Caribbean region has definitely not been spared from the global economic downturn, with all of the sample countries estimated to have recorded economic contractions in 2009. Antigua and Barbuda is expected to have shrunk the most, given the impact of the Stanford failure upon various facets of that economy. While the downturn is not as severe as in 2009, 2010 is expected to remain difficult for the Caribbean. With the exception of Trinidad & Tobago, every country is likely to further contract/ remain stagnant and this compares to a relatively strong rebound in the US, expected to record growth in excess of 2% in 2010. As mentioned previously, this difference in prospects can partly be attributed to the expansionary fiscal policy adopted by the US over the last two years. Even though many have called for the Caribbean region to pursue fiscal stimulus to offset the contraction in private demand, most of these countries are unable to actively implement such counter-cyclical fiscal policies. Indeed, the region has historically faced inherent limitations in terms of the structure of their economies as well as their already constrained fiscal flexibility. Table 2 shows the Caribbean fiscal space, which clearly shows the severe restrictions faced by most of the region. The average level of public sector debt to GDP is in excess of 90% in the Caribbean, with some of the countries exceeding 100% and some being the world's most indebted emerging markets. The public sector debt in St Kitts and Nevis is currently equivalent to just about 180% of the country's GDP, while Jamaica is around 120% of GDP.

TABLE 2: CARIBBEAN FISCAL SPACE

| Country | Credit rating | Public debt/ GDP |
|---------------------|---------------|------------------|
| Antigua and Barbuda | Not rated | 113% |
| Barbados | BBB | 82.7% |
| Grenada | B- | 114% |
| Jamaica | B- | 127% |
| St Lucia* | CariBBB+ | 70% |
| St Kitts & Nevis | Not rated | 178% |
| Trinidad & Tobago | A | 46% |

Source: Standard and Poor's, IMF

* - rating by CariCRIS, and not the same scale as S&P

Even though the debt ratio is at a comfortable level in Trinidad and Tobago, the issue lies in the country's reliance on energy prices and demand internationally. Indeed, the collapse in natural gas and oil prices would have impacted directly upon public finances and the government's ability to provide fiscal stimulus. In fact, energy sector revenue accounts for more than 50% of government revenue. Further to this, the collapse of CL Financial would have put extra pressure on the fiscal accounts, as the government led the bailout of the largest conglomerate in the country. The government will have a deficit of around 5% of GDP in the fiscal year 2010, which it will need to finance. On the positive side though, with an investment grade credit rating, the government has the ability to tap the domestic and international capital market to finance this deficit and because the current debt level is around 40% of GDP, increasing this moderately would not significantly damage the country's debt profile. This puts Trinidad and Tobago in a better position than the rest of its Caribbean counterparts.

The other Caribbean countries have been traditionally plagued by high indebtedness and very weak and narrow economies. In this context, financing a growing fiscal deficit becomes increasingly challenging in an environment where the regional governments' revenue base is quite narrow as well. In addition, interest payments usually account for a substantial chunk of government revenue for many Caribbean countries, particularly Jamaica when in 2009, interest payments accounted for 63% of general government revenue, which significantly inhibits fiscal flexibility. Further to this, with the exception of Barbados (who is also rated investment grade); the other Caribbean countries are either rated as junk, (also called speculative grade) or not rated at all. This poses another major challenge in terms of accessing the international capital markets to raise funds to fill the shortfalls in the fiscal accounts.

Despite these challenges and limited options to finance fiscal deficits in the Caribbean, many governments have been able to come to market successfully, and issue mainly domestic debt, which in my opinion is a better long run solution. While this increases the debt load, the proportion of external debt will not rise, which reduces vulnerabilities in terms of interest rate and foreign exchange fluctuations. Additionally, with interest rates at relatively low levels, governments were able to borrow at a cheaper cost to them. Demand is still high for some of the stronger government paper, like in the case of Trinidad and Tobago, where many of the bonds were issued at a premium due to excessive demand.

As the dust settles in the global economy, it is clear that the Caribbean region will stumble a bit longer, largely as a result of the region's inability to respond to the same extent as the rest of the world. Fiscal deficits are already high in the region, and there is little that can be done to improve the situation. These deficits can either be reduced through increasing the revenue base, or reducing expenditure. In a time when expansionary fiscal policy may be necessary to bolster economic activity alongside limited options in terms of enhancing the revenue base, higher fiscal deficits and increased financing requirements for the region is a real possibility. Governments however must be prudent in its conduct of fiscal policy so that the region's legacy of debt should not be aggravated further, as this can threaten to undermine the economic stability of the Caribbean region.

FINANCIAL & ECONOMIC INDICATORS

As at 18 March, 2010

| <u>Exchange Rate/US\$</u> | <u>Closing Value</u> | <u>Previous Week</u> |
|---------------------------|----------------------|----------------------|
| Yen | 90.39 | 90.51 |
| Euro | 1.36 | 1.37 |
| Jamaica | 89.73 | 89.73 |
| Guyana | ND | ND |

| <u>Commodity Prices</u> | <u>Closing Value</u> | <u>Previous Week</u> |
|--------------------------|----------------------|----------------------|
| Crude oil (US\$/bbl) | 82.20 | 82.11 |
| Natural Gas (US\$/mmbtu) | 4.20 | 4.46 |
| Gold (US\$/Troy Ounce) | 1,105.65 | 1,109.50 |

Eurobond Indices (As at 018-03-10)

| | |
|---|------|
| JP Morgan EMBI+ (Basis points) | 257 |
| JP Morgan Central America and Caribbean Index (CACI) (YTD return %) | 5.86 |

| <u>Policy Interest Rates (%)</u> | <u>Closing Value</u> | <u>Previous Week</u> |
|----------------------------------|----------------------|----------------------|
| United States | 0.25 | 0.25 |
| Euro Zone | 1.00 | 1.00 |
| Japan | 0.11 | 0.10 |
| Brazil | 8.65 | 8.75 |
| Trinidad | 5.00 | 5.00 |
| Jamaica | 10.00 | 10.00 |
| Barbados | 2.50 | 2.50 |

| <u>Market Interest Rates (%)</u> | <u>Closing Value</u> | <u>Previous Week</u> |
|----------------------------------|----------------------|----------------------|
| US 90-day T-Bill | 0.15 | 0.15 |
| US 10-Yr Treasury | 3.68 | 3.73 |
| 3-month UK Libor | 0.65 | 0.64 |
| Japan 90-day T-Bill | 0.28 | 0.28 |
| Brazil 90-day T-Bill | 8.95 | 9.56 |
| TT 90-day T-Bill | 1.32 | 1.29 |
| Jamaica 90-day T-Bill | 10.35 | 10.35 |
| Barbados 90-day T-Bill | 3.27 | 3.27 |

Sources: Bloomberg, J.P. Morgan, CMMB Research Center, Central Bank of Trinidad and Tobago, Bank of Jamaica, Central Bank of Barbados

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