INTERNATIONAL MONETARY FUND

Staff Country Reports

St. Kitts and Nevis: 2009 Article IV Consultation and Request for Emergency Natural Disaster Assistance—Staff Report; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for St. Kitts and Nevis

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the combined discussion of the 2009 Article IV consultation with St. Kitts and Nevis and a request for emergency natural disaster assistance, the following documents have been released and are included in this package:

- The staff report for the combined 2009 Article IV Consultation and Request for Emergency Natural Disaster Assistance, prepared by a staff team of the IMF, following discussions that ended on March 20, 2009, with the officials of St. Kitts and Nevis on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 30, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its May 15, 2009, discussion of the staff report on issues related to the Article IV consultation and the request, respectively.
- A statement by the Executive Director for St. Kitts and Nevis.

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INTERNATIONAL MONETARY FUND

ST. KITTS AND NEVIS

**Staff Report for the 2009 Article IV Consultation
and Request for Emergency Natural Disaster Assistance**

Prepared by the Staff Representatives
for the 2009 Consultation with St. Kitts and Nevis

Approved by Patricia Alonso-Gamo (WHD) and Philip Gerson (SPR)

April 30, 2009

EXECUTIVE SUMMARY

Background and Challenges: The global financial crisis, the collapse of CL Financial Group, and the devastating impact of Hurricane Omar are creating the perfect economic storm. After growing by 3.2 percent in 2008, St. Kitts and Nevis' real output is projected to contract by 1.2 percent in 2009, with risks clearly on the downside. The government has shown its commitment to debt reduction by achieving a large primary surplus in 2008 for the fourth consecutive year, with the public debt ratio down by 20 percentage points over the past three years. But the country's still heavy debt burden has left no space for fiscal policy to respond to the downturn. Liquidity risks posed by the large rollover needs of short-term debt have also risen. Financial sector vulnerability stems from banks' continued high government exposure and inadequate supervision of the nonbank sector.

Key Policy Recommendations: Sustaining large primary surpluses over the medium term will require continued and strengthened expenditure control, together with further structural fiscal reforms, including, most critically, the VAT. Other key policy actions include: tightening oversight of the broader public sector; working closely with donors/creditors to tap grants or highly concessional loans; strengthening debt management capacity; strengthening financial sector regulations; and accelerating land/asset sales to lower debt more rapidly. In the current environment, developing a full-fledged contingency plan has also become more urgent.

External Competitiveness: The real effective exchange rate and medium-term current account deficits are broadly in line with fundamentals, but maintaining competitiveness remains a challenge. Fiscal consolidation will be important for supporting competitiveness, maintaining stability, and underpinning the quasi-currency board arrangement.

Request for Fund Financing: The authorities have made a request for a purchase under the Fund's Emergency Assistance for Natural Disasters (ENDA) equivalent to 25 percent of quota (SDR 2.225 million). Fund financing is expected to partly offset the balance of payments impact of Hurricane Omar, estimated at almost US\$19 million.

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I. CONTEXT

1. **Over the past decade, economic developments in St. Kitts and Nevis have been shaped by the need to respond to a series of shocks**—a succession of hurricanes in the late 1990s; the sharp drop in tourism after the September 11 attacks; and the closure of the loss-making sugar industry, a mainstay of the economy for more than three centuries. Fiscal policy typically responded through reconstruction and social programs to maintain employment and limit the social impact of these shocks. The result was an accumulation of public debt, with the debt ratio peaking in 2005 at 197 percent of GDP, among the highest in the world.

2. **Now the country faces another, perhaps even larger, exogenous shock in the form of the global financial crisis.** The sharp global recession has been taking a toll on the St. Kitts and Nevis economy. Economic activity has weakened markedly, particularly tourism and FDI-related construction, the drivers of growth in recent years. The drop-off in tourism receipts, FDI, and other capital flows could lead to a worsening of the balance-of-payments position. Strains from the global crisis are also increasingly evident in the local financial system, including through insurance, investment, and banking linkages with the troubled Trinidad-based CL Financial Group. Should the slowdown deepen further, the adverse impact could spread to the banking sector through a rise in nonperforming loans and a loss of confidence.

3. **But the major risk to macroeconomic stability stems from the very high level of debt and associated large financing requirements.** Although the public debt ratio has fallen markedly since 2005, it is still excessively high, and debt service takes up nearly a quarter of government revenues. Moreover, access to external financing is now extremely limited, forcing the government to increasingly rely on the already heavily exposed banking system to meet the large rollover needs.

4. **Social indicators have strengthened in recent years.** Based on preliminary findings of the Country Poverty Assessment, the government has made remarkable strides in reducing poverty and strengthening other social indicators, a reflection of the government's focus on improving living standards. However, the global financial crisis is already threatening these gains, with layoffs and shortened workweeks accelerating across an increasingly wide spectrum of the economy.

St. Kitts and Nevis: Selected Social and Demographic Indicators

	St. Kitts and Nevis	ECCU
HDI rank (rank out of 177 countries), 2008	60	73
Life expectancy at birth (years), 2006	71.2	73.6
Adult illiteracy rate (% of people ages 15 and above), 2006	2.2	8.2
Infant mortality (per 1,000 live births), 2006	16.8	14.2
GNI per capita (US\$), 2007	9,785	6,622
Gini coefficient	0.445	0.480

Sources: World Bank, WDI; United Nations, Human Development Report 2008; and Fund staff estimates.

5. **St. Kitts and Nevis form a twin-island federation with a unicameral parliament, with parliamentary elections due by October 2009.** The incumbent Labor Party won a

third consecutive five-year term in the October 2004 elections, while the Nevis Reformation Party returned to power in Nevis in July 2006 after 14 years in opposition. The political cycle is complicating the needed decisions to pursue fiscal consolidation and structural reforms.

II. RECENT ECONOMIC DEVELOPMENTS AND NEAR-TERM OUTLOOK

6. **Economic activity slowed down significantly in the wake of the deteriorating global environment.** Real GDP growth for 2008 is estimated at about 3.2 percent, despite slower growth in the second half of the year as tourism declined. The impact of the global downturn is expected to take full effect in 2009, adversely impacting both tourism and construction (via slower FDI inflows). Furthermore, in October 2008, Hurricane Omar's storm surge severely damaged Nevis' largest tourism resort, the mainstay of the island's economy, and is likely to remain closed during 2009 (Section III). Real GDP is, therefore, projected to contract by 1.2 percent in 2009, with the decline tempered by continued construction of some high-end resorts in St. Kitts, the expansion of the medical and nursing schools, the opening of a new horse racing complex, and the start of the geothermal project on Nevis. But risks to the outlook are clearly on the downside.

7. **The global surge in food and fuel prices led to a pick-up in inflation** from 2.1 percent at end-2007 to a peak of 8.3 percent in October 2008, before moderating somewhat to 7.6 percent by end-2008. Inflation is projected to ease further in 2009 on the back of lower oil prices.

8. **Monetary developments also reflected the economic slowdown.** Broad money growth fell to 2.2 percent in 2008 from 11.2 percent during 2007, while growth of private sector credit also slowed to 7.5 percent by end-2008 from 9.2 percent a year earlier.

9. **Reflecting strong FDI-related imports, the current account deficit widened to 24 percent of GDP in 2007.** This was more than fully financed by tourism-related FDI (30 percent of GDP). The current account deficit in 2008 is expected to widen to about 29 percent due to lower tourism receipts, but the deficit is projected to narrow substantially (about

7 percentage points) in 2009, as the decline in tourism receipts is more than offset by a sharp drop in FDI-related imports.

10. **Prudential indicators point to some weakening of the banking system, which also remains vulnerable to high public sector exposure** (Figure 1). While liquidity in the banking system remained ample through 2008, the nonperforming loans (NPLs) ratio rose by 1 percentage point over the course of the year to 5.2 percent, slightly above the ECCB's prudential target of 5 percent.¹ Gross government exposure to total capital of the banking system stood at an uncomfortably high 207 percent at end-2008, with the banking system's public sector exposure at 51 percent of total loans. For locally incorporated banks, public sector exposure was even higher, at 79 percent of total loans.

11. **In 2008, the government achieved a primary surplus for the fourth consecutive year, with the surplus estimated at 5.3 percent of GDP.** (Figure 2). The

improvement in the primary surplus over that in 2007 reflects a large cutback in capital expenditure (by about 60 percent relative to the approved budgets), which more than offset a decline in revenues and an increase in current expenditure. The rise in the latter reflected higher interest payments and an additional 7.5 percent increase (approved in September) in civil service salaries

retroactive to January 2008 (estimated to cost 0.9 percent of GDP). Government measures to compensate for the high food and fuel prices (including removing the consumption tax on critical food items) were estimated to cost about 0.3 percent of GDP.

12. **Despite passage of the Financial Administration Act in 2008, there remains little current information on the financial accounts of the broader public sector.** However, the share of public enterprises' debt in total public sector debt remains substantial, at 22 percent as of end-2008.

St. Kitts and Nevis: Selected Fiscal Indicators, 2005–09

	2005	2006	2007	Prel. 2008	Proj. 2009
(Central government, in percent of GDP)					
Revenue	36.7	36.7	37.4	36.9	34.9
Grants	2.7	2.7	2.1	2.0	1.7
Expenditure					
Current	36.8	36.5	36.0	36.5	38.8
Of which					
Interest payments	8.1	9.8	8.4	9.0	11.0
Capital spending and net lending	6.7	7.9	8.2	6.1	6.4
Current balance	-0.1	0.2	1.4	0.4	-3.9
Primary balance	4.0	4.7	3.7	5.3	2.4
Overall balance	-4.0	-5.0	-4.8	-3.7	-8.6
Central government debt	124.8	141.7	137.7	137.9	142.9
Public sector debt	196.8	188.7	181.7	177.6	187.2

Sources: St. Kitts and Nevis authorities; and Fund staff estimates.

¹ The 2004 ECCU FSSA noted that there were some problems with loan classification by locally-incorporated banks in the ECCU, particularly with regard to public sector debt, so the actual NPL ratio could be higher.

Figure 1. St. Kitts and Nevis: Banking System Developments, 2000–08
(In percent)

Figure 2. St. Kitts and Nevis: Fiscal Developments, 2003–08
(In percent of GDP, central government)

Sources: St. Kitts and Nevis authorities; and Fund staff estimates.

13. **Although it has fallen by about 20 percent of GDP since 2005, the public debt ratio is still 178 percent of GDP (Figure 3).** Most critically, debt service costs have increased about threefold over the past decade, and the government is under increasing stress to meet debt service obligations. Liquidity risks posed by the large rollover needs of short-term debt have also risen in the current difficult climate. Interest payments alone represented 24 percent of total government revenue in 2008, crowding out social and other development-related spending and leaving little room for maneuver to respond to adverse shocks. Borrowing from commercial banks—increasingly in the form of tapping the expensive overdraft facility (with interest rates and penalties as high as 11.5 percent)²—has exacerbated the heavy debt service burden. Interest payments are expected to swell from about 8 percent of GDP in 2007 to 15 percent in 2014.

St. Kitts and Nevis: Implicit Interest Rates on Central Government Debt (In percent)

Sources: St. Kitts and Nevis authorities; and Fund staff estimates.

St. Kitts and Nevis: Central Government Debt Service, 2001–08

Sources: St. Kitts and Nevis authorities; and Fund staff estimates.

14. **In 2008, the government made some progress in improving the debt profile and reducing banking system vulnerability.** Proceeds from an

EC\$150 million bond issued in March 2008 under the Caribbean Development Bank (CDB) policy-based guarantee and the first tranche of the CDB's policy-based loan (US\$10 million disbursed in July 2008) were used to reduce the overdraft facility, reversing the steady upward trend in the overdraft for the first time in

St. Kitts and Nevis: Government's Overdraft Borrowing from Commercial Banks (In millions of EC dollars)

Source: St. Kitts and Nevis authorities; and Fund staff estimates.

² Parliament passed a resolution in March 2009, in compliance with the Finance Administration Act, to allow the government to access the overdraft facility up to EC\$150 million. The resolution's passage eliminated the 2 percent penalty charged on the overdraft facility.

Figure 3. St. Kitts and Nevis: Evolution of Public Debt, 2000–08
(In percent of GDP)

Sources: ECCB; St. Kitts and Nevis authorities; and Fund staff estimates.

1/ SSMC debt was reclassified as central government debt since 2006.

several years. As a result, the overdraft in the domestic banking system by mid-2008 was more than halved from 23 percent of GDP at end-2007. However, the sharp drop in the overdraft was not fully reflected as a decline in the banking system's exposure, as about half of the bond was purchased by a local indigenous bank, and another large portion was bought by the Social Security Board, also heavily exposed to the government. Since July 2008, banking exposure has been on the increase again. The government has returned to tapping the overdraft, reflecting the government's limited access to other forms of financing. This increase was briefly reversed in January 2009, when the €5.4 million sugar grant from the EU was used to pay down the overdraft, before returning to a rising trend.

III. ECONOMIC IMPACT OF THE HURRICANE

15. St. Kitts and Nevis, particularly the island of Nevis, has been badly affected by Hurricane Omar, which passed the region over the period of October 16–17, 2008.

Severe damage was caused by the extremely high storm surge, which flooded the major tourism resort on Nevis and caused some destruction to the federation's roads and coastal infrastructure. The impact of the hurricane unfolded very slowly, with the hotel initially estimated to be closed for about six months. However, substantial redesign of the property—to avoid future flooding—is now expected to keep it closed for much longer.

16. The damage caused by Hurricane Omar contributed to the economic slowdown in St. Kitts and Nevis in 2008 and could depress growth by about 1 percentage point in 2009. The impact will be more severe in Nevis as the decline in economic activity spills over to other sectors like agriculture and light manufacturing that supply the tourism sector. The closure could also affect airlift. The impact on unemployment will also be significant, since the damaged hotel is the largest employer in Nevis.³

17. The fiscal impact for Nevis is expected to be reflected in a sharp decline in tax revenues. Staff's preliminary estimates suggest that total revenue of the Nevis Island Authority (NIA) would decline by about 1.5 percent of GDP in 2009 from the previous year due to the combined impact of the global downturn and the damage from Hurricane Omar. Hotel room and restaurant tax accounted for about 13 percent of NIA's budget revenue, and the resort's closure is expected to have a direct impact of about EC\$8 million on tax revenue (0.5 percent of GDP) over a 12-month period.

³ Over 600 employees have already been laid off.

18. **The balance of payments impact of the hurricane, estimated at EC\$50 million (3½ percent of GDP), will be felt mostly in 2009.** The resort's closure is estimated to

cause a decline in tourism receipts of EC\$11 million in 2008 and EC\$50 million in 2009. The net impact on imports is a reduction of about EC\$10 million, reflecting a decline in

imports as fewer visitors are accommodated and a decline in spending of displaced workers, partially offset by higher imports for rehabilitation of the hotel, road repairs, and strengthening sea defenses. There will be no offsetting inflows of insurance payments as these have been impounded by the bank holding the resort's mortgage. The balance of payments impact is equivalent to about one month of 2008 imports.

St Kitts and Nevis: Key External Sector Indicators
(In percent of GDP)

	2007	Before Hurricane 2008 Est.	After Hurricane 2008 Est.	Before Hurricane 2009 Proj.	After Hurricane 2009 Proj.
External current account balance	-24.2	-27.8	-28.5	-19.6	-22.1
Exports of goods and services	45.4	39.5	38.7	33.6	29.9
Imports of goods and services	-67.7	-65.1	-65.1	-50.4	-49.2

Sources: ECCB; and Fund staff estimates and projections.

19. **The authorities are attempting to address the effects of the hurricane, but face severe financing constraints.** Immediate relief has already been provided to those affected by the natural disaster, and repair to damaged infrastructure has been largely completed. The government is also taking steps to cushion the impact on the displaced workers by ensuring they receive severance benefits and facilitating alternative employment. Moreover, as discussed in Section IV, the authorities are developing a comprehensive economic program—aimed at strengthening public finances to reduce public debt ratios, while undertaking structural reforms to help reactivate the economy—to deal with the effects of the natural disaster within the context of the difficult economic situation facing the country. The slow unfolding of the effects have stretched the finances of the NIA, which has had to bear most of the cost, as assistance from development partners has not been forthcoming. Furthermore, although the country participates in the Caribbean Catastrophe Risk Insurance Facility (CCRIF), wind speed, not flooding, is the trigger for an insurance payout, so St. Kitts and Nevis could not benefit from this source of financing. This situation is complicated by the tight constraints on central government finances.

IV. POLICY DISCUSSIONS⁴

Discussions centered on adopting bold adjustment policies for restoring fiscal and debt sustainability, mitigating vulnerabilities, and enhancing competitiveness and growth, all in the context of the most difficult global environment in decades. The authorities and staff were in broad agreement on the approach for addressing these challenges, but recognized that implementation risks were high.

A. Restoring Fiscal and Debt Sustainability

20. **The government reiterated its commitment to an ambitious medium-term strategy.** The strategy, first elaborated in the 2006 Budget, aims at raising the central government primary surplus to 8 percent of GDP by 2010 and placing debt on a sustainable path. Over the recent past, the authorities have already taken crucial steps toward this goal, including decisive actions to close the state sugar company to stem further losses, strengthen tax administration (the tax-to-GDP ratio is now among the highest in the region), and implement an automatic fuel pricing mechanism. The market-valuation-based property tax, adopted at the beginning of 2008 (with assessments nearly completed), is expected to further enhance the tax base. The authorities recognized the need for greater expenditure control and prioritization, but noted the pressure on government spending this year to address the impact of the global recession. Staff stressed that there is little room for counter-cyclical fiscal measures due to the very high debt level.

21. **Based on current policies and the 2009 budget parameters (the “baseline” scenario), the primary surplus is projected to decline to about 2.4 percent of GDP.** The surplus falls considerably short of the government’s goal (Box 1). Staff, therefore, recommended the adoption of additional adjustment measures (the “active” scenario) aimed at achieving primary

Source: Fund staff estimates.

⁴ The discussions took place from March 9–20, 2009. The team comprised N. Wagner (Head), W. Samuel, Y. Wong (all WHD), and M. Anthony (MCM) and was joined by staff of the ECCB and the CDB. G. Purves (OED) participated in the final meetings. The team met with Prime Minister Douglas, Deputy Prime Minister Condor, Minister of Finance Harris, Nevis Premier Parry, other senior officials, and representatives of the trade unions and the private sector.

Box 1: The 2009 Budget

Policy Initiatives. Both governments emphasized their commitment to reduce public debt to sustainable levels, with public debt projected to fall from 169 percent of GDP at end-2008 to 165 percent of GDP at end-2009.¹ The medium-term strategy includes: refocusing the Fiscal Stabilization Program on debt reduction; committing to land sales and privatization to generate EC\$50–100 million per year (3–7 percent of GDP); cutting expenditure through rationalization of public sector employment; greater prioritization of capital projects and funding capital expenditure through concessional financing (to the extent possible) over the next five years; and reducing interest rate costs in part through the issuance of treasury bills on the Regional Government Securities Market (RGSM).

Key fiscal measures of the two budgets for 2009 include:

- Providing immediate relief to the tourism sector. With effect from January 1, 2009, small hotels are exempted from duty and consumption tax on food and beverage. Nevis is also establishing a Tourism Contingency Fund, through an additional 1 percent charge on the hotel accommodation tax, to assist hotels that are under financial stress from external shocks. The Cabinet also approved a Special Incentives Package for small hotels with incentives such as duty free concessions for refurbishment.
- No new taxes for 2009, although the government indicated they might consider introducing “billable services” in customs and raising some government service charges. Fiscal measures introduced in 2008 to alleviate the effect of higher food and energy prices—such as the exemption of the consumption tax on selected food items and the cap on the fuel surcharge to 50 percent—would remain in place. The VAT is being considered for possible introduction in 2010.

Fiscal Outlook. The government’s consolidated 2009 budget projects an overall primary surplus of 5.3 percent of GDP, larger than staff’s baseline projection of about 2.4 percent. The budget’s current revenue projections for 2009 are based on gains from strengthening tax administration and real GDP growth of 3 percent, in contrast to staff projections of a pronounced contraction by 1.2 percent.

St. Kitts and Nevis: Central Government Fiscal Operations, 2008–09

	2008 Prel.		2009 Proj.				
	Baseline	Active	Staff Est.		Budget		Nevis
			Budget 1/	Total	St. Kitts		
	(In percent of GDP)						
Total revenue and grants	38.9	36.6	39.1	43.1	48.2	40.0	8.2
Current revenue	36.9	34.9	34.9	38.6	38.6	30.4	8.2
Capital revenue	-	-	-	-	5.1	5.1	-
Grants	2.0	1.7	4.3	4.4	4.4	4.4	0.0
Total expenditure and net lending	42.5	44.8	43.6	46.9	46.9	37.5	9.4
Current expenditure	36.3	38.4	38.2	37.0	37.0	30.0	7.0
Of which: Interest	8.8	10.6	10.5	9.1	9.1	8.3	0.8
Capital expenditure	5.1	5.4	5.1	9.5	9.5	7.1	2.4
Net lending	1.0	1.0	0.3	0.3	0.3	0.3	0.0
Overall balance	-3.5	-8.2	-4.4	-3.8	1.4	2.5	-1.2
Primary balance	5.3	2.4	6.0	5.3	10.5	10.9	-0.4
St. Kitts	4.9	3.8	6.8	5.7			
Nevis	0.3	-1.3	-0.1	-0.4			

Sources: St. Kitts and Nevis authorities; and Fund staff estimates.

1/ Except for capital revenue, which has been reclassified as “below-the-line” financing, other classifications in the budget are assumed to be in line with Fund staffs presentation.

¹In contrast, staff foresees public debt rising from 178 percent of GDP at end-2008 to close to about 186 percent by end-2009 under the baseline scenario.

surpluses of about 6–8½ percent of GDP during 2009–14. Under this scenario, public debt is projected to decline to under 140 percent of GDP by 2014, in contrast to rising above 200 percent of GDP under the baseline.

22. The fiscal measures under the active scenario could yield a primary surplus of 6.0 percent of GDP in 2009,

implying a fiscal adjustment (relative to 2008) of 0.9 percent of GDP by the St. Kitts Government and 0.5 percent by the NIA and the unlocking of additional grants (largely from the EU) of about 2.6 percent of GDP. As major tax reforms, such as the VAT, are to be introduced only after 2009 and the revenue-to-GDP ratio is already among the region's highest, the focus of near-term fiscal adjustment will have to be expenditure containment.

St. Kitts and Nevis: Options for Fiscal Adjustment in 2009
Additional Measures Under Active Scenario Relative to Baseline
(In percent of GDP)

Measures	Total	St. Kitts	Nevis
Expenditures	1.0	0.7	0.3
Contain wages	-	-	-
Contain expenditure on goods and services	0.0	0.0	0.0
Corporatize the Electricity Department (net effect)	...	...	...
Implement well-targeted social transfers	(0.1)	0.0	(0.1)
Reduce transfers/net lendings to public enterprises	0.7	0.7	0.1
Contain capital expenditure	0.3	-	0.3
Revenue	0.4	0.2	0.2
Increase efforts to collect tax arrears	0.1	0.1	(0.0)
Strictly enforce hotel taxes	0.1	0.1	...
Refrain from price control tax concessions	-	-	...
Increase efforts to collect nontax arrears	0.2	...	0.2
Total impact of fiscal measures	1.4	0.9	0.5

Sources: St. Kitts and Nevis authorities; and Fund staff estimates.

23. Key expenditure measures would include:

- Civil service reform.** Staff encouraged the government to press ahead with their plans for comprehensive civil service reform. With the government wage bill among the region's highest and given the recent substantial increases in public sector wages, comprehensive reform has become all the more urgent. Moderating wage increases (e.g., keeping them in line with inflation) would serve to reverse fiscal slippages, prevent fueling inflationary pressures, and contribute to external competitiveness.

ECCU: Wage Bill of Central Government, 2004–08 1/
(In percent of GDP, period average)

1/ St. Kitts and Nevis' high wage bill reflects in part the costs of two autonomous administrations.

Sources: ECCU country authorities; and Fund staff estimates.

- Goods and services.** Tight control over spending on goods and services is key to fiscal consolidation with, at a minimum, growth in expenditure kept in line with inflation.

- **Electricity department.** Staff supported the government's plans to corporatize the electricity department, stressing that it should be completed as soon as feasible to remove the substantial drain on the budget (the shortfall was estimated to amount to almost 2 percent of GDP in 2007, and the revenue loss arising from the 50-percent cap on the electricity fuel surcharge since January 2008 was estimated to amount to 0.6 percent of GDP). Thus, under the active scenario, it is assumed that corporatization occurs in early 2010, while the baseline scenario assumes further delays, pushing back corporatization until early 2011.
- **Targeted support.** Given the limited fiscal space, staff commended the government for taking the initial steps, as part of the institutional strengthening effort, toward targeted support of the most vulnerable. It also recommended moving as quickly as feasible to put this in place and phasing back in the consumption taxes by end-year. Should this prove politically difficult, staff suggested raising excise taxes and expediting the implementation of the VAT to replace the lost revenues.
- **Capital expenditure.** Continued efforts to streamline and prioritize capital spending over the medium term are critical for fiscal consolidation. Prioritization should be based on rigorous cost-benefit analysis and availability of appropriate financing (grants or highly concessional financing), supported by a strengthened PSIP process.

St. Kitts and Nevis: Medium-Term Projections Under Baseline and Active Scenarios
(In percent of GDP unless otherwise indicated)

	Prel. 2008	Projections					
		2009	2010	2011	2012	2013	2014
Real GDP growth (in percent)							
Active	3.2	-1.2	1.0	3.0	4.0	4.0	4.0
Baseline	3.2	-1.2	0.0	1.0	2.0	2.0	2.0
Primary balance							
Active	5.3	6.0	6.3	6.8	7.4	8.0	8.5
Baseline	5.3	2.4	0.9	1.3	1.7	1.6	1.5
Overall balance							
Active	-3.7	-4.4	-3.1	-2.9	-3.0	-2.5	0.7
Baseline	-3.5	-8.2	-9.3	-9.9	-11.3	-12.6	-13.6
Asset sales							
Active	3.6	2.0	3.0	3.0	3.0	3.0	3.0
Baseline	3.6	1.0	1.0	1.0	1.0	1.0	1.0
Financing gaps							
Active	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Baseline	0.0	3.1	5.6	6.2	8.0	11.3	13.3
Public debt							
Active	178	179	174	164	155	146	135
Baseline	178	186	192	196	200	206	213

Sources: Fund staff estimates.

24. Staff supported plans to push ahead with additional fiscal revenue reforms:

- **Value-added tax (VAT).** A VAT would broaden coverage of the tax system, while consolidating a range of taxes under a single framework (including fully replacing the current consumption tax). Successful implementation should allow for some increase in revenues to more than offset the potential revenue losses from the elimination of tariff

under the Phase IV of the Common External Tariff (CET) under CARICOM. Progress has been made in terms of the VAT team (comprising staff from both islands), which began preparatory work in December 2008. Critical to success, however, will be a unified regime administered at the federal level with effective revenue-sharing between St. Kitts and Nevis, and staff urged the two island governments to quickly agree on a solution on this core aspect necessary for advancing implementation.

- ***Tax concessions.*** St. Kitts and Nevis has relied heavily on tax concessions, among the highest in the region, to attract investment. Thus, staff welcomed the authorities' work on preparing a new Investment Code that would specify a transparent, nondiscretionary regime for providing investment incentives based on projected economic return.
- ***Corporate income tax.*** Staff endorsed the plan to introduce a new Corporate Tax Act, with the aim of modernizing the existing Income Tax Act enacted some 40 years ago. Together with the Investment Code, the new Act could also help limit the room for granting tax concessions.

25. Further fiscal efforts would facilitate achievement of policy goals:

- ***Strict enforcement of the new Finance Administration Act.*** Combined with stronger control of borrowing by public enterprises, this will be a core element toward achieving debt sustainability. The process of providing debt guarantees for public enterprises should be strengthened, including by requiring full and timely submission/disclosure of financial statements and setting explicit debt limits. Strengthening of debt control and management within the public enterprises could also pave the way for privatization of those deemed viable under commercial operations. In all events, using land as collateral for public enterprise borrowing should be strictly avoided.
- ***Strengthening debt management capacity.*** The government is rightly focused on this area of reform. As a starting point, the debt unit has made much progress in compiling a comprehensive government debt database, although weaknesses remain regarding the timely inclusion of debt of public enterprises and the NIA. The government also employed a private debt consultant and received Fund technical assistance (Box 2), with the aim of developing a medium-term debt management strategy, building capacity within the debt unit to undertake debt sustainability and debt strategy analyses, and exploring options to reduce the debt burden. Also crucial is strengthening institutional arrangements for debt management, including enhancing coordination and information dissemination among ministries and both island administrations.

26. While running primary surpluses is necessary for restoring debt sustainability, it will not be sufficient. The government is also pursuing other options to more rapidly lower the public debt and the economy's vulnerability to external shocks. These, together

Box 2: Debt Management

St. Kitts and Nevis' high public debt poses a serious risk to the economy. This risk is compounded by the susceptibility of the economy to external shocks, including the current global slowdown. At the authorities' request, a Fund mission visited the country in October 2008 and provided technical advice on how to address these risks, including actions to restore debt sustainability and strengthen the institutional framework for debt management. Among the mission's recommendations:

- **Restore debt sustainability.** Although the authorities' recent fiscal efforts have resulted in a fall in the public debt ratio, current policies imply a resumption of an upward trend and the emergence of financing gaps. In the absence of prompt corrective action, a debt restructuring might become unavoidable. A substantial increase in the primary surplus to around 8 percent of GDP would be needed to place debt firmly on a downward path. Pushing ahead with land sales to the private sector would be a critical component. Delaying land sales in anticipation of appreciating land values seems very risky in light of pressing liquidity needs. While the assets of the Social Security Board (SSB) help to ameliorate the public debt situation, in fact, the majority of its assets are invested in public sector debt; the sale of land to the SSB (as happened in 2008) and the SSB's move into real estate development in 2009 eventually reduce public sector liquidity.
- **Rationalize the structure of public liabilities.** Simplifying the structure of the public debt would help to improve control and reduce risks. The complexity and nontransparency of the cross-liabilities and guarantees among various parts of the public sector, including the federal and Nevis governments, public corporations, the SSB and the state-owned bank, may have facilitated the rise in public debt. The currently very high exposure of the banking system to public debt would be reduced by direct government borrowing from the SSB rather than channeling the resources through the state-owned bank. Moreover, the SSB's integrity could be improved by reducing its exposure to public corporations whose operations appear to be quasi-fiscal. Nevertheless, borrowing from the SSB is a second-best financing option, driven by necessity rather than optimality.
- **Strengthen debt management capacity and institutional arrangements.** As a first step, the government should identify its debt management objectives. These would provide the basis for the formulation and implementation of a medium-term debt management strategy and help to identify and manage financial risks. It is also important to develop urgently the capacity to analyze, manage, and control guarantees. A Public Debt Committee, chaired by the Minister of Finance, with the participation of the ECCB as appropriate, should be established with the responsibility for approving the debt strategy and the associated annual financing plan. To facilitate more rigorous analysis of debt service cash flows, a single integrated database for recording all public debt should be created.

with accelerated structural reforms, are key features of the active scenario (with more productive private investment and higher real growth over the medium term):

- **Land/asset sales.** The government may be cash-constrained, but it is asset-rich with considerable land, some of which secures the sugar debt in the banking system. There was broad agreement on aiming for land sales to the private sector at about 3 percent of GDP per year (although the global downturn might make this target difficult to meet this year), with sales proceeds used to pay down the most expensive public debt first. The establishment of a land sales agency should be given top priority, with the goal of putting in place a transparent, market-based procedure for the sale of land.
- **Concessional resources.** The authorities met the conditions for the first tranche of the CDB's policy-based loan and the first disbursement of the EU's pledged sugar grants (2–3 percent of GDP per year through 2014). The government plans to continue working closely with the CDB and the EU to meet the remaining requirements (Table 9)—such as progress with the labor market assessment, the country poverty assessment, and the national adaptation strategy—for further disbursements of the EU sugar assistance.⁵ As with land sales proceeds, these resources would be used to pay down the most expensive public debt.

27. **The active scenario is, nevertheless, subject to substantial downside risks.** Due to very limited fiscal room for maneuver, any exogenous shock could raise debt to much higher levels (Annex I and Figures 6 and 7). Growth may also remain stagnant under the backdrop of a more severe or prolonged global downturn than currently projected. Moreover, land sales of 3 percent of GDP per year, as under this scenario, may prove too optimistic against the difficult global environment and popular resistance. Under these more pessimistic scenarios, the decline in the debt ratio is much slower and could even be reversed in some years but would still be significantly lower than that under the baseline scenario.

B. Enhancing Competitiveness and Fostering Growth

28. **Restoring growth to its medium-term potential will help accelerate the reduction in the public debt-to-GDP ratio and improve living standards.** While the level of the real effective exchange rate is broadly in line with fundamentals (Box 3), external competitiveness remains a challenge. Recent minimum and government wage increases have been directed at mitigating the effects of the commodity price shocks, but have kept private sector and government wage levels among the highest in the region. Moreover, St. Kitts and Nevis has given up some of the recent gains in the share of the Caribbean tourist market since 2006 (Figure 4).⁶

⁵ Fulfilling these conditions would also be necessary for the United Kingdom's DFID to write off £2.3 million in debt under the Commonwealth Debt Initiative.

⁶ Tourism arrivals declined in 2007 following a 1.6 percent increase in 2006, compared to double-digit growth in 2003–05 after the opening of a large Marriott resort in 2003.

Box 3. Assessment of External Stability

The real effective exchange rate (REER) does not appear to be misaligned. Staff analysis suggests that the REER is broadly in line with macroeconomic fundamentals.¹ Through mid-2008, the CPI-based REER depreciated in line with the weakening of the U.S. dollar against other major currencies, sufficient to offset the effects of higher food and fuel prices. The more recent strengthening of the U.S. dollar has reversed some of these competitiveness gains, but not sufficiently to suggest misalignment. The competitor- and customer-based REER have remained roughly stable since 2005, suggesting no significant change in competitiveness.

St. Kitts and Nevis: Actual and Equilibrium REER, 1979–2008 1/
(Index 2000=100)

Sources: IMF, Information Notice System; and Pineda and Cashin, "Assessing Exchange Rate Competitiveness in the ECCU," forthcoming IMF Working Paper.
1/ The dotted lines around the equilibrium exchange rate represent 90 percent confidence intervals of the prediction.

The external current account deficit remains elevated, but is close to the estimated norm. The recent surge in the external current account reflects mainly strong FDI growth and the commodity price shocks. The current account deficit is projected to decline over the medium term supported by the fiscal consolidation incorporated in the authorities' program. Nevertheless, the current account deficit will remain high as a result of FDI-financed imports.²

This level appears to be consistent with the long-run equilibrium external current account deficit of 30 percent of GDP.

St. Kitts and Nevis: Current Account Deficit, Actual and Estimated Norms 1/
(In percent of GDP)

Sources: Fund staff estimates and projections.

1/ In computing the norms, medium-term values of the fiscal balance, oil-balance, output growth, and relative income are drawn from staff projections. Band is ± 1 standard error of the prediction. CARICOM sample includes ECCU countries and The Bahamas, Barbados, Belize, and Jamaica. Full sample includes 24 tourism-dependent economies as defined by Bayoumi and others (2005).

2/ Based on Fund staff estimates. Medium-term is 2013.

¹ See IMF Working Paper 09/78, "Assessing Exchange Rate Competitiveness in the Eastern Caribbean Currency Union," by E. Pineda, P. Cashin, and Y. Sun.

² Staff estimates show that a large equilibrium current account is a feature of all ECCU economies. The projected medium-term current account balance for St. Kitts and Nevis is below the estimated level of the equilibrium current account (see also Pineda, Cashin, and Sun (2009)).

Figure 4. St. Kitts and Nevis: External Competitiveness, 1991–2008

The REER has appreciated recently...

...while the government wage bill increases rapidly in 2007-08.

Exports of goods continues to decline while services exports have trended down after 2005...

...and tourism-related FDI inflows have peaked in 2007.

Competitiveness, measured by customer-based and competitor-based REER, deteriorated recently...

...and there has been a reversal in gains in market share in the Caribbean tourist market.

Sources: ECCB; Caribbean Tourism Organization; St. Kitts and Nevis authorities; and Fund staff calculations.

1/ An increase (decrease) indicates an appreciation (depreciation).

2/ The spike in the competitor-based real exchange rate in 2002–03 was largely caused by the real effective depreciation and subsequent appreciation of the Dominican Republic's peso.

29. **The authorities reaffirmed their commitment to advancing reforms to the business climate and the labor market, aimed at providing a conducive environment for vibrant private sector-led growth.** The following reforms would be key to achieving this goal and would help St. Kitts and Nevis take advantage of opportunities under the recently signed Economic Partnership Agreement with the EU:

- ***Business climate.*** Reflecting recent steps to lower the cost of doing business, St. Kitts and Nevis now ranks 67th out of 181 countries on the World Bank's 2009 *Doing Business Indicators* survey (Figure 5). Simplifying procedures for starting and closing businesses, strengthening contract enforcement, and improving the availability of credit information would help improve the country's ranking among the OECS and internationally. The establishment of the St. Kitts Investment Promotion Agency (SKIPPA) as a one-stop shop for investors is highly commendable, but adopting an Investment Code should be expedited.
- ***The role of government.*** It is important that the public sector facilitates private-sector-led growth by removing infrastructure bottlenecks and creating a supportive environment. Corporatization of the electricity department and water services, as well as comprehensive reform of the civil service, are all critical for achieving this goal.
- ***Labor market.*** The window of opportunity given by the slowing implementation of large-scale investment projects should be used to implement measures to avoid the future emergence of labor shortages, including strengthening vocational and technical education making the labor market more flexible (firing costs in St. Kitts and Nevis are the highest in the region), and supporting initiatives to improve labor mobility within the Caribbean Single Market and Economy (CSME).
- ***Regional integration.*** Deepening regional cooperation would assist in taking full advantage of recent trade agreements; facilitate the movement of goods, services and labor; and lower the cost of providing government services.

C. Mitigating Vulnerability

30. **Financial sector risks have intensified recently.** The failure and subsequent intervention of CL Financial Group have sent shockwaves through the Caribbean financial sector,⁷ exposing weaknesses in the region's regulatory framework for nonbanks. The government has appropriately adopted an open communication policy about the risks involved, and this should ultimately help to underpin confidence about the government's efforts to resolve the problems. In the banking sector, nonperforming loans have begun to

⁷ CL Financial subsidiaries are holding about 17 percent of GDP in deposits and investments and about 3 percent of GDP of the public debt

Figure 5. St. Kitts and Nevis: Doing Business Indicators, 2008 1/

Source: World Bank, 2009 *Doing Business Indicators* (2008).

Note: ATG stands for Antigua and Barbuda, DMA stands for Dominica, GRD stands for Grenada, JAM stands for Jamaica, KNA stands for St. Kitts and Nevis, LCA stands for St. Lucia, TTO stands for Trinidad and Tobago and VCT stands for St. Vincent and the Grenadines.

1/ Smaller numbers represent greater ease in doing business. The indicators are comparable across 178 countries.

2/ This is an overall indicator that captures the regulatory costs of doing business; it can be used to analyze specific regulations that enhance or constrain investment, productivity, and growth.

3/ This topic identifies the bureaucratic and legal hurdles an entrepreneur must overcome to incorporate and register a new firm. It examines the procedures, time, and cost involved in launching a commercial or industrial firm with up to 50 employees and start-up capital of ten times the economy's per capita gross national income.

4/ This topic examines the steps, time, and cost involved in registering property, assuming a standardized case of an entrepreneur who wants to purchase land and a building in the largest business city—already registered and free of title dispute.

5/ This topic explores two sets of issues—credit information registries and the effectiveness of collateral and bankruptcy laws in facilitating lending.

6/ This topic looks at the efficiency of contract enforcement by following the evolution of a sale of goods dispute and tracking the time, cost, and number of procedures involved from the moment the plaintiff files the lawsuit until actual payment.

7/ This topic identifies weaknesses in existing bankruptcy laws and the main procedural and administrative bottlenecks in the bankruptcy process.

increase following a period of rapid credit growth, as a slowing economy and employment losses constrain repayment capacity. Key risks include:

- Government exposure of the banking system.** St. Kitts and Nevis is home to the largest indigenous bank in the ECCU, with more than 50 percent of the domestic deposit base and holding over 60 percent of the domestic public sector debt. The bank's gross government exposure-to-capital ratio has come down recently with the lowering of the overdraft and an increase in its capital but remains above 200 percent, a still formidably high level. In this environment of tightening liquidity and public concerns about the safety and soundness of financial institutions, any disruption of government payment capacity could create severe problems in the banking system.

Sources: St. Kitts and Nevis authorities; and Fund staff estimates.

- The liquidity squeeze.** The social security system, which is currently generating large surpluses (albeit much reduced this year owing to employment losses), has been one of the major financiers of the government, either directly through loans and treasury bills or indirectly through the banking system and land sales. The hitherto large deposits of the social security system have provided a ready source of liquidity to the banking system. Recently, however, this source of liquidity has been reduced, as the Social Security Board (SSB) has changed its investment strategy away from fixed deposits (mostly in the indigenous banks) and toward real estate development, together with some essentially quasi-fiscal activities. This will markedly reduce the extent of financing available to the government from the banking or social security systems at a time when alternative sources of financing are becoming scarce.
- The nonbank financial sector.** The intervention of CL Financial Group and the fraud accusations against the Antigua-based Stanford International Bank highlight the risks of lax regulatory frameworks for nonbanks.⁸ This sector had been growing rapidly, with the high-interest-rate deposit-taking activities of associated insurance companies a clear red

⁸ See the *ECCU Staff Report for the 2009 Common Policy Discussions* (IMF Country Report No. 09/175) for a more detailed discussion.

flag. Deposits held on behalf of individuals in St. Kitts and Nevis now amount to EC\$120 million and, should there be a “run” on these deposits,⁹ the government could not give a credible guarantee.

31. The banking sector vulnerabilities warrant close monitoring of both the domestic banking system and international markets. Frequent on-site inspections, stress testing, enforcement of banking regulations,¹⁰ and development of a full-fledged contingency plan are becoming ever more important, as is the need to monitor more closely developments at the headquarters of foreign banks.

32. Staff recommended the elimination of the intermediary role of the indigenous bank between social security and the central government. Given the current paucity of financing options, the government should consider borrowing directly from the social security system and cease the SSB’s quasi-fiscal and real estate development activities. *It is crucial that this direct borrowing be only a temporary measure*, transitioning as early as feasible to a model where the SSB can once again independently choose how to invest its assets. Of necessity, this arrangement must be transitory in order to preserve the long-term viability of social security.

33. Another component of the nonbank financial system—the offshore sector—is currently under threat, but the authorities are taking steps to protect the sector. The combination of the fraud accusations against the Stanford International Bank and the global recession’s threat to advanced countries’ tax bases have led a number of OECD and G-20 countries to begin a concerted effort to go after tax havens. St. Kitts and Nevis has been included on the OECD’s list of tax havens. Were the offshore sector to be shut down, this would be particularly harmful to the NIA’s already difficult fiscal situation, as this sector provides about 10 percent of tax revenues. On the positive side, however, the preliminary report of the Caribbean Financial Action Task Force (CFATF) for St. Kitts and Nevis indicates a better evaluation than that of the last such evaluation. Moreover, the government is working urgently to resolve any remaining issues highlighted in this most recent report. This includes moving ahead quickly with the Tax Cooperation Act, the aim of which is to exchange information with relevant countries to prevent the evasion of taxes by their residents through the use of local offshore companies.

34. From a longer term perspective, the mission welcomes the government’s plan to have a Single Regulatory Unit (SRU) in place as soon as feasible in an effort to

⁹ Indeed, by mid-March, depositors and policyholders had requested EC\$40 million in withdrawals from one of the insurance companies, most of which was not accommodated.

¹⁰ In fact, if the overdraft facility continues to rise and to capitalize interest, this would effectively be “evergreening” the loan, and it should be classified as a nonperforming loan (NPL). Enforcement of banking regulations would require the bank to provision for these loans, thereby building a buffer in the event of a crisis.

strengthen the regulatory framework for nonbanks. This will be a crucial first step toward closing the legal loopholes which allowed the type of regulatory arbitrage in which insurance companies could engage in risky deposit-taking behavior while avoiding the requirements placed on banks. Staff commended the government's efforts to press ahead with legislation which will expand the role of the Financial Services Commission (the staff has already more than doubled in size) into a fully operational SRU, as well as early passage of supporting legislation, such as the Insurance Act and Cooperatives Act.

35. The confluence of recent events has greatly increased the economy's vulnerability, making contingency planning an urgent necessity. Restoring debt sustainability is only part of the challenge to avoiding a debt crisis—financing needs also have to be met on a continuous basis. If a debt and/or financial sector crisis were to occur, the government should be well prepared to respond, particularly in light of the ECCB's limited role as a lender of last resort. A contingency/crisis preparedness plan should, therefore, be top priority, taking into account various growth and asset sales scenarios, together with a range of exogenous shocks (e.g., natural disasters, terms-of-trade shocks, elimination of offshore banking sector), any of which could greatly impair the government's ability to service its debt. As a first step, the government should develop a set of emergency fiscal measures (e.g., special levy on incomes, temporary import surcharge, nominal public sector wage cut). The government should also continue to consult closely with its legal and financial advisors regarding the design and implementation of a debt strategy and include various scenarios in the contingency plan.

D. Risks to the Adjustment Strategy

36. Aside from the challenging external environment, the main risks to the authorities' adjustment strategy include policy slippages, weak implementation capacity, and the ever-present threat of natural disasters. The local financial market could come under serious stress from the global turmoil, and the indirect adverse impact on the real sector could be substantial. A more protracted global slowdown could further exacerbate the weakening tourism sector and cause the postponement or outright cancellation of FDI-financed projects. Reduced demand for local real estate could undermine the government's land sales strategy and plans for upscale tourism development, while weakening bank portfolios. These, and the risks outlined below, underscore the urgency for developing contingency plans.

- ***Financing of the external current account deficit.*** FDI, external grants (mainly from the EU), and other private flows constitute a large proportion of the financing for the current account. Should these flows not materialize, commercial banks could be forced to reduce their holdings of net foreign assets, increasing their vulnerability. Imports would fall, further constraining output growth and contributing to explosive debt dynamics. A liquidity squeeze could also complicate rolling over public sector external debt—about EC\$53 million (3½ percent of GDP) falling due in 2009.

- **Implementation risks.** The active adjustment scenario is a very ambitious strategy, which may face strong public resistance. The authorities' resolve to implement this strategy could be tested in the run up to the general elections due by October 2009. Limited implementation capacity could also delay the achievement of some of their goals. With this in mind, staff has encouraged the authorities to align their targets with those they have established with other development partners like the CDB and the EU.
- **Natural disasters.** A direct hit by a hurricane could severely derail the authorities' economic strategy. Indeed, the impact of Hurricane Omar has already placed great strains on the Nevis economy and its financial autonomy. Thus, the staff welcomed the authorities' emphasis on preparedness and more widespread use of insurance (including as a participant in the CCRIF) for mitigating and managing natural disasters.¹¹ More effective oversight of insurance companies by the SRU would ensure that adequate reinsurance contracts are in place.

V. ACCESS AND CAPACITY TO REPAY

37. **The authorities have requested a purchase for an amount equivalent to SDR 2.23 million (25 percent of quota) under the Fund's policy of ENDA.** The purchase—which represents approximately ½ percent of St. Kitts and Nevis' 2009 GDP—would help meet the immediate foreign exchange needs stemming from the disaster, thereby mitigating a decline in external reserves.

38. **It is expected that St. Kitts and Nevis will be able to discharge its obligations with the Fund in a timely manner.** The public sector and external debt ratios had been declining before the impact of Hurricane Omar, as a result of the authorities' strong fiscal efforts to maintain a primary surplus of more than 4 percent of GDP over the last four years. However, the effects of the hurricane will likely contribute to the projected rise in debt (Figure 6). An important source of vulnerability is the large gross financing needs of almost 30 percent of GDP during 2009–13, which could become more burdensome when the repurchases for ENDA fall due in 2012 and 2013 (Figure 7 and Table 10). Nonetheless, in staff's view, these risks are mitigated by the government's strong debt servicing record, recent fiscal efforts to reduce the public debt ratio, and their commitment to generate even larger surpluses over the medium term, coupled with land sales to help reduce public debt levels.

¹¹ However, the analysis in Y. Wong, A. Lemus, and N. Wagner, "Insuring Against Natural Disasters in the Caribbean," in the *ECCU Selected Issues* paper (IMF Country Report No. 09/176), suggests that St. Kitts and Nevis' insurance coverage under the CCRIF is much below the optimal level.

VI. STAFF APPRAISAL

39. **The global recession, the financial meltdown of CL Financial Group, and the devastating impact of Hurricane Omar are creating the perfect economic storm for St. Kitts and Nevis.** On the heels of several years of robust growth driven by tourism and construction, the economy is now set to contract, with risks clearly on the downside. And the country's heavy debt burden has left no space for fiscal policy to respond to these challenges.

40. **The authorities are rightly focused on restoring debt sustainability, with fiscal adjustment the workhorse of the strategy.** The government's commitment to debt reduction has been evidenced by the achievement of four consecutive years of large primary surpluses, contributing to a substantive lowering of the public debt ratio. But this year will prove much more challenging, with the debt ratio expected to rise again. Nevertheless, the government should push ahead with their goal of sustaining even larger primary surpluses over the medium term. This will require continued and strengthened expenditure control, together with further structural fiscal reforms including, most critically, the VAT.

41. **But fiscal adjustment alone will not be sufficient to achieve debt sustainability.** The authorities appropriately aim to tighten oversight of the broader public sector; work closely with donors/creditors to tap additional grants or highly concessional loans; strengthen debt management capacity; put in place an effective single regulatory unit for the nonbank financial sector; enhance regulation of the banking system; and accelerate land/asset sales to lower debt more rapidly.

42. **Fiscal consolidation will also be important for supporting competitiveness, maintaining stability, and underpinning the ECCU quasi-currency board arrangement.** Although the real effective exchange rate and medium-term current account balances are broadly in line with fundamentals, maintaining competitiveness remains challenging, particularly in light of the country's high wage levels and the highly competitive tourism market.

43. **Financial sector risks, both in the banking and nonbank sectors, merit intensified monitoring.** A much less benign global environment, limited access to external credit markets, and the heavy exposure of the domestic banking system to the government imply strong efforts, including enhanced supervision, are needed to mitigate risks. Recent developments have also brought to light serious weaknesses in the nonbank financial regulatory framework, particularly in the insurance sector. Staff welcomes the authorities' imminent plans to put in place an effective single regulatory unit for the nonbank financial sector.

44. **The difficult financial climate, combined with the country's high vulnerability to exogenous shocks, highlights the urgency of developing a full-fledged contingency/crisis preparedness plan.** Given the government's large financing and rollover needs, a strong adjustment program is all the more critical to help prevent a debt or financial crisis. But at the

same time, having at hand a detailed contingency plan, including a set of emergency fiscal measures, would allow the government to respond quickly to various adverse scenarios, avoiding the chaos often associated with unanticipated shocks.

45. While the global downturn and heavy debt burden are likely to weigh heavily on near-term growth, there is light at the end of the tunnel if appropriate policies are implemented swiftly. If the authorities take serious action now and move forward with their reform agenda—together with completion of some planned high-end tourism projects and geothermal energy development in Nevis—real growth could potentially rise to 4 percent per year or higher over the medium and longer terms, helping to secure the impressive social and economic gains achieved in recent years.

46. Staff supports the authorities' request for a purchase under the Fund's policy on emergency assistance for natural disasters. Although Hurricane Omar struck in October 2008, the full impact, due to the indefinite closure of a major tourism resort on Nevis, has been slow to evolve. The staff's support is based on the severe effect on the economy and associated large balance of payment needs and the authorities' commitment to push ahead with an ambitious reform strategy focused on debt reduction. The large public debt and the inherent vulnerability of this small-island economy pose some risks to the Fund's resources. Nonetheless, these risks are mitigated by the authorities' exemplary record of debt service on external obligations and their resolve to sustain fiscal consolidation, foster private sector-led growth, and work closely with the Fund in pursuing their reform strategy.

47. Data are broadly adequate for surveillance, but improvements in coverage and timeliness in some areas would strengthen economic management. Considerable progress has been made in improving the quality and coverage of fiscal and debt data, but further improvements are needed in national accounts (particularly tourism data), fiscal data for public enterprises, fiscal financing, and labor statistics.

48. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Annex I. Medium-Term Fiscal Scenarios and Debt Sustainability Analysis

There is a high risk that current fiscal policies will contribute to an explosive public debt path. While strong fiscal and structural adjustments could place debt on a downward trajectory, debt would remain at uncomfortably high levels over the medium term.

This section considers two fiscal scenarios—baseline and active. Under the baseline scenario, debt follows an explosive path, as delays in major reforms and insufficient control of expenditure result in large financing gaps and an ever-rising public debt ratio. In contrast, the active scenario, with sustained fiscal adjustment and structural reforms, debt trends steadily downward, although the pace depends heavily on exogenous factors.

➤ **Baseline scenario.** Real growth is projected to contract by about 1.2 percent in 2009 before recovering to 2 percent in the medium term, reflecting delayed structural reforms, including sluggish land/asset sales. On revenue, a VAT will be introduced in mid-2011 due to slower-than-expected implementation, and tax concessions continue to be granted. On expenditure, the electricity department is corporatized in early 2011, the wage bill as a share of GDP remains constant, net lending continues, and capital expenditure as a share of GDP trends up again in 2010. Under this scenario, the central government primary surplus will hover around 1½ percent of GDP, resulting in large financing gaps. Public enterprises are assumed to borrow mainly from domestic sources, while their debt ratio (as a percent of GDP) is projected to be only marginally lower than that at end-2007, reflecting lax enforcement and control despite passage of the Finance Administration Act. Total public debt is projected to increase to above 200 percent of GDP by 2014.

➤ **Active scenario.** With accelerated structural reforms, including land/asset sales of 3 percent of GDP per year from 2010 (which contribute to more productive private investment and with the proceeds fully used to pay down more expensive debt), real growth is projected to increase to 4 percent over the medium term. On revenue, the VAT will be introduced as envisaged in late 2010. Tax concessions are contained, and efforts to collect tax arrears are strengthened. On expenditure, the electricity department is corporatized in early 2010, growth in the wage bill is capped in line with inflation, there is no net lending, and capital expenditures are solely financed by resources freed up by EU sugar grants (with disbursements of 2–3 percent of annual GDP during 2009–13). Under this scenario, the central government primary balance will rise, reaching close to 8 percent of GDP by 2013. Strict enforcement of the Finance Administration Act, combined with strong control of borrowing by public enterprises, will lead to the projected decline of public enterprise indebtedness from 40 percent of GDP in 2008 to around 32 percent by 2014. The overall public debt is projected to decline steadily to under 140 percent of GDP by 2014.

The above active scenario is subject to substantial downside risks. In particular, any exogenous shock could raise debt to much higher levels. Stagnant growth in the event of a more severe or prolonged global downturn or lower land sales would also hamper debt reduction. Under these more pessimistic scenarios, the decline in the debt ratio is much slower and could even be reversed in some years but would still be significantly lower than that under the baseline scenario.

The active scenario is modified as follows:

- **Disaster in 2009 and 2013.** Reflecting the vulnerability to hurricanes, this assumes that real growth is reduced by 5 percent in 2009 and 2013, respectively, and expenditure is increased by 2–3 percent, while revenue declines by about 2 percent of annual GDP during 2009–13.
- **Lower growth with land sales of 1 percent of GDP.** This has the same fiscal path as the active scenario but GDP growth and land sales remains at low levels as in the baseline scenario.
- **Lower growth with land sales of 3 percent of GDP.** This has the same fiscal path and land sales as the active scenario but GDP growth declines as in the baseline scenario.

Public Sector Debt Dynamics (In percent of GDP)

Sources: St. Kitts and Nevis authorities; and Fund staff estimates and projections.

1/ Combined accounts of the St. Kitts Government and the Nevis Island Administration.

2/ Public debt comprises debts of the St. Kitts Government, Nevis Island Administration, and statutory bodies, including debt to the social security system. The active scenario assumes a land sales equivalent to 2 percent of GDP in 2009.

Figure 6. St. Kitts and Nevis: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)

Sources: International Monetary Fund, country desk data; and Fund staff estimates.

1/ Based on the current policy scenario. Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Figure 7. St. Kitts and Nevis: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)

Sources: International Monetary Fund, Country desk data; and Fund staff estimates.

1/ Based on the current policy scenario. Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ One-time real depreciation of 30 percent occurs in 2009.

Annex II. Summary of Appendices

The full appendices to this report are issued as a supplement.

Fund relations. St. Kitts and Nevis has no outstanding Fund resources. It is a member of the Eastern Caribbean Currency Union (ECCU), which has a common central bank, the Eastern Caribbean Central Bank (ECCB). The common currency, the EC dollar, has been pegged to the U.S. dollar at the rate of EC\$2.70 since July 1976. St. Kitts and Nevis has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement. The exchange system is free of restrictions on the making of payments and transfers for current international transactions.

Relations with the World Bank Group. The country assistance strategy (CAS) for FY 2006–09 supports the region’s development through: (1) stimulating growth and improving competitiveness; and (2) reducing vulnerability. There are three active projects in St. Kitts and Nevis with a commitment of US\$9.6 million of which US\$6.6 million has been disbursed: (i) Telecommunications and ICT Development Project, (US\$0.54 million) approved on May 12, 2005, to improve the access, quality, and use of telecommunications and ICT services; (ii) Education Development Project (US\$5 million) approved in June 2003, to increase equitable access to secondary education and improve the quality of the teaching and learning processes; and (iii) HIV/AIDS Prevention and Control Program (US\$4 million), approved in January 2003.

Relations with the Caribbean Development Bank. The CDB has approved loans of US\$169.6 million, of which US\$135.1 million has been disbursed as of end-2008. Major projects under implementation include: a basic education project; a natural disaster management project; loans to Nevis Electricity Company (NEVLEC); the West Basseterre bypass road project; a child development project; a policy-based guarantee; and a policy based loan in support of policy and institutional reforms.

Statistical Issues. St. Kitts and Nevis has participated in the General Data Dissemination System since October 2000 and its metadata are posted on the Fund’s Dissemination Standards Bulletin Board. There are significant weaknesses in real, fiscal, and balance of payments data. Data on GDP by type of expenditure are not available at constant prices, while the data at current prices are not reliable due to weaknesses in estimating gross capital formation. A new CPI with weights from the 2000 household survey has been introduced. There are no data on labor market developments. Fiscal data are not reported for publication in IFS. After 1994, the latest data published in the *GFS Yearbook* are for 2003 and 2006 only. No data are available on the nonfinancial public sector. Data on external trade (especially exports) are not comprehensive, as they omit important categories of goods. Most components of the financial account also need improvement. There are no data on private external debt.

Table 1. St. Kitts and Nevis: Basic Data

I. Social and Demographic Indicators							
Area (sq. km)	269.4				Adult literacy rate (percent, 2004)		97.8
Population					Health and nutrition		
Total (thousands, 2001)	46.1				Calorie intake (per capita a day, 1996)		2,639
Rate of growth (percent per year, 2001)	0.02				Population per physician (thousand, 1993)		2.2
Density (per sq. km., 2001)	171.2				Access to safe water (percent, 1994)		100
Net migration rate (per thousand, 2002)	-9.8				AIDS incidence rate (per 100,000, 1998)		14
Population characteristics					Gross domestic product (2008)		
Life expectancy at birth (years, 2006)	71.2				(millions of U.S. dollars)		546
Infant mortality (per thousand live births, 2006)	16.8				(millions of E.C. dollars)		1,474
Under 5 mortality rate (per thousand, 2006)	19.0				(US\$ per capita)		10,310
II. Economic and Financial Indicators, 2003–09 (Baseline)							
	2003	2004	2005	2006	2007	Prel. 2008	Proj. 2009
(Annual percentage change; unless otherwise specified)							
National income and prices							
Real GDP (factor cost)	-1.2	7.3	5.2	2.5	2.9	3.2	-1.2
Consumer prices, end-of-period	2.9	1.7	6.0	7.9	2.1	7.6	3.5
Real effective exchange rate (end-of-period) 1/	-3.9	-4.0	5.4	2.6	-4.5	9.7	...
Banking system							
Net foreign assets 2/	13.6	-5.7	8.4	7.1	7.7	12.1	-5.2
Net domestic assets 2/	-6.7	27.8	-4.1	5.7	3.5	-9.8	6.3
Of which							
Credit to private sector 2/	3.4	6.8	5.1	8.2	9.2	9.5	3.7
Broad money	6.9	22.1	4.3	12.8	11.2	2.2	1.0
Of which							
Money	11.0	25.4	-1.9	12.7	11.2	8.6	1.0
Quasi-money	6.2	21.6	5.5	12.8	11.2	1.2	1.0
Weighted average deposit rate 3/	4.1	3.6	4.1	3.7	3.8	3.7	...
Weighted average lending rate 3/	12.0	9.9	9.7	9.4	9.0	8.8	...
(In percent of GDP)							
Public sector 4/							
Primary balance	-1.4	-0.8	4.0	4.7	3.7	5.3	2.4
Overall balance	-9.0	-7.9	-4.0	-5.0	-4.8	-3.5	-8.2
Total revenue and grants	33.5	34.3	39.4	39.4	39.5	38.9	36.6
Total expenditure and net lending	42.5	42.1	43.4	44.5	44.3	42.5	44.8
Foreign financing	14.5	1.5	-1.1	0.2	-2.9	3.1	0.1
Domestic financing	-3.1	8.7	18.9	6.4	3.2	-6.8	4.0
Sale of assets	0.2	0.4	0.3	0.5	2.6	3.6	1.0
Statistical discrepancy	-2.6	-2.8	-14.2	-2.1	1.8	3.6	-
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	2.5
Total public debt (end-of-period)	182.4	194.4	196.8	188.7	181.7	177.6	186.1
Of which							
Central government 5/	120.4	122.0	124.8	141.7	137.7	137.9	143.1
Public enterprises 5/	62.1	72.4	72.0	47.0	44.0	39.7	43.0
External sector							
External current account balance	-34.8	-20.1	-18.2	-20.4	-24.2	-28.5	-22.1
Trade balance	-32.7	-25.6	-27.7	-33.0	-36.5	-34.8	-19.9
Services, net	7.7	13.6	15.5	15.6	14.1	8.4	0.6
Of which							
Tourism receipts	20.8	25.7	27.6	26.9	24.6	19.4	12.1
Transfers, net	5.1	4.6	5.4	6.6	6.5	6.3	6.1
Net capital inflow 6/	34.6	23.6	16.7	23.9	25.6	29.9	18.8
FDI (net)	20.9	11.6	21.2	22.6	30.8	24.1	12.1
External public debt (end-of-period)	89.5	85.0	76.4	67.4	59.3	63.3	63.1
(In percent of exports of goods and nonfactor services)							
External public debt service	25.4	26.2	22.0	22.7	22.9	23.9	31.7
External public debt (end-of-period)	196.1	175.0	147.8	139.7	130.7	163.5	211.4
(In millions of U.S. dollars; unless otherwise specified)							
Gross international reserves of the ECCB, end-of-period	539.9	632.4	600.8	696.0	764.5	759.0	692.2
In percent of ECCU broad money	19.8	20.4	17.9	18.6	18.6	17.9	16.4

Sources: St. Kitts and Nevis authorities; ECCB; UNDP; World Bank; and Fund staff estimates and projections.

1/ Weights given by the average trade share during 1999–2003. Depreciation (-).

2/ In relation to broad money at the beginning of the period.

3/ End of period. Weighted by the size of loans or deposits. There was a break in the average interest rate series in June 2003.

4/ Central government unless otherwise noted.

5/ SSMC debt included in central government debt since 2006.

6/ Includes errors and omissions.

Table 2. St. Kitts and Nevis: Central Government Fiscal Operations, 2003–09 1/
(In millions of Eastern Caribbean dollars)

	2003	2004	2005	2006	2007	Prel. 2008	Baseline 2009	Active 2009
Total revenue	321.4	365.3	434.4	484.2	517.3	543.7	520.4	519.3
Current revenue	321.4	365.3	434.4	484.2	517.3	543.7	520.4	519.3
Tax revenue	233.9	281.9	344.8	373.1	400.4	419.1	406.3	411.3
Taxes on income	64.1	80.4	101.6	97.6	116.0	130.1	127.2	129.2
Taxes on property	5.2	5.1	5.0	8.7	7.4	6.9	8.5	8.5
Taxes on domestic goods and consumption	45.2	56.0	68.7	90.8	84.1	86.3	74.6	77.6
Taxes on international trade and transactions	119.3	140.5	169.5	175.9	192.9	195.9	196.0	196.0
Nontax revenue	87.5	83.5	89.6	111.1	116.8	124.6	114.1	108.0
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	415.6	454.1	514.6	586.6	611.6	626.0	667.7	649.3
Current expenditure	333.2	376.0	435.8	481.9	497.8	535.8	572.6	568.3
Wages and salaries	144.1	159.7	163.1	171.1	185.8	205.2	209.3	209.3
Goods and services	79.0	95.8	114.7	127.5	141.5	139.8	146.2	145.5
Interest	74.5	76.1	95.8	128.7	116.3	129.6	158.6	156.1
Domestic	31.0	30.1	48.4	87.0	77.3	84.8	103.8	101.2
Foreign	43.5	46.1	47.4	41.7	39.0	44.9	54.8	54.8
Transfers	35.6	44.3	62.2	54.7	54.1	61.2	58.5	57.5
Net lending	13.9	11.3	0.0	8.7	13.1	15.0	15.2	5.0
Capital expenditure	68.6	66.7	78.8	96.0	100.7	75.2	80.0	76.0
Current balance	-11.7	-10.7	-1.4	2.3	19.5	7.9	-52.2	-49.1
Overall balance (before grants)	-94.2	-88.7	-80.2	-102.4	-94.3	-82.3	-147.3	-130.0
Grants	6.1	4.1	32.2	36.1	28.4	30.2	25.0	63.9
Overall balance (after grants)	-88.2	-84.7	-48.0	-66.3	-65.9	-52.1	-122.3	-66.2
Primary balance	-13.7	-8.6	47.8	62.4	50.5	77.5	36.3	89.9
Financing	113.7	114.5	215.6	93.7	41.0	-0.8	85.7	66.2
Net foreign financing	141.8	16.6	-12.6	2.3	-40.1	45.6	1.9	1.9
Disbursements	187.1	62.9	7.5	44.5	24.8	97.2	54.9	54.9
Amortization	42.1	45.3	55.6	49.9	64.9	51.6	53.0	53.0
Other 2/	-3.2	-1.0	35.5	7.7	0.0	0.0	0.0	0.0
Net domestic financing	-30.3	93.3	224.2	84.3	44.7	-99.8	60.0	25.5
Banking system	-68.5	61.8	230.5	69.6	38.4	-210.4	20.0	-33.8
Nonbanks	38.2	31.5	-6.3	13.8	6.3	104.5	40.0	59.3
Arrears 3/	0.0	0.0	0.0	0.9	0.0	6.0	0.0	0.0
Sale/purchase of assets	2.2	4.6	4.0	7.0	36.4	53.5	14.9	29.8
Emergency assistance							9.0	9.0
Statistical discrepancy	-25.6	-29.8	-167.7	-27.3	24.9	52.9	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	36.6	0.0
Memorandum items:								
GDP (market prices)	977	1,078	1,185	1,319	1,382	1,474	1,490	1,490
Public sector debt (end of period)	1,783	2,096	2,331	2,489	2,510	2,619	2,772	2,671
Of which								
Central government 4/	1,176	1,315	1,478	1,869	1,902	2,033	2,132	2,061
Domestic	523	643	873	1,259	1,328	1,313	1,409	1,338
External	653	673	605	610	574	721	722	722

Sources: St. Kitts and Nevis authorities; and Fund staff estimates.

1/ Combined accounts of the Federal Government of St. Kitts and Nevis and the Nevis Island Administration.

2/ Changes in the foreign assets of the federal government.

3/ Capitalized interest arrears of SSMC debt held by the Development Bank in 2006 and current expenditures arrears in 2008.

4/ SSMC debt included in central government debt since 2006.

Table 3. St. Kitts and Nevis: Central Government Fiscal Operations, 2003–09 1/
(In percent of GDP)

	2003	2004	2005	2006	2007	Prel. 2008	Baseline 2009	Active 2009
Total revenue	32.9	33.9	36.7	36.7	37.4	36.9	34.9	34.9
Current revenue	32.9	33.9	36.7	36.7	37.4	36.9	34.9	34.9
Tax revenue	23.9	26.2	29.1	28.3	29.0	28.4	27.3	27.6
Taxes on income	6.6	7.5	8.6	7.4	8.4	8.8	8.5	8.7
Taxes on property	0.5	0.5	0.4	0.7	0.5	0.5	0.6	0.6
Taxes on domestic goods and consumption	4.6	5.2	5.8	6.9	6.1	5.9	5.0	5.2
Taxes on international trade and transactions	12.2	13.0	14.3	13.3	14.0	13.3	13.2	13.2
Nontax revenue	9.0	7.7	7.6	8.4	8.5	8.4	7.7	7.2
Capital revenue	-	-	-	-	-	-	-	-
Total expenditure and net lending	42.5	42.1	43.4	44.5	44.3	42.5	44.8	43.6
Current expenditure	34.1	34.9	36.8	36.5	36.0	36.3	38.4	38.2
Wages and salaries	14.7	14.8	13.8	13.0	13.4	13.9	14.1	14.0
Goods and services	8.1	8.9	9.7	9.7	10.2	9.5	9.8	9.8
Interest	7.6	7.1	8.1	9.8	8.4	8.8	10.6	10.5
Domestic	3.2	2.8	4.1	6.6	5.6	5.7	7.0	6.8
Foreign	4.5	4.3	4.0	3.2	2.8	3.0	3.7	3.7
Transfers	3.6	4.1	5.2	4.1	3.9	4.2	3.9	3.9
Net lending	1.4	1.1	0.0	0.7	0.9	1.0	1.0	0.3
Capital expenditure	7.0	6.2	6.7	7.3	7.3	5.1	5.4	5.1
Current balance	-1.2	-1.0	-0.1	0.2	1.4	0.5	-3.5	-3.3
Overall balance (before grants)	-9.6	-8.2	-6.8	-7.8	-6.8	-5.6	-9.9	-8.7
Grants	0.6	0.4	2.7	2.7	2.1	2.0	1.7	4.3
Overall balance (after grants)	-9.0	-7.9	-4.0	-5.0	-4.8	-3.5	-8.2	-4.4
Primary balance	-1.4	-0.8	4.0	4.7	3.7	5.3	2.4	6.0
Financing	11.6	10.6	18.2	7.1	3.0	-0.1	5.8	4.4
Net foreign financing	14.5	1.5	-1.1	0.2	-2.9	3.1	0.1	0.1
Drawings	19.1	5.8	0.6	3.4	1.8	6.6	3.7	3.7
Amortization	4.3	4.2	4.7	3.8	4.7	3.5	3.6	3.6
Other 2/	-0.3	-0.1	3.0	0.6	0.0	0.0	0.0	0.0
Net domestic financing	-3.1	8.7	18.9	6.4	3.2	-6.8	4.0	1.7
Banking system	-7.0	5.7	19.5	5.3	2.8	-14.3	1.3	-2.3
Nonbanks	3.9	2.9	-0.5	1.0	0.5	7.1	2.7	4.0
Arrears 3/	0.0	0.0	0.0	0.1	0.0	0.4	0.0	0.0
Sale/purchase of assets	0.2	0.4	0.3	0.5	2.6	3.6	1.0	2.0
Emergency assistance							0.6	0.6
Statistical discrepancy	-2.6	-2.8	-14.2	-2.1	1.8	3.6	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	2.5	0.0
Memorandum items:								
Public sector debt (end of period)	182.4	194.4	196.8	188.7	181.7	177.6	186.1	179.3
Of which								
Central government 4/	120.4	122.0	124.8	141.7	137.7	137.9	143.1	138.3
Domestic	53.6	59.6	73.7	95.5	96.2	89.0	94.6	89.8
External	66.8	62.4	51.1	46.2	41.5	48.9	48.5	48.5

Sources: St. Kitts and Nevis authorities; and Fund staff estimates.

1/ Combined accounts of the Federal Government of St. Kitts and Nevis and the Nevis Island Administration.

2/ Changes in the foreign assets of the federal government.

3/ Capitalized interest arrears of SSMC debt held by the Development Bank in 2006 and current expenditures arrears in 2008.

4/ SSMC debt included in central government debt since 2006.

Table 4. St. Kitts and Nevis: Structure of the Public Debt, 2003–08 1/

(In millions of U.S. dollars, unless otherwise stated)

	2003	2004	2005	2006	2007	2008
Total stock of debt	660.4	776.2	863.4	921.8	929.6	969.9
(In percent of GDP)	182.4	194.4	196.8	188.7	181.7	177.6
Total external debt (by debtor)	324.0	339.4	335.1	329.3	303.3	330.1
St. Kitts Government	188.9	184.1	177.2	181.8	171.0	214.2
Nevis Island Administration	52.9	65.0	47.0	44.1	41.4	37.0
Public enterprises 2/	82.2	90.3	110.9	103.4	90.9	78.9
Total external debt (by creditor)	324.0	339.4	335.1	329.3	303.3	330.1
Bilateral	47.7	42.7	36.4	41.2	39.0	33.9
Taiwan, Province of China	18.5	17.1	15.3	24.0	24.9	23.0
Kuwait	11.8	11.2	9.9	8.4	7.7	6.2
Other	17.3	14.4	11.2	8.8	6.4	4.7
Multilateral	91.7	97.6	98.9	105.6	106.6	112.3
CDB	72.7	76.9	79.8	84.3	86.1	94.2
World Bank	11.9	13.2	13.0	14.6	14.8	12.8
Other	7.0	7.5	6.1	6.7	5.8	5.3
Commercial and other	181.2	201.2	202.0	168.7	156.6	181.6
Total domestic debt (by debtor)	336.4	436.8	528.3	592.6	626.3	624.0
St. Kitts Government	168.0	207.8	286.7	420.8	433.4	419.9
Nevis Island Administration	25.9	30.3	36.6	45.5	58.6	66.3
Public enterprises 2/	142.5	198.7	204.9	126.2	134.3	137.8
Total domestic debt (by instruments)	336.4	436.8	528.3	592.6	626.3	624.0
Loans and advances	186.8	268.3	337.7	410.4	445.5	402.2
Treasury bills	111.6	130.4	152.4	144.0	143.1	150.6
Debentures	10.2	10.3	9.0	10.4	10.4	43.4
Regional government securities market	27.8	27.8	15.6	15.6	15.6	15.6
Other	0.0	0.0	13.6	12.2	11.8	12.1
Total domestic debt (by creditor)	336.4	436.8	528.3	592.6	626.3	624.0
ECCB	3.7	4.8	4.8	5.0	5.5	3.3
Commercial banks	196.3	262.2	356.1	413.5	442.4	401.9
of which: overdrafts	0.0	39.0	61.6	96.1	118.3	72.4
Social security	69.3	80.9	87.4	91.1	91.9	93.3
Other	67.0	89.0	80.0	82.9	86.6	125.5
Memorandum items (in percent of GDP):						
Public sector debt excluding debt to social security system	163.3	174.2	176.8	170.0	163.7	160.5
Net assets of Social Security Board	64.0	63.8	63.9	63.1	65.9	67.2

Sources: St. Kitts and Nevis authorities; ECCB; and financial statements of public enterprises.

1/ Public debt comprises debts of the St. Kitts government, Nevis Island Administration, and public enterprises, including government guaranteed debt and debt to the social security system but excluding all other intra-public sector debt.

2/ Debt of St. Kitts Sugar Manufacturing Corporation (SSMC) held by the National Bank (SKNA) (EC\$270.4 million) was reclassified as central government debt since 2006; the remaining (EC\$79 million) held by the Development Bank was acquired by SKNA and reclassified as central government debt in 2008Q2.

Table 5. St Kitts and Nevis: Balance of Payments (Baseline) 2005–14

	2005	2006	Prel. 2007	2008	2009	Projections				
						2010	2011	2012	2013	2014
(In millions of Eastern Caribbean dollars)										
Current account	-216.2	-268.7	-334.7	-420.7	-329.8	-331.5	-331.4	-335.6	-344.3	-355.3
Trade balance	-328.6	-435.5	-504.1	-513.3	-296.9	-333.9	-385.4	-453.4	-501.4	-552.4
Exports, f.o.b.	171.5	157.4	155.5	152.3	138.5	143.4	149.8	157.2	165.6	173.3
Imports f.o.b.	-500.1	-592.9	-659.6	-665.6	-435.5	-477.3	-535.2	-610.6	-667.1	-725.7
Of which										
Mineral fuel	-74.1	-88.0	-59.8	-81.6	-37.0	-43.7	-48.3	-51.7	-53.8	-55.9
Services and transfers (net)	112.4	166.8	169.3	92.6	-32.9	2.4	54.1	117.8	157.1	197.1
Services (net)	184.2	206.0	194.9	124.2	8.7	31.6	87.3	150.5	188.4	227.8
Services (receipts)	440.5	479.0	471.0	418.9	306.5	335.9	401.0	477.1	528.5	581.9
Of which										
Tourism receipts	327.1	355.5	340.5	285.6	179.6	209.4	272.4	345.6	392.1	440.3
Services (payments)	-256.3	-273.0	-276.2	-294.7	-297.8	-304.2	-313.7	-326.6	-340.1	-354.1
Factor income (net)	-136.3	-126.2	-115.6	-124.0	-132.4	-121.6	-128.1	-131.0	-134.1	-137.3
Of which										
Public sector interest	-60.7	-59.1	-52.6	-56.8	-64.4	-52.2	-56.5	-56.5	-56.5	-56.5
Transfers (net)	64.5	87.0	90.1	92.5	90.7	92.3	94.9	98.4	102.8	106.6
Official (net)	8.2	23.3	23.7	23.7	23.7	23.7	23.7	23.7	23.7	23.7
Private (net)	56.3	63.7	66.4	68.8	67.0	68.6	71.2	74.7	79.1	82.9
Capital and financial account	127.2	235.6	261.6	440.1	279.6	267.6	331.4	335.6	344.3	355.3
Official	24.0	1.7	-41.9	48.4	31.6	0.5	3.3	-1.3	-31.9	6.0
Capital transfers (net)	31.6	26.7	20.2	30.2	25.0	6.0	6.0	6.0	6.0	6.0
Long-term borrowing (net)	-7.6	-25.0	-62.1	18.2	6.6	-5.5	-2.7	-7.3	-37.9	0.0
Disbursements	66.3	18.2	29.0	98.1	83.4	15.2	13.2	12.3	21.7	18.4
Amortization	73.9	43.1	91.1	79.9	76.8	20.7	15.8	19.6	59.6	96.9
Private capital	103.2	233.9	303.5	391.7	248.0	267.2	328.0	336.8	376.2	349.3
Capital transfers (net)	8.2	9.3	10.5	10.2	10.0	10.0	10.0	10.1	10.2	10.3
Foreign direct investment (net)	251.1	298.1	425.3	355.6	180.8	260.3	312.1	336.0	358.4	382.1
Portfolio investment (net)	-40.6	-56.6	-43.4	-43.4	-43.4	-43.4	-43.4	-43.4	-43.4	-43.4
Short-term capital (net)	-107.9	-35.3	-80.5	-154.6	26.9	-45.1	-44.3	-50.1	-48.8	-8.1
Other private (net)	-7.6	18.4	-8.3	224.0	73.7	85.4	93.6	84.3	99.9	8.4
Errors and omissions	70.5	79.2	92.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-18.5	46.1	19.1	19.4	-50.2	-63.9	0.0	0.0	0.0	0.0
Overall financing	18.5	-46.1	-19.1	-19.4	50.2	63.9	-	-	-	-
Net international reserves	18.5	-46.1	-19.1	-19.4	50.2	63.9	-	-	-	-
Gross reserve (increase = -)	18.5	-46.1	-19.1	-19.4	41.2	63.9	-	2.3	4.5	2.3
IMF reserve liabilities (purchase = +)	-	-	-	-	9.0	-	-	-2.3	-4.5	-2.3
(In percent of GDP)										
Current account	-18.2	-20.4	-24.2	-28.5	-22.1	-21.8	-21.1	-20.5	-20.2	-20.1
Exports of goods and nonfactor services	51.7	48.2	45.4	38.7	29.9	31.5	35.1	38.8	40.8	42.6
Merchandise exports	14.5	11.9	11.3	10.3	9.3	9.4	9.5	9.6	9.7	9.8
Nonfactor services	37.2	36.3	34.1	28.4	20.6	22.1	25.6	29.2	31.1	32.8
Of which										
Tourism receipts	27.6	26.9	24.6	19.4	12.1	13.8	17.4	21.2	23.0	24.9
Imports of goods and nonfactor services	-63.8	-65.6	-67.7	-65.1	-49.2	-51.4	-54.1	-57.4	-59.2	-61.0
Merchandise imports	-42.2	-44.9	-47.7	-45.1	-29.2	-31.4	-34.1	-37.4	-39.2	-41.0
Nonfactor services	-21.6	-20.7	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0
Foreign direct investment (net)	21.2	22.6	30.8	24.1	12.1	17.1	19.9	20.6	21.1	21.6
Overall balance	-1.6	3.5	1.4	1.3	-3.4	-4.2	0.0	0.0	0.0	0.0
Overall financing	1.6	-3.5	-1.4	-1.3	3.4	4.2	0.0	0.0	0.0	0.0
Net international reserves	1.6	-3.5	-1.4	-1.3	3.4	4.2	0.0	0.0	0.0	0.0
Gross reserve (increase = -)	1.6	-3.5	-1.4	-1.3	2.8	4.2	0.0	0.1	0.3	0.1
IMF reserve liabilities (purchase = +)	0.0	0.0	0.0	0.0	0.6	0.0	0.0	-0.1	-0.3	-0.1
External public debt	76.4	67.4	59.3	63.3	63.1	60.2	56.2	52.2	47.1	41.4
(Annual percentage change)										
Merchandise exports	8.0	-8.2	-1.2	-2.1	-9.0	3.5	4.5	4.9	5.4	4.6
Tourism receipts	18.0	8.7	-4.2	-16.1	-37.1	16.6	30.1	26.9	13.4	12.3
Merchandise imports	15.2	18.6	11.2	0.9	-34.6	9.6	12.1	14.1	9.3	8.8
Terms of trade	-5.4	-4.5	-0.9	-3.1	11.6	-2.7	-1.2	-0.7	-0.3	-0.2
(In percent of exports of goods and nonfactor services)										
External public debt	147.8	139.7	130.7	163.5	211.4	191.2	160.1	134.4	115.5	97.0
External debt service	22.0	16.1	22.9	23.9	31.7	15.2	13.1	12.0	16.7	7.5
Of which										
Interest	9.5	8.8	7.9	9.3	13.2	10.0	9.5	8.3	7.6	7.0

Sources: ECCB; and Fund staff estimates and projections.

Table 6. St. Kitts and Nevis: Monetary Survey, 2003–09

	2003	2004	2005	2006	2007	Prel. 2008	Proj. 2009
(In millions of EC\$)							
Net foreign assets	438.9	387.6	480.7	562.1	661.7	835.7	758.6
ECCB imputed reserves	174.6	211.5	193.0	239.1	258.3	277.6	227.4
Crown agents	9.6	10.6	10.6	10.6	10.6	10.6	10.6
Commercial banks	254.7	165.5	277.0	312.3	392.8	547.5	520.5
Net domestic assets	464.1	715.2	670.2	736.2	781.9	640.3	732.6
Net credit to the public sector	51.4	216.4	318.0	392.1	393.4	366.3	353.2
Net credit to central government	198.2	263.0	351.7	422.5	464.8	337.2	357.2
Net credit to St. Kitts	160.1	216.0	296.7	397.5	464.8	263.0	283.0
Net credit to Nevis	38.1	47.0	55.0	25.0	52.2	74.2	74.2
Net credit to non-financial public sector	-146.8	-46.5	-33.7	-30.3	-71.4	29.1	-4.0
Net credit to nonbank financial inst.	25.1	48.8	41.0	37.9	34.1	-20.3	30.0
Credit to the private sector	687.4	748.5	804.6	899.5	1,018.7	1,156.6	1,211.7
Net other assets 1/	-299.8	-298.5	-493.4	-593.3	-664.4	-862.3	-862.3
Broad money (M2)	903.0	1,102.9	1,150.8	1,298.3	1,443.6	1,476.0	1,491.2
Money	133.1	166.9	163.7	184.5	205.1	222.8	225.1
Currency in circulation	39.9	44.6	49.9	55.1	56.2	70.1	70.8
Demand deposits	93.2	122.3	113.8	129.4	148.9	152.7	154.3
Quasi-money	769.9	936.0	987.1	1,113.8	1,238.4	1,253.2	1,266.1
Savings deposits	361.2	418.2	468.1	518.9	562.5	597.8	603.9
Time deposits	144.6	203.5	183.3	188.1	232.9	264.5	267.2
Foreign currency deposits	264.2	314.2	335.7	406.8	443.0	390.9	394.9
(Percentage change relative to broad money at beginning of period)							
Net foreign assets	13.6	-5.7	8.4	7.1	7.7	12.1	-5.2
Net domestic assets	-6.7	27.8	-4.1	5.7	3.5	-9.8	6.3
Net credit to the public sector	-10.8	18.3	9.2	6.4	0.1	-1.9	-0.9
Net credit to central government	-8.1	7.2	8.0	6.2	3.3	-8.8	1.4
Net credit to non-financial public sector	-2.7	11.1	1.2	0.3	-3.2	7.0	-2.2
Net credit to nonbank financial inst.	4.9	2.6	-0.7	-0.3	-0.3	-3.8	3.4
Credit to the private sector	3.4	6.8	5.1	8.2	9.2	9.5	3.7
Net other assets 1/	-4.1	0.1	-17.7	-8.7	-5.5	-13.7	0.0
(Annual percentage change)							
Broad money (M2)	6.9	22.1	4.3	12.8	11.2	2.2	1.0
Money	11.0	25.4	-1.9	12.7	11.2	8.6	1.0
Currency in circulation	5.9	11.7	11.8	10.5	2.0	24.8	1.0
Demand deposits	13.4	31.2	-6.9	13.7	15.1	2.5	1.0
Quasi-money	6.2	21.6	5.5	12.8	11.2	1.2	1.0
Savings deposits	7.8	15.8	11.9	10.9	8.4	6.3	1.0
Time deposits	-5.9	40.8	-9.9	2.6	23.8	13.5	1.0
Foreign currency deposits	11.8	19.0	6.8	21.2	8.9	-11.8	1.0
Credit to the private sector (in nominal terms)	4.3	8.9	7.5	11.8	13.3	13.5	4.8
Credit to the private sector (in real terms)	1.4	7.1	1.4	3.6	11.0	8.6	1.2
Memorandum items:							
Income velocity of money	7.3	6.5	7.2	7.1	6.7	6.6	6.6
Income velocity of broad money	1.1	1.0	1.0	1.0	1.0	1.0	1.0
Private sector credit/GDP (in percent)	70.3	69.4	67.9	68.2	73.7	78.4	81.3
Foreign currency deposits/GDP (in percent)	27.0	29.2	28.3	30.8	32.1	26.5	26.5

Sources: ECCB; and Fund staff estimates and projections.

1/ Includes subsidiaries and affiliates and capital accounts.

Table 7. St Kitts and Nevis: Summary Medium-Term Projections (Baseline), 2005–14

(In percent of GDP, unless otherwise noted)

	2005	2006	2007	Prel. 2008	Projections					
					2009	2010	2011	2012	2013	2014
National accounts and prices										
Real GDP at factor cost (percent change)	5.2	2.5	2.9	3.2	-1.2	0.0	1.0	2.0	2.0	2.0
CPI inflation, end of period (percent change)	6.0	7.9	2.1	7.6	3.5	2.2	2.2	2.2	2.2	2.2
Savings-investment balance										
Domestic expenditures	112.2	117.4	122.4	126.4	119.3	119.9	119.0	118.5	118.4	118.3
Consumption	69.9	63.4	72.4	76.4	69.3	71.9	71.0	70.5	70.4	70.3
Gross capital formation	42.3	54.0	50.0	50.0	50.0	48.0	48.0	48.0	48.0	48.0
Net exports	-12.2	-17.4	-22.4	-26.4	-19.3	-19.9	-19.0	-18.5	-18.4	-18.3
Gross national savings	24.1	33.6	25.8	21.5	27.9	26.2	26.9	27.5	27.8	27.9
Savings-investment gap	18.2	20.4	24.2	28.5	22.1	21.8	21.1	20.5	20.2	20.1
Central government accounts										
Total revenue and grants	39.4	39.4	39.5	38.9	36.6	35.8	33.0	33.5	33.5	33.4
Tax revenue	29.1	28.3	29.0	28.4	27.3	27.8	28.0	28.5	28.5	28.5
Nontax revenue, including capital revenue 1/	7.6	8.4	8.5	8.4	7.7	7.6	4.7	4.6	4.6	4.6
Grants	2.7	2.7	2.1	2.0	1.7	0.4	0.4	0.4	0.4	0.3
Expenditure and net lending	43.4	44.5	44.3	42.5	44.8	45.1	42.9	44.8	46.1	47.0
Current	36.8	36.5	36.0	36.3	38.4	38.3	35.0	37.0	38.2	39.1
Wages and salaries	13.8	13.0	13.4	13.9	14.1	14.1	14.1	14.1	14.1	14.1
Goods and services 1/	9.7	9.7	10.2	9.5	9.8	10.1	5.8	5.9	5.9	6.0
Interest	8.1	9.8	8.4	8.8	10.6	10.2	11.2	13.1	14.3	15.1
Transfers	5.2	4.1	3.9	4.2	3.9	4.0	4.0	4.0	4.0	4.0
Capital	6.7	7.3	7.3	5.1	5.4	5.8	6.8	6.8	6.8	6.8
Net lending	0.0	0.7	0.9	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Current balance	-0.1	0.2	1.4	0.5	-3.5	-2.8	-2.4	-3.8	-5.1	-6.0
Primary balance	4.0	4.7	3.7	5.3	2.4	0.9	1.3	1.7	1.6	1.5
Overall balance	-4.0	-5.0	-4.8	-3.5	-8.2	-9.3	-9.9	-11.3	-12.6	-13.6
Net external financing	-1.1	0.2	-2.9	3.1	0.1	0.0	0.1	-0.2	-2.0	-3.0
Net domestic financing	18.9	6.4	3.2	-6.8	4.0	2.6	2.5	2.4	2.4	2.3
Asset sales	0.3	0.5	2.6	3.6	1.0	1.0	1.0	1.0	1.0	1.0
IMF emergency assistance	-	-	-	-	0.6	-	-	-0.1	-0.3	-0.1
Statistical discrepancy	-14.2	-2.1	1.8	3.6	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	2.5	5.6	6.2	8.2	11.5	13.5
Total public debt (end of period)	196.8	188.7	181.7	177.6	186.1	192.1	196.1	200.2	206.5	213.2
Of which : External debt	76.4	67.4	59.3	63.3	63.1	60.2	56.2	52.2	47.1	41.4

Sources: St. Kitts and Nevis authorities; and Fund staff estimates and projections.

1/ Assumes that Electricity Department is corporatized and removed from central government accounts during 2008.

Table 8. St. Kitts and Nevis: Indicators of External and Financial Vulnerability, 2003–08

(12-month percentage change, unless otherwise stated)

	2003	2004	2005	2006	2007	Prel. 2008
External indicators						
Merchandise exports	-5.1	2.6	8.0	-8.2	-1.2	-2.1
Merchandise imports	-1.1	-8.4	15.2	18.6	11.2	0.9
Terms of trade deterioration (-)	1.0	-3.5	-5.4	-4.5	-0.9	-3.1
Tourism earnings	31.9	36.2	18.0	8.7	-4.2	-16.1
Current account balance (percent of GDP)	-34.8	-20.1	-18.2	-20.4	-24.2	-28.5
Capital and financial account balance (percent of GDP) 1/	44.3	24.1	10.7	17.9	18.9	29.9
<i>Of which</i>						
Foreign direct investment	20.9	11.6	21.2	22.6	30.8	24.1
Gross international reserves of the ECCB						
In millions of U.S. dollars	539.9	632.4	600.8	696.0	764.5	759.0
In percent of broad money	19.8	20.4	17.9	18.6	18.6	17.9
Commercial banks' net foreign assets (millions of U. S. dollars)	94.3	61.3	102.6	115.7	145.5	202.8
External public debt (percent of GDP)	89.5	85.0	76.4	67.4	59.3	63.3
External debt service (in percent of exports of goods and services)	25.4	26.2	22.0	16.1	22.9	23.9
<i>Of which</i>						
Interest	12.1	10.5	9.5	8.8	7.9	9.3
Nominal exchange rate (E.C. dollars per U.S. dollar, end period)	2.7	2.7	2.7	2.7	2.7	3.7
Real effective exchange rate depreciation (-), end period 2/	-3.9	-4.0	5.4	2.6	-4.5	9.7
Financial indicators						
Broad money	6.9	22.1	4.3	12.8	11.2	2.2
Credit to the private sector	4.3	8.9	7.5	11.8	13.3	13.5
Share of nonperforming assets to total assets of banks (percent)	8.6	7.8	6.1	4.8	4.1	5.2
Provisions for loan losses/nonperforming assets (percent)	23.2	17.0	19.3	24.3	23.9	17.3
Provisions for loan losses/total loans (percent)	2.0	1.3	1.2	1.2	1.0	0.9
Gross government exposure/total assets (percent)	24.6	28.9	30.1	31.0	29.1	28.2
Total loans/total deposits (percent)	71.7	75.0	80.4	85.1	86.9	88.7
Net liquid assets/total deposits (percent)	39.7	33.1	34.3	33.8	33.8	41.1
Foreign currency deposits/total deposits (percent)	20.9	22.0	21.1	25.0	23.4	22.9
Liquid assets/total deposits (percent)	43.4	37.3	36.9	36.8	35.4	38.8
Liquid assets/current liabilities (percent)	55.6	41.9	49.3	41.8	43.8	47.4
Total capital/total assets (percent) 3/	11.8	11.7	12.7	13.2	15.1	19.6
Total Capital/Risk Weighted Assets (percent) 3/	33.7	33.8	45.1	38.9	41.8	47.3
Tier 1 Capital/Risk Weighted Assets (percent) 3/	36.6	30.0	39.7	35.0	35.8	44.7
Ratio of bank's before-tax profits to average assets (percent)	2.4	2.8	3.1	3.4	3.9	4.7

Sources: ECCB; Ministry of Finance; and Fund staff estimates.

1/ Includes errors and omissions.

2/ Estimated on the basis of weights given by the average trade share during 1999–2003.

3/ For locally incorporated banks only.

Table 9. St. Kitts and Nevis: Status of Policy Conditions for the Second Disbursement of PBL 1/
(As of March 31, 2009)

Conditions	Status
General Fiscal Policy <ul style="list-style-type: none"> • Maintenance or strengthening of existing fiscal policy arrangements to achieve and maintain sustainable fiscal and debt outturns; • Central government primary balance not to fall below 3.5 percent of GDP 2/; • IMF to have no objections to fiscal policy stance and policy arrangements; • Arrangements in place satisfactory to CDB for the management of the PSIP. 	Pending Preliminary fiscal data for 2008 indicated a primary balance of EC\$77.5 million (about 5.2 percent of GDP) for the St. Kitts government.
Revenue Measures <ul style="list-style-type: none"> • Completion of valuation of at least 50 percent of total registered properties for property tax assessment. • Enactment and bringing into force of new Income Tax Act (condition brought forward from the first tranche). • Arrangements in place for the collection of corporate income tax under the new Income Tax Act, and evidence of collections under the new Act. • Submission to CDB of a schedule, acceptable to CDB, for the implementation of a transaction-based tax. 	Done As of end-February 2009, the Inland Revenue Department completed 60.4 percent of the total registered properties for property tax assessment. Pending The revised draft of the of the new Income Tax Act was completed with assistance from CARTAC. Further discussions with key stakeholders were scheduled to be completed by end-March 2009. The enactment of the new Income Tax Act is expected by the second quarter of 2009. Pending Partially done A VAT Implementation Plan outlining detailed elements of the various components and timelines was submitted to CDB. However, major policy decisions regarding VAT implementation are still to be made. The implementation of the VAT is expected by October 2010.
Expenditure Management <ul style="list-style-type: none"> • Written agreement on a detailed, time-phased programme for the introduction of multiyear budgeting for the Federal Government. Engagement of consultants to recommend and/or assist with implementation. Starting of work by consultants. • A Unit established and made operational in MOF to monitor and report to the Financial Secretary on the operations and management of public enterprises, in line with oversight responsibilities of MOF under the Finance Administration Act. 	Done Partially Done The Government Entities Monitoring Unit was established within the Fiscal Division of the Ministry of Finance. A Government Entities Oversight Board was also formed. However, financial reports from many public entities are still outstanding.
Debt Management <ul style="list-style-type: none"> • Substantial implementation of arrangements acceptable to the CDB for the management of the public debt and its integration with budget management processes, arising out of the recommendations of the debt management consultants. 	Pending The debt management strategy has been approved by the cabinet. Details of the debt strategy are being finalized.
Land Sales <ul style="list-style-type: none"> • Establishment of a single public sector entity with transparent and accountable arrangements for governance and management responsible for development, management and sale of public land. • To identify land, in excess of 1,000 acres and in addition to 1,200 acres already earmarked for sale as at December 2006, for development and sale. • Development of a program for land development and sale covering at least the period to December 2013. • Commencement of sales from the 1,200 acres of land, with the proceeds, except for administrative costs, used to reduce public debt until the public/GDP ratio falls below 60 percent. 	Pending The government has requested technical assistance from the CDB to help set up a land sales agency. The terms of reference for the consultancy have been agreed to by both the government and CDB. Approval for financing of the consultant is being arranged by CDB. Pending Pending Sale of land is ongoing. The Land Sales Agency is to be established which will be responsible for the sale of land at market prices.
Privatization <ul style="list-style-type: none"> • Corporatization of electricity utility completed. 	Pending The technical consultant's report is being revised, implying some delay in corporatization. Corporatization is now likely to be completed in mid-2010.

Sources: CDB; and the Ministry of Finance.

1/ Two sources of funds will be used for the PBL: US\$12 million from Ordinary Capital Resources (OCR) and US\$8 million from Special Funds Resources (SFR). (i) The OCR portion is to be repaid in 20 years, inclusive of a grace period of five years, at a variable interest rate (reviewed semi-annually). The rate at end-2006 was 6.25 percent per year. A commitment fee of 1 percent is also applied. If the CDB's Board of Directors agrees to establish an Interest Subsidization Fund (ISF), an interest subsidy of 2 percent could be applied. (ii) The SFR portion is to be repaid in 25 years, inclusive of a grace period of five years, at an interest rate of 2.5 percent per year.

2/ Referring to only the St. Kitts Government and excluding the NIA.

Table 10. St. Kitts and Nevis: Indicators of Capacity to Repay the Fund, 2008–14 1/

	2008	Projections					
		2009	2010	2011	2012	2013	2014
Fund obligations based on existing credit							
(in millions of SDRs)	-	-	-	-	-	-	-
Principal	-	-	-	-	-	-	-
Charges and interest	-	-	-	-	-	-	-
Fund obligations based on existing and prospective credit							
(in millions of SDRs)	-	0.03	0.04	0.04	0.6	1.1	0.6
Principal	-	-	-	-	0.6	1.1	0.6
Charges and interest	-	0.03	0.04	0.04	0.03	0.02	-
Total obligations based on existing and prospective credit							
In millions of SDRs	-	0.03	0.04	0.04	0.6	1.1	0.6
In percent of government revenue	-	0.0	0.0	0.0	0.4	0.8	0.4
In percent of exports of goods and services	-	0.0	0.0	0.0	0.4	0.7	0.3
In percent of debt service 2/	-	0.1	0.1	0.1	1.0	1.5	0.7
In percent of GDP	-	0.0	0.0	0.0	0.1	0.3	0.1
In percent of quota	-	0.3	0.4	0.4	6.6	12.7	6.3
In percent of net international reserve	-	0.1	0.1	0.1	1.5	2.8	1.4
Outstanding Fund credit 2/							
In millions of SDRs	-	2.2	2.2	2.2	1.7	0.6	-
In percent of government revenue	-	1.7	1.7	1.7	1.2	0.4	-
In percent of exports of goods and services	-	2.0	1.9	1.6	1.1	0.3	-
In percent of debt service 2/	-	4.2	5.3	4.8	3.0	0.8	-
In number of months of imports of goods	-	0.2	0.2	0.2	0.1	0.0	-
In percent of GDP	-	0.6	0.6	0.6	0.4	0.1	-
In percent of quota	-	25.0	25.0	25.0	18.8	6.3	-
In percent of net international reserve	-	3.9	5.5	5.5	4.1	1.4	-
Net use of Fund credit (millions of SDRs)	-	2.2	-	-	-0.6	-1.1	-0.6
Disbursements	-	2.2	-	-	-	-	-
Repayments and Repurchases	-	-	-	-	0.6	1.1	0.6
Memorandum items:							
Nominal GDP (in millions of U.S. dollars)	546.1	551.7	563.6	581.3	605.2	630.1	656.0
Government revenue (in millions of U.S. dollars)	201.4	192.7	199.8	189.8	200.5	208.6	217.1
Exports of goods and services (in millions of U.S. dollars)	211.5	164.8	177.5	204.0	234.9	257.1	279.7
Debt service (in millions of U.S. dollars) 2/	67.1	78.1	62.0	68.4	83.8	110.2	124.4
Imports of goods (in millions of U.S. dollars)	246.5	161.3	176.8	198.2	226.1	247.1	268.8
Net international reserves (in millions of U.S. dollars)	102.8	84.2	60.6	60.6	60.6	60.6	60.6

Source: Fund staff estimates and projections.

1/ Assumes purchase in an amount of SDR 2.225 million (25 percent of quota).

2/ Total debt service includes external debt amortization, interest, and IMF repurchases and repayments.

3/ US\$1= 0.671105 SDR (as of March 30, 2009)

Table 11. Public Sector Debt Sustainability Framework, 2004–14
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing primary balance 1/ 7.6		
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014			
I. Baseline Projections														
1 Public sector debt 2/	194.4	196.8	188.7	181.7	177.6	186.1	192.1	196.1	200.2	206.5	213.2			
Of which: Foreign-currency denominated	85.0	76.4	67.4	59.3	63.3	63.1	60.2	56.2	52.2	47.1	41.4			
2 Change in public sector debt	12.0	2.3	-8.1	-7.0	-4.1	8.5	6.0	4.0	4.2	6.2	6.7			
3 Identified debt-creating flows (4+7+12)	-1.4	-5.8	-12.4	-5.7	-10.9	5.7	4.6	3.3	2.9	4.0	4.8			
4 Primary deficit	5.0	0.2	-2.9	-4.3	-5.9	-3.5	-1.9	-2.4	-2.8	-2.7	-2.5			
5 Revenue and grants	44.8	50.4	47.9	47.9	47.3	45.4	44.6	41.8	42.2	42.2	42.1			
6 Primary (noninterest) expenditure	49.8	50.5	44.9	43.6	41.4	41.9	42.7	39.4	39.4	39.5	39.6			
7 Automatic debt dynamics 3/	-6.0	-5.6	-8.9	1.2	-1.3	10.2	7.6	6.7	6.7	7.7	8.3			
8 Contribution from interest rate/growth differential 4/	-6.0	-5.6	-8.9	1.2	-1.3	10.2	7.6	6.7	6.7	7.7	8.3			
9 Of which contribution from real interest rate	6.7	4.3	0.5	2.8	2.7	8.1	7.5	8.7	10.4	11.6	12.3			
10 Of which contribution from real GDP growth	-12.6	-9.9	-9.4	-1.5	-4.0	2.1	0.0	-1.9	-3.8	-3.9	-4.0			
11 Contribution from exchange rate depreciation 5/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			
12 Other identified debt-creating flows	-0.4	-0.3	-0.5	-2.6	-3.6	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0			
13 Privatization receipts (negative)	-0.4	-0.3	-0.5	-2.6	-3.6	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0			
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			
16 Residual, including asset changes (2-3)	13.4	8.1	4.3	-1.3	6.8	2.8	1.4	0.6	1.3	2.2	2.0			
Public sector debt-to-revenue ratio 2/	434.3	390.5	394.3	379.2	375.2	410.0	430.7	469.2	474.1	489.4	505.9			
Gross financing need 6/	75.7	93.4	66.2	70.5	67.2	70.8	71.4	81.1	86.0	93.8	102.4			
In billions of U.S. dollars	0.3	0.4	0.3	0.4	0.4	0.4	0.4	0.5	0.5	0.6	0.7			
Key Macroeconomic and Fiscal Assumptions						10-Year Historical Average	10-Year Standard Deviation					Projected Average		
Real GDP growth (in percent)	7.6	5.6	5.3	0.9	2.4	3.3	2.4	-1.2	0.0	1.0	2.0	2.0	1.4	
Average nominal interest rate on public debt (in percent) 7/	6.7	6.7	6.3	5.4	6.0	6.8	0.8	6.8	6.3	6.7	7.7	8.1	8.3	7.4
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	4.2	2.7	0.6	1.6	1.7	3.6	1.9	4.6	4.1	4.7	5.6	6.1	6.2	5.3
Nominal appreciation (increase in U.S. dollar value of local currency, in percent)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Inflation rate (GDP deflator, in percent)	2.4	4.1	5.7	3.8	4.3	3.2	1.3	2.2	2.2	2.1	2.1	2.1	2.1	2.1
Growth of real primary spending (deflated by GDP deflator, in percent)	7.4	7.2	-6.3	-2.1	-2.9	3.5	15.6	0.0	1.8	-6.7	2.1	2.2	2.2	0.3
Primary deficit	5.0	0.2	-2.9	-4.3	-5.9	0.9	15.6	-3.5	-1.9	-2.4	-2.8	-2.7	-2.5	-2.5
II. Stress Tests for Public Debt Ratio												Debt-stabilizing primary balance 1/ 7.3		
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2009–14 8/													-0.6	
A2. No policy change (constant primary balance) in 2009–14													7.3	
B. Bound Tests														
B1. Real interest rate is at baseline plus one standard deviations													10.0	
B2. Real GDP growth is at baseline minus one-half standard deviation													11.2	
B3. Primary balance is at baseline minus one-half standard deviation													9.3	
B4. Combination of B1-B3 using one-quarter standard deviation shocks													11.5	
B5. One time 30 percent real depreciation in 2010 9/													9.0	
B6. 10 percent of GDP increase in other debt-creating flows in 2010													8.0	

1/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

2/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

3/ Derived as $[(r - p(1+g) - g + ae(1+r))/(1+g+p+gp)]$ times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

4/ The real interest rate contribution is derived from the denominator in footnote 3/ as $r - \pi(1+g)$ and the real growth contribution as $-g$.

5/ The exchange rate contribution is derived from the numerator in footnote 3/ as $ae(1+r)$.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ Derived as nominal interest expenditure divided by previous period debt stock.

8/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

9/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 12. External Debt Sustainability Framework, 2004–14
(In percent of GDP, unless otherwise indicated)

	Actual					Projections							Debt-stabilizing non-interest current account 1/ -17.2
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014		
	I. Baseline Projections												
1 External debt	85.5	76.9	64.6	59.1	63.3	63.1	60.2	56.2	52.2	47.1	41.4		
2 Change in external debt	-3.0	-8.7	-12.3	-5.5	4.3	-0.2	-2.9	-4.0	-4.0	-5.0	-5.8	0.0	
3 Identified external debt-creating flows (4+8+9)	2.8	-7.2	-5.8	-6.3	3.6	12.3	6.2	2.2	0.4	-0.3	-0.9	0.0	
4 Current account deficit, excluding interest payments	14.8	13.1	15.9	20.4	24.7	17.8	18.4	17.5	16.6	16.3	16.0	17.2	
5 Deficit in balance of goods and services	11.9	12.2	17.4	22.4	26.4	19.3	19.9	19.0	18.5	18.4	18.3		
6 Exports	48.6	51.7	48.2	45.4	38.7	29.9	31.5	35.1	38.8	40.8	42.6		
7 Imports	60.5	63.8	65.6	67.7	65.1	49.2	51.4	54.1	57.4	59.2	61.0		
8 Net nondebt creating capital inflows (negative)	-9.1	-17.8	-18.3	-27.6	-21.2	-9.2	-14.2	-17.1	-17.9	-18.5	-19.1	-19.1	
9 Automatic debt dynamics 2/	-2.9	-2.6	-3.3	0.9	0.1	3.7	2.1	1.8	1.7	1.9	2.2	1.9	
10 Contribution from nominal interest rate	5.3	5.1	4.5	3.8	3.9	4.3	3.4	3.6	3.9	3.9	4.1	3.6	
11 Contribution from real GDP growth	-6.1	-4.4	-3.7	-0.5	-1.3	0.7	0.0	-0.6	-1.1	-1.0	-0.9	-0.8	
12 Contribution from price and exchange rate changes 3/	-2.1	-3.3	-4.1	-2.4	-2.4	-1.4	-1.4	-1.2	-1.1	-1.1	-1.0	-0.8	
13 Residual, incl. change in gross foreign assets (2-3)	-5.8	-1.5	-6.5	0.8	0.6	-12.5	-9.1	-6.2	-4.4	-4.7	-4.9	0.0	
External debt-to-exports ratio (in percent)	176.1	148.8	133.8	130.2	163.5	211.4	191.2	160.1	134.4	115.5	97.0		
Gross external financing need (in billions of U.S. dollars) 4/	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2		
in percent of GDP	35.6	32.3	30.5	37.0	39.5	33.6	29.3	28.0	27.1	28.8	30.1		
Key Macroeconomic Assumptions						10-Year Historical Average	10-Year Standard Deviation					For debt stabilization	Projected Average
Real GDP growth (in percent)	7.6	5.6	5.3	0.9	2.4	3.3	2.4	-1.2	0.0	1.0	2.0	2.0	1.4
Exchange rate appreciation (U.S. dollar value of local currency, change in percent)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GDP deflator in U.S. dollars (change in percent)	2.4	4.1	5.7	3.8	4.3	3.2	1.3	2.2	2.2	2.1	2.1	2.1	2.1
Nominal external interest rate (in percent)	6.6	6.6	6.5	6.2	7.0	6.7	0.7	6.9	5.5	6.2	7.3	7.9	7.2
Growth of exports (U.S. dollar terms, in percent)	17.4	16.9	4.0	-1.5	-8.8	4.1	8.3	-22.1	7.7	14.9	15.2	9.4	11.2
Growth of imports (U.S. dollar terms, in percent)	-5.5	15.9	14.5	8.1	2.6	6.6	8.6	-23.6	6.6	8.6	10.4	7.5	8.1
Current account balance, excluding interest payments	-14.8	-13.1	-15.9	-20.4	-24.7	-21.9	7.0	-17.8	-18.4	-17.5	-16.6	-16.3	-16.0
Net nondebt creating capital inflows	9.1	17.8	18.3	27.6	21.2	25.2	8.8	9.2	14.2	17.1	17.9	18.5	19.1
A. Alternative Scenarios													Debt-stabilizing non-interest current account 1/ -25.2
A1. Key variables are at their historical averages in 2009–14 5/								63.1	51.1	42.1	34.9	27.5	20.0
B. Bound Tests													
B1. Nominal interest rate is at baseline plus one-half standard deviation								63.1	60.4	56.6	52.8	48.0	42.4
B2. Real GDP growth is at baseline minus one-half standard deviations								63.1	60.7	56.9	52.8	47.3	40.6
B3. Non-interest current account is at baseline minus one-half standard deviations								63.1	63.7	63.3	63.0	61.8	60.2
B4. Combination of B1-B3 using 1/4 standard deviation shocks								63.1	62.3	60.3	58.3	55.1	51.1
B5. One time 30 percent real depreciation in 2010								63.1	79.8	65.3	51.0	34.9	17.1

1/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

2/ Derived as $[r - g - r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

3/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

Attachment: Letter of Intent

April 24th, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431

Dear Mr. Strauss-Kahn,

St. Kitts and Nevis, particularly the island of Nevis, has been badly affected by Hurricane Omar, which passed the region over the period of October 16–17, 2008. Parts of the Federation suffered significant damage to roads and coastal infrastructure from the impact of extremely high storm surge. The major hotel on the island of Nevis, the Four Seasons Resort, which is the largest private sector employer, is expected to remain closed until at least the end of 2009.

Additionally, tourism arrivals have declined by 80 percent in the last quarter of 2008 and this trend is expected to continue during 2009. The initial estimate of the overall damage is about EC\$150 million, nearly 11 percent of GDP, including loss of external earnings through 2009 of some EC\$50 million, or 3½ percent of GDP. Our preliminary estimates suggest that growth in the economy is likely to move into negative territory compared to marginally positive growth projected prior to the hurricane. This follows very strong growth in the previous three years, reflecting strong FDI inflows and tourism-related construction. The balance of payments will likely deteriorate significantly despite the fall in international fuel prices, as tourism receipts fall sharply.

The impact of the hurricane has evolved very slowly. It was initially estimated that the Four Seasons Resort would be closed for about six months. However, international insurers have requested a substantial redesign of the property to avoid future flooding. This is now expected to keep the property off the market for at least one year. In addition to the substantial shortfall of tourism receipts, this would result in a significant loss of employment and government revenue—both directly, and indirectly through lower economic activity.

The Government is dealing with the effects of the crisis on several fronts. In the short run, measures have been introduced to ease the economic effects of the natural disaster by reprogramming expenditure to repair and build critical infrastructure. The Government has also taken steps to cushion the impact on the displaced workers by ensuring they receive their benefits from the hotel and facilitating alternative employment.

More broadly, the Government is developing a comprehensive economic program to deal with the twin issues of the fallout from the global slowdown and the effects of the natural disaster. The program focuses on sustaining large fiscal primary surpluses to place public debt ratios on a

downward trajectory and undertaking structural reforms to help reactivate the economy. The government remains committed to fiscal reforms, including implementation of the value added tax, to boost revenues and strengthen the viability of public finances. The government will stay current in all debt-service payments to creditors and accelerate the reduction in debt levels through asset/land sales. As a first step, the Government will shortly establish an appropriately-staffed agency to help expedite market-based sales of land to the private sector in order to achieve our debt reduction targets.

Thus, the Government has reoriented its medium-term economic policies toward reducing public debt, while pursuing structural reforms aimed at faster economic growth and lower poverty. With the assistance of the European Union (EU), the Government is developing a growth and poverty reduction strategy to guide its medium-term reform agenda. The Government believes that this strategy will play a key role in achieving our policy objectives. The main priorities for reform will be (i) strengthening fiscal policies to place debt on a firmly declining path; (ii) enhancing the investment climate for private sector development, including through privatization of public assets; (iii) and strengthening oversight of the financial sector.

The slow evolution of the effects precluded immediate donor assistance and, hence, the Nevis Island Administration has had to bear the full brunt of the impact. Accordingly, the Government of St. Kitts and Nevis requests a purchase equivalent to SDR 2.225 million (25 percent of quota) under the Fund's Emergency Natural Disaster Assistance. The purchase will help meet the immediate foreign exchange needs stemming from the disaster, thereby easing pressure on our external reserves and maintaining confidence in the external position.

It is hoped that the international financial community will support our efforts to restore economic growth and the country's social structure. We look forward to an early approval by the Fund of the request for emergency assistance, and to accelerated and increased financial and technical assistance from other donors, in particular the EU, the Caribbean Development Bank, the World Bank, and governments.

The Government will continue to cooperate with the Fund in an effort to strengthen St. Kitts and Nevis' balance of payments situation and maintain economic stability. The Government does not intend to impose new or intensify existing restrictions on the making of payments and transfers for current international transactions, introduce new or intensify existing trade restrictions for balance of payments purposes, or enter into bilateral payments agreements which are inconsistent with Article VIII of the Fund's Articles of Agreement.

Sincerely yours,

-----/s/-----

Dr. the Hon. Timothy Harris
Minister of Finance

INTERNATIONAL MONETARY FUND

ST. KITTS AND NEVIS

Staff Report for the 2009 Article IV Consultation—Informational Annex

Prepared by the Western Hemisphere Department

April 29, 2009

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Appendix I. St. Kitts and Nevis—Fund Relations

(As of March 31, 2009)

I. Membership Status: Joined August 15, 1984; Article VIII.

II. General Resources Account:	SDR Million	Percent of Quota
Quota	8.90	100.00
Fund holdings of currency	8.82	99.09
Reserve position in the Fund	0.08	0.92

III. SDR Department:	SDR Million	Percent of Allocation
Holdings	0.00	N/A

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements: None

VI. Projected Payments to Fund: None

VII. Implementation of HIPC Initiative: Not Applicable

VIII. Implementation of MDRI Assistance: Not Applicable

IX. Exchange Arrangement

St. Kitts and Nevis is a member of the Eastern Caribbean Central Bank (ECCB), which manages monetary policy and the exchange system for its eight members. The common currency, the Eastern Caribbean dollar, has been pegged to the U.S. dollar at the rate of EC\$2.70 per U.S. dollar since July 1976. In practice the ECCB has operated like a quasi-currency board, maintaining foreign exchange backing of its currency and demand liabilities of close to 100 percent. St. Kitts and Nevis accepted the obligations of Article VIII, Sections 2, 3, and 4 in December 1984. The exchange system is free of restrictions on the making of payments and transfers for current international transactions.

X. Safeguards Assessment

Under the Fund's safeguards assessment policy, the Eastern Caribbean Central Bank (ECCB) is subject to a full safeguards assessment under a four-year cycle. The most recent

assessment was completed in July 2007 and concluded that the ECCB continues to have appropriate control mechanisms in place, which have strengthened since the first safeguards assessment completed in 2003. ECCB management places emphasis on good governance and sound controls, and has enhanced the bank's transparency and accountability since the last assessment, including publications of financial statements that comply with International Financial Reporting Standards. The assessment made some recommendations to sustain the ECCB's safeguards framework going forward.

XI. Last Article IV Consultation

St. Kitts and Nevis is on the standard 12-month consultation cycle. The last Article IV consultation was concluded by the Executive Board on February 4, 2008. The staff report is IMF Country Report No. 08/126, and the accompanying statistical appendix is IMF Country Report No. 08/127.

XII. FSAP Participation, ROSCs, and OFC Assessment

St. Kitts and Nevis participated in the regional ECCU FSAP conducted in September and October 2003. The Financial System Stability Assessment is available at www.imf.org/external/pubs/ft/scr/2004/cr04293.pdf. A review of St. Kitts and Nevis AML/CFT Assessment was conducted by a team of assessors representing the Caribbean Financial Action Taskforce (CFATF) in September 2003.

XIII. Technical Assistance: (2005–Present)

Since 2005, St. Kitts and Nevis has benefited from technical assistance in the areas of tax policy, tax administration, economic statistics, financial supervision and macroeconomic management, both from IMF headquarters and the Caribbean Regional Technical Assistance Centre (CARTAC).

- Experts from CARTAC and the IMF's Statistics Department (STA) advised the Central Statistics Office on improving the national accounts, rebasing the consumer price index, and developing export-import price indices. In response to a request from the authorities, experts from CARTAC assisted in compiling separate production-based measures of GDP for St. Kitts and Nevis.
- Experts from CARTAC, the IMF's Monetary and Capital Markets Department (MCM), and the IMF's Legal Department (LEG) advised the authorities on strengthening financial regulation and supervision, including risk-based supervision. With assistance from the Office of the Superintendent of Financial Institutions in Canada (OSFI), experts from CARTAC have provided technical assistance to the ECCB on drafting the OECS Insurance Act. They have also, in conjunction with

LEG, provided technical assistance to the ECCB in finalizing the drafting of the OECS Money Services business Act. Experts from CARTAC also assisted in the development of the Single Regulatory Unit.

- Experts from CARTAC and MCM also provided technical assistance on public debt management to strengthen management capacity and develop a medium-term debt strategy.
- Experts from CARTAC, the IMF's Fiscal Affairs Department (FAD) and LEG provided assistance to improve cash management and tax administration—including collection enforcement. Experts from CARTAC have also provided assistance in Property Tax reform to move the property tax base from rental value to market value, and in improving central government fiscal and debt data.
- CARTAC, FAD and LEG are providing assistance for implementation of a value-added tax (VAT). CARTAC and FAD have provided extensive assistance, through frequent expert visits, to sensitize politicians and technicians from the Ministry of Finance on the VAT. This provided a general explanation on VAT, a VAT sensitivity study, and the main steps in its introduction. Experts from CARTAC have assisted with the preparation of a VAT Implementation Project Plan, and experts from LEG assisted in the drafting of the VAT and excise tax legislation.
- Experts from LEG also provided assistance in tax legislation in the areas of Social Service Levy and Corporate Income Tax.
- Experts from CARTAC provided assistance in the administration and design of a new pension plan for public sector employees.
- As part of the Stabilization and Adjustment Technical Assistance Program (SATAP), St. Kitts and Nevis have benefited from capacity building in macroeconomic analysis.

Appendix II. St. Kitts and Nevis: Relations with the World Bank Group

(As of March 6, 2009)

The World Bank's Management presented to its Board the Eastern Caribbean Sub-Region Country Assistance Strategy (CAS), on September 13, 2005. The World Bank Group's strategy for the four years covered by this CAS (FY 2006–09) supports the sub-region's development agenda through two main pillars: (1) stimulating growth and improving competitiveness; and (2) reducing vulnerability, by promoting greater social inclusion and strengthening disaster risk management. Recognizing the Organization of the Eastern Caribbean States (OECS) countries' weakened creditworthiness due to high debt ratios, Bank activities will focus on leveraging available donor grant financing. Following the recommendations of the 2005 growth and competitiveness study for the OECS, IBRD and IDA support would focus on providing technical and financial assistance for interventions to support the two main pillars. The CAS proposes new commitments of US\$103.4 million for six borrowing member states of the OECS, including St. Kitts and Nevis. Planned IBRD lending to St. Kitts and Nevis amounts to US\$10 million under the high-case lending scenario.

A. Projects

There are three active World Bank projects in St. Kitts and Nevis for commitment of approximately US\$9.6 million, of which approximately US\$6.6 million has been disbursed.

The St. Kitts and Nevis **Telecommunications and ICT Development Project**, approved on May 12, 2005 for US\$0.54 million, aims at improving the access, quality, and use of telecommunications and ICT services to achieve socioeconomic development in the OECS. The project has the following four components: Component (1) will strengthen the national and regional regulatory frameworks and promote additional competition in the telecommunications sector. Emphasis will be given to capacity building of Eastern Caribbean Telecommunications Authority (ECTEL) and the National Telecommunications Regulatory Commissions (NTRCs) by providing them with assistance to revise the regional and national sector legislation, and develop a modern interconnection regime. Component (2) will review current universal access policy, create related guidelines, and provide financial support to establish a Universal Service Fund (USF). Component (3) will improve growth and competitiveness in ICT-enabled services through utilization of broadband infrastructure. Component (4) will ensure management and administration of the overall project.

The **St. Kitts and Nevis Education Development Project** was approved in June 2003 for US\$5.0 million. The overall objective of this project is to build human capital which, in turn, will contribute to the diversification of the economy and more sustainable growth. This objective will be achieved by: (i) increasing equitable access to secondary education; (ii) improving the quality of the teaching and learning process, with more direct interventions

at the school level and a focus on student-centered learning, and (iii) strengthening management of the sector and governance of schools.

The HIV/AIDS Prevention and Control Program, which was approved in January 2003 for US\$4.0 million, is funded under the Multi-Country APL for the Caribbean Region, with the following objectives: (i) curbing the spread of HIV/AIDS epidemic; (ii) reducing the morbidity and mortality attributed to HIV/AIDS; (iii) improving the quality of life for persons living with HIV/AIDS (PLWAs); and (iv) developing a sustainable organizational and institutional framework for managing the HIV/AIDS epidemic over the longer term.

B. Economic and Sector Work

Economic and Sector Work: The Bank has completed a series of analytical work relating to public expenditure, fiscal and debt sustainability, growth and competitiveness, the financial sector, public sector management, and social protection. The ongoing dissemination of these reports represents a key instrument for policy dialogue with the OECS governments, including St. Kitts and Nevis.

The Bank's program in St. Kitts and Nevis is further supported by a comprehensive series of completed, ongoing and planned analytical and advisory activities including the following: "Towards a New Agenda for Growth"—OECS growth and competitiveness study (2005); An OECS Skills Enhancement Policy Note (2006); a Caribbean Air Transport Report (2006); a regional study on Crime, Violence, and Development: Trends, Costs, and Policy Options in the Caribbean (2007); an OECS Private Sector Financing Study (2008); the OECS Tourism Backward Linkages Study (2008); the report "Caribbean—Accelerating Trade Integration: Policy Options for Sustained Growth, Job Creation and Poverty Reduction" (2009); a CARICOM study on Managing Nurse Migration (ongoing) ;and a preparatory study aimed at developing a Caribbean-wide Regional Energy Strategy (ongoing).

C. Financial Relations

(In millions of U.S. dollars)

Operation	Original Principal	Available*	Disbursed*
TELECOMMUNICATIONS & ICT DEVELOPMENT PROJECT—ST. KITTS AND NEVIS	0.54	0.27	0.25
OECS EDUCATION DEVELOPMENT PROJECT— ST. KITTS AND NEVIS	5.0	0.84	3.71
HIV/AIDS PREVENTION AND CONTROL PROGRAM—ST. KITTS AND NEVIS	4.05	1.20	2.62
	9.58	2.31	6.58

* Amounts may not add up to Original Principal due to changes in the SDR/US exchange rate since signing.

Disbursements and Debt Service (Fiscal Year Ending June 30)

	Actual									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009*
Total disbursements	2.88	1.38	1.90	4.12	2.38	1.66	1.35	1.85	2.04	1.77
Repayments	0.07	0.05	0.12	0.33	0.67	0.89	1.18	1.75	2.56	1.55
Net disbursements	2.82	1.32	1.78	3.79	1.71	0.77	0.17	0.10	-0.52	0.22
Interest and fees	0.22	0.34	0.40	0.64	0.60	0.65	0.67	0.76	0.75	0.28

Note: * Data for June 2008 to February 2009.

Appendix III: St. Kitts and Nevis—Relations with the Caribbean Development Bank

(As of December 31, 2008)

The Caribbean Development Bank (CDB) has approved loans totalling US\$169.6 million, of which US\$34.5 million are undisbursed.

A. Major Projects

1. *Basic Education Project*—to assist the Government of St. Kitts and Nevis (GOSKN) in the provision and maintenance of a more appropriate learning environment for a greater number of students in the system (including those with learning disabilities) who are pursuing basic education at primary and secondary schools; and enhancement of the education system in the areas of management, in particular, planning, data collection and analysis, student assessment, school management, curriculum development and pedagogy.
2. *West Basseterre By-Pass Road*—to construct approximately 3.8 kilometres of road to relieve traffic congestion in the city of Basseterre. The proposed road runs to the north of Basseterre and along the boundary fence of the Robert L. Bradshaw International Airport.
3. *Second Power Project*—consists of the installation of a generator of approximate size 2.5MW and ancillary switchgear and the establishment of an operations facility at the Nevis Electricity Company Limited (NEVLEC). The project will provide additional generating capacity to satisfy projected electricity demand and to replace existing engines that are past their useful life.
4. *Student Loan Scheme (Sixth Loan)*—to assist the National Bank of St Kitts-Nevis-Anguilla in financing loans to students attending local, regional and extra-regional institutions for programmes in technical, vocational and academic studies.
5. *Child Development Project*—to provide a comprehensive framework for addressing the care and protection of children and the reform of juvenile offenders. The project will enhance the life chances of children in St. Kitts and Nevis by improving their connectedness with the school system and providing rehabilitative care for those at risk and those who have committed offences.
6. *Natural Disaster Management Project*—to contribute to the rehabilitation of economic infrastructure caused by Hurricane Lenny. The project consists of rehabilitating 8.66 metres of sea defence structures with rock armouring and stone on geo-textile sheeting; reconstruction of a reinforced concrete ramp; and repairs to other infrastructure and public buildings. The project promotes the reduction of

vulnerability to natural disasters through support for the development and adoption of mitigation policies, standards and practices.

7. *Policy-Based Guarantee*—to support a bond issue of up to EC\$150 million by the Government to refinance high cost debt, thereby supporting ongoing macroeconomic reforms and structural reforms in St. Kitts and Nevis. The refinancing would also improve the debt dynamics, thus lowering the time path of the debt-to-GDP ratio.
8. *Policy-Based Loan*—is intended to support policy and institutional reforms while helping the Federal Government to improve debt dynamics by using the proceeds of the loan to replace some of its high-cost debt. The policy reforms are designed to improve public finance management, particularly budget management and revenue systems, and public enterprise governance systems to achieve fiscal and debt sustainability.

B. Current Portfolio

(In millions of U.S. dollars)

	Approved	Undisbursed
Basic Education Project	14.18	1.97
Natural Disaster Management Project	6.7	3.47
Student Loan Scheme (Sixth Loan)	6.2	6.2
Second Power Project	8.43	8.38
West Basseterre By-Pass Road	7.56	0.82
Child Development Project	2.64	2.64
Corporatisation of the Electricity	0.6	0.27
Policy-Based Guarantee	8.3	8.3
Policy-Based Loan	20.0	10.0

C. Loan Disbursement

(In millions of U.S. dollars)

	2004	2005	2006	2007	2008
Net Disbursement	4.08	3.13	4.32	6.44	9.26
Disbursement	6.48	6.02	7.38	10.41	15.43
Amortization	2.4	2.89	3.06	3.97	6.17
Interest and charges	2.8	3.07	3.35	3.77	3.93
Net resource flow	1.28	0.06	0.97	2.67	5.33

Appendix IV. St. Kitts and Nevis: Statistical Issues

Data provision is broadly adequate for surveillance, although significant shortcomings in data provision and data quality remain. St. Kitts and Nevis has been participating in the General Data Dissemination System (GDDS) since October 2000, and its metadata are posted on the Fund's Dissemination Standards Bulletin Board (DSBB).

A. Real Sector

There are a number of deficiencies in the real sector statistics. GDP data by type of expenditure are not available at constant prices, while the data at current prices are not reliable due to weaknesses in estimating gross capital formation. Private final consumption expenditure is estimated as a residual. A new CPI with weights from the 2000 household survey has now been introduced. Monthly CPI data are reported regularly but with a long lag. Detailed data on tourism arrivals and expenditure have not been compiled since end-2001. Limited data are available on labor market developments.

B. Public Finances

Data on revenue, expenditure, and financing of the consolidated central government are made available to Fund staff on request. Commendable progress has recently been made in improving the quality and coverage of central government fiscal data, including on government and public enterprise debt. However, discrepancies between overall balance and available financing need to be resolved. It would be important to produce a set of fully integrated accounts for the central government on a regular basis. Also, it would be beneficial to institute a mechanism for the regular reporting of financial data on the rest of the public sector. The most recent data on the central government published in the *GFS Yearbook* are for 2003 and 2006.

C. Balance of Payments and External Debt

Estimates are currently provided on an annual basis by the Eastern Caribbean Central Bank (ECCB). The latest data published in *IFS* are for 2007. Incomplete provisional data have been produced for 2008 by the ECCB; these will be completed and finalized in early 2009. Data on external trade (especially exports) are not comprehensive, as they omit important categories of goods. Most components of the financial account also need improvement. It would be useful to reconcile the data on the public sector investment plan for external loans with the public external debt database. There are no data on private external debt.

D. Monetary and Financial Statistics

The 2003 money and banking statistics mission indicated that enhanced institutional coverage, classification of financial instruments, and sectorization of economic units would facilitate identification of credit flows to different sectors of the economy and compilation of monetary aggregates. It recommended that the institutional coverage for other depository corporations be expanded to include credit unions, finance companies, and building societies, which also accept demand and other deposits. Further, the mission recommended broadening the coverage to include insurance companies, pension funds, development banks, and offshore institutions and foundations.

In April 2007, a data ROSC mission assessed the monetary statistics with reference to the GDDS and the Data Quality Assessment Framework (DQAF, July 2003). It indicated that the quality of the ECCB and Eastern Caribbean Currency Union member countries' monetary statistics has improved over recent years, and the monetary statistics are broadly adequate for macroeconomic analysis and policy design and monitoring. Nevertheless, the mission identified shortcomings that have the potential for detracting from accurate and timely analysis of economic and financial developments. In particular, the institutional coverage of the other depository corporations remains incomplete, as data for mortgage companies, finance companies, building societies, and credit unions—all of which accept deposits—are excluded. Also, accrued interest is not incorporated in the value of the interest-bearing assets and liabilities, and valuation adjustments are included in other liabilities. In addition, source data for the commercial banks do not provide the disaggregation recommended in the Monetary and Financial Statistics Manual. The authorities endorsed the mission's recommendations and an action plan for enhancing the analytical usefulness of the monetary statistics. In this context, with effect from January 1, 2009, the definition of broad money aggregates is revised to include the deposits of non-bank financial institutions and subsidiaries and affiliates held at commercial banks, and this change is first reflected in the monetary statistics from January 2009.

St. Kitts and Nevis: Table of Common Indicators Required for Surveillance
(As of April 15, 2009)

	Date of latest observation	Date received	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of publication ⁶
Exchange Rates	Fixed Rate	n.a.	n.a.	n.a.	n.a.
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	02/09	04/09/09	M	M	M
Reserve/Base Money	02/09	04/09/09	M	M	M
Broad Money	02/09	04/09/09	M	M	M
Central Bank Balance Sheet	02/09	04/09/09	M	M	M
Consolidated Balance Sheet of the Banking System	02/09	04/09/09	M	M	M
Interest Rates ²	02/09	04/09/09	M	M	M
Consumer Price Index	12/08	2/23/09	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ —General Government ⁴	02/09	3/20/09	M	M	A
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	12/08	03/13/09	Q	Q	A
External Current Account Balance	2008	03/10/09	A	A	A
Exports and Imports of Goods and Services	2008	03/10/09	A	A	A
GDP/GNP	2008	03/10/09	A	A	A
Gross External Debt	12/08	03/13/09	Q	Q	A

¹Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

²Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³Foreign, domestic bank, and domestic nonbank financing.

⁴Central government only.

⁵Including currency and maturity composition.

⁶Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

I
FOR IMMEDIATE RELEASE
June 1, 2009

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2009 Article IV Consultation with St. Kitts and Nevis

On May 15, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with St. Kitts and Nevis.¹

Background

Near-term growth prospects have deteriorated markedly in the wake of the global recession, the collapse of Trinidad-based CL Financial Group, and damage from Hurricane Omar, further complicating an already difficult situation. The island of Nevis, in particular, has been badly affected by Hurricane Omar which passed the region in October 2008, with the island's largest hotel likely to remain closed during 2009 due to damage from the hurricane's storm surge. Thus, after growing by 3.2 percent in 2008, St. Kitts and Nevis' real output is projected to contract by 1.2 percent in 2009. Risks to the outlook are clearly on the downside, as strains from the global crisis have become increasingly evident in the local financial system, including through extensive cross-border linkages with the troubled CL Financial Group.

Higher food and fuel prices led to a pick-up in inflation in the first ten months of 2008, peaking in October 2008 at 8.3 percent before moderating to 7.6 percent at end-2008. Inflation is projected to ease further in 2009 on the back of lower oil prices.

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

The government's commitment to debt reduction resulted in a fiscal primary surplus in 2008—at more than 5 percent of GDP—for the fourth consecutive year, helping to lower the public debt ratio (as a percent of GDP) by 20 percentage points over the past four years. However, the primary surplus is projected to decline to 2½ percent of GDP in 2009, largely due to an expected drop in revenues without concomitant cuts in expenditures, and the debt ratio is expected to trend up again.

With a debt ratio at more than 175 percent of GDP by end-2008, debt service comprises nearly a quarter of government revenues, leaving no space for fiscal policy to respond to the adverse shocks. Fiscal consolidation will be important not only for restoring debt sustainability, but also for supporting competitiveness, maintaining stability, and underpinning the Eastern Caribbean Currency Union (ECCU) quasi-currency board arrangement.

Financial sector vulnerability stems from banks' continued high government exposure and a needed further strengthening of supervision of the nonbank sector. Moreover, should the global slowdown be prolonged, the adverse impact could spread to the banking sector through a rise in nonperforming loans. The insurance sector, meanwhile, is grappling with the fallout of CL Financial Group's problems.

The authorities have made a request for an Emergency Natural Disaster Assistance (ENDA) purchase equivalent to 25 percent of quota (SDR 2.225 million). Although Hurricane Omar struck in October 2008, the full impact due to the indefinite closure of a major tourism resort on Nevis, has been slow to evolve. The authorities are attempting to address the effects of the hurricane, but face severe financing constraints. Fund financing is expected to partly offset the balance-of-payments impact, estimated at 3½ percent of GDP due largely to a decline in tourism receipts.

Executive Board Assessment

The Executive Directors noted that, on the heels of several years of robust growth, the economy of St. Kitts and Nevis has weakened markedly in the wake of the shocks from the global recession, the collapse of the Trinidad and Tobago-based CL Financial Group, and the devastating impact of Hurricane Omar. Directors concurred that, while the global downturn and heavy debt burden are likely to weigh heavily on near-term growth, the economy is well placed to achieve strong growth over the medium term provided that the authorities continue to implement appropriate policies and press ahead with the reform agenda.

Directors welcomed the authorities' commitment to restore fiscal and debt sustainability, as evidenced by the achievement of four consecutive years of large primary surpluses, contributing to a substantial lowering of the public debt ratio. Given the continued large financing needs, Directors encouraged the authorities to push ahead with their goal of achieving even larger primary surpluses over the medium term. They underscored the need for strengthened expenditure control, together with further structural fiscal reforms including, most critically, the implementation of the VAT. Directors also encouraged the authorities to tighten oversight of the broader public sector; work closely with donors to tap additional grants or highly concessional

loans; accelerate land and/or other asset sales to lower debt more rapidly; and strengthen debt management capacity.

Directors underscored the importance of fiscal consolidation in supporting competitiveness and underpinning the ECCU's quasi-currency board arrangement. Although the real effective exchange rate is broadly in line with fundamentals, they noted that maintaining competitiveness in the context of relatively high wage levels and a highly competitive tourism market will require sustained efforts to improve the business climate and labor market.

Directors stressed the need to enhance monitoring and supervision of both the bank and nonbank financial sectors, given the much less benign global environment, the heavy exposure of the domestic banking system to the government, and the recent shocks to the insurance and offshore financial sectors. They welcomed the plans to put in place an effective single regulatory unit for the nonbank financial sector. Directors also commended the authorities' efforts to coordinate with other regional governments to address the regional financial turmoil resulting from the fallout of the collapse of the CL Financial Group.

Directors generally agreed that the Fund's emergency assistance for natural disasters will provide valuable support in assisting the authorities with their efforts to mitigate Hurricane Omar's severe effects on the economy and the balance of payments. While noting the country's large public debt and inherent vulnerability, Directors were encouraged by the authorities' exemplary record of debt service on external obligations and their resolve to sustain fiscal consolidation, foster private sector-led growth, and work closely with the Fund in pursuing their reform strategy. In this context, some Directors felt that the Stand-By Arrangement might be a more appropriate instrument.

Directors encouraged the authorities to develop a full-fledged contingency and crisis preparedness plan, including the identification of emergency fiscal measures. This would allow the government to respond quickly to possible adverse scenarios that may arise against the present background of the difficult financial climate and the country's high vulnerability to exogenous shocks.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

St. Kitts and Nevis: Selected Economic Indicators, 2004–09

	2004	2005	2006	2007	Prel. 2008	Proj. 1/ 2009
(Annual percentage change, unless otherwise specified)						
Output and prices						
Real GDP (factor cost)	7.3	5.2	2.5	2.9	3.2	-1.2
Consumer prices, end-of-period	1.7	6.0	7.9	2.1	7.6	3.5
Real effective exchange rate (end-of-period) 2/	-4.0	5.4	2.6	-4.5	9.7	...
Banking system						
Net foreign assets 3/	-5.7	8.4	7.1	7.7	12.1	-5.2
Net domestic assets 3/	27.8	-4.1	5.7	3.5	-9.8	6.3
<i>Of which:</i> Credit to private sector 3/	6.8	5.1	8.2	9.2	9.5	3.7
Broad money	22.1	4.3	12.8	11.2	2.2	1.0
(In percent of GDP, unless otherwise specified)						
Public sector 4/						
Total revenues and grants	34.3	39.4	39.4	39.5	38.9	36.6
Total expenditure and net lending	42.1	43.4	44.5	44.3	42.5	44.8
Overall balance	-7.9	-4.0	-5.0	-4.8	-3.5	-8.2
<i>Of which:</i> Primary balance	-0.8	4.0	4.7	3.7	5.3	2.4
Total public sector debt (end-of-period)	194.4	196.8	188.7	181.7	177.6	186.1
<i>Of which:</i>						
Central government 5/	122.0	124.8	141.7	137.7	137.9	143.1
Public enterprises 5/	72.4	72.0	47.0	44.0	39.7	43.0
External sector						
External current account	-20.1	-18.2	-20.4	-24.2	-28.5	-22.1
Trade balance	-25.6	-27.7	-33.0	-36.5	-34.8	-19.9
Services, net	13.6	15.5	15.6	14.1	8.4	0.6
<i>Of which:</i> Tourism receipts	25.7	27.6	26.9	24.6	19.4	12.1
FDI (net)	11.6	21.2	22.6	30.8	24.1	12.1
External public debt (end-of-period)	85.0	76.4	67.4	59.3	63.3	63.1

Sources: St. Kitts and Nevis authorities; ECCB; and IMF staff estimates and projections.

1/ Based on the baseline (current policy) scenario.

2/ Weights given by the average trade share during 1999-2003. Depreciation (-).

3/ In relation to broad money at the beginning of the period.

4/ Central government unless otherwise noted.

5/ Debt of the St. Kitts Sugar Manufacturing Corporation included in central government debt since 2006.

Press Release No. 09/167
FOR IMMEDIATE RELEASE
May 15, 2009

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US\$3.4 Million in Emergency Natural Disaster Assistance for St. Kitts and Nevis

The Executive Board of the International Monetary Fund today approved a request for SDR 2.225 million (about US\$3.4 million) in Emergency Natural Disaster Assistance for St. Kitts and Nevis.

St. Kitts and Nevis was hit by Hurricane Omar in October 2008. The damage caused by the hurricane has greatly aggravated the economic slowdown, with a significant impact on unemployment, fiscal revenues, and tourism receipts, particularly on the island of Nevis. Fund financing will help offset the balance of payments impact of the hurricane, estimated at US\$19 million (about 3½ percent of GDP).

The IMF provides emergency assistance to help member countries with urgent balance of payments financing needs in the wake of natural disasters or armed conflicts. See Factsheet about the Emergency Natural Disaster Assistance.

Following the Executive Board discussion, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, issued the following statement:

“The damage caused by Hurricane Omar has resulted in substantial loss of employment and great hardship to St. Kitts and Nevis. In particular, Nevis has suffered the temporary closure of its largest tourism resort. The adverse balance of payments impact of the hurricane has been compounded by the global recession and the collapse of the Trinidad and Tobago-based CL Financial Group.

“The authorities are responding with a comprehensive economic program to deal with the effects of the natural disaster within the context of the difficult economic situation facing the country. They aim at strengthening public finances to reduce public debt ratios, while undertaking structural reforms. These efforts will be supported by Fund emergency assistance for natural disasters.

“The government, with the assistance of its development partners, is developing a growth and poverty reduction strategy to guide its medium-term reform agenda. In addition to strengthening fiscal policies and debt management, the main priorities for reform are enhancing the investment climate for private sector development, including through privatization and sale of public land and assets, and strengthening oversight of the financial sector.

“While the global downturn and the heavy debt burden of St. Kitts and Nevis are likely to weigh heavily on near-term growth, the authorities’ implementation of prudent policies and their reform agenda, together with support from the international community, should help St. Kitts and Nevis recover from the setbacks caused by the hurricane and place the economy on a path of sustainable, strong growth,” Mr. Portugal stated.

**Statement by Michael Horgan, Executive Director for St. Kitts and Nevis,
and Glenn Purves, Senior Advisor
May 15, 2009**

The authorities of St. Kitts and Nevis (SKN) thank the staff for a constructive set of meetings and a well-focused report that succinctly highlights the challenges facing the country, especially during this turbulent period for world financial markets and the global economy. The authorities also appreciate the efforts the staff has made in facilitating their request for Emergency Natural Disaster Assistance (ENDA).

Most of the central issues facing SKN are common to the other small Caribbean islands, and have already been well-articulated in the ECCU surveillance paper and Buff. SKN is a unique federation with a population of only 45,000 spread across two islands. As a result, the federation faces an inherent problem of very small size and consequent high overhead costs of administration and provision of public services. Compounding this fiscal challenge is a high level of public debt which stands, in large part, as a legacy of the long decline of the sugar industry (which was closed in 2005). As the government owns most of the useable land on St. Kitts and Nevis, the state sugar company incurred very large debts over many years by borrowing against the security of the land holdings. Naturally, the costs associated with hurricanes and other weather-related disasters also contributed to this burden.

The closure of the sugar company marked a necessary step for SKN in realigning its fiscal position, and since 2005 the authorities have been running large primary surpluses, allowing for the public debt ratio to decline by 20 percent. Nevertheless, a key challenge for SKN continues to be divesting itself of the land holdings in a manner that results in a very substantial reduction in the debt ratio. The turbulent global financial and economic environment has presented many challenges in this regard.

Economic Performance

Even with the closure of the sugar industry, SKN has posted favorable economic growth over the past five years, with real GDP growth estimated to have reached 3.2 percent in 2008. Yet despite the authorities continuing to receive firm commitments to further major tourism projects, the combined impact of the global downturn and impact of Hurricane Omar on Nevis's largest tourism resort is expected to take full effect in 2009, adversely impacting tourism and construction via slower FDI inflows. As a result, the GDP of SKN is expected to contract by 1.2 percent in 2009.

The Caribbean islands in the ECCU have traditionally enjoyed relatively low inflation. However, spikes in commodity and food prices, and fluctuations in the strength of the dollar (transmitted via the peg) has created some recent volatility. As a result, inflation stood at 7.6 percent at the end of 2008, and while this has been a source of concern for authorities in

the past, there is less concern looking ahead given that lower oil prices have yet to be factored in. It should also be noted that for an economy such as SKN, a sizeable current account deficit (roughly 30 percent of GDP in 2008) is mostly financed by FDI-related investments in the tourism sector, and should not be mistaken for a competitiveness/exchange rate issue.

Fiscal Policy

The sizable public debt in SKN has been a driving force in guiding the authorities' prudent fiscal policy, including the generation of primary surpluses since 2005. Given the challenging environment ahead, the staff has clearly articulated two distinct paths and corresponding outlooks for SKN's authorities to pursue - a baseline scenario and an active scenario. At the outset, the authorities wish to convey their commitment to taking an active role and adopting bold adjustment policies for restoring fiscal and debt sustainability, and mitigating vulnerabilities. They are examining the specific suggestions outlined by the staff in this regard.

A testament of their commitment has been their proven track record, including decisive actions to close the state sugar company, strengthen tax administration, the introduction of an electricity surcharge, and the implementation of an automatic pass-through of fuel prices. The implementation of the market-based property tax regime is ongoing. To date, over 60 percent of the residential properties have been valued at market and the authorities are currently working on valuing commercial properties. In addition, they acknowledge that further expenditure restraint is essential and are pushing forward with comprehensive civil service reform to contain the wage bill and pension costs. They are also planning to introduce a new Investment Code and Corporate Tax Act, which taken together will help limit discretionary concessions.

The planned introduction of a VAT has been complicated by the existence of separate tax administrations on the two islands. Nevertheless, the authorities are aware that the existence of two VAT systems would be costly, complicated and lend themselves to leakages. Every effort is being made to design one VAT system that can fit into the constitutional and political environment. As the staff report highlights, progress has been made in terms of forming a VAT team, with representation from both islands, and discussions on a revenue-sharing agreement remain ongoing.

Public Debt Management and Reduction

On public debt management, the authorities of SKN are actively pursuing a combination of stricter guidelines and policies on borrowing and provision of debt guarantees through a new Financial Administration Act. This is in addition to efforts being taken to enhance the debt management capacity of SKN, including seeking ways to reduce their dependence on high

cost, short-term bank financing. These are fundamental pillars for achieving medium-term debt sustainability. To date, concessional resources have greatly assisted SKN, and the authorities have met the conditions for the first tranche of the Caribbean Development Bank's (CDB) Policy-Based Loan and the release of the first in a series of EU sugar grants. They look forward to continuing their engagement with the CDB, the EU and other developmental partners for the remainder of the program.

Despite the efforts above, the authorities are also aware that a reduction of debt stock is essential, and that meaningful debt reduction must come via a comprehensive and effective sale of substantial amounts of the government's land holdings. The staff report rightly notes that there is broad agreement on aiming for land sales to the private sector at about 3 percent of GDP per year, with proceeds being used to pay down the highest interest-bearing debt first. However, this complex undertaking, both politically and technically, requires careful planning and execution, and difficulties have only been compounded by the weakened state of the global economy. Nevertheless, the authorities recognize that pursuing a strategy of putting into place a transparent, market-based procedure for the sale of land must proceed, but must occur over a considerable period of time.

Financial Sector Matters

The staff has expressed concerns about the high level of exposure of domestic banks to the government, and as part of their strategy for addressing the public debt, the authorities are aiming to reduce this exposure over time. The authorities have noted the staff's suggestion to borrow directly, albeit temporarily, from the social security system (eliminating the intermediary role of the indigenous private bank), and will be factoring this into their consideration. It should also be noted that the SKN authorities just passed a new Insurance Law, strengthening their regulation over the insurance sector.

On challenges pertaining to the non-bank sector, notably the offshore sector of SKN, the authorities continue to work constructively with the Caribbean Financial Action Task Force (CFATF) and are looking to resolve, expeditiously, any remaining issues highlighted in its most recent evaluation. This is an important sector for SKN, and as such the authorities continue to harbour concerns about the risk that global measures taken against non-cooperative jurisdictions, including tax havens, could have unintended negative impacts on well-regulated, transparent, financial centers. As a principle, countries that comply with international standards should be protected from such measures, and the authorities of SKN and the ECCU will continue to work constructively to ensure that the views of important regional bodies such as the CFATF continue to be taken into consideration, internationally.

Concluding Comment and Request for ENDA Support

Overall, the authorities continue along their path of transforming the economy away from sugar. Despite the tremendous accomplishments they have made to date, the authorities recognize the inherent vulnerability of SKN to developments in the world economy and to catastrophic risk, and are thus fully committed to policies, such as those articulated in the “active scenario”, to enhance the flexibility and resilience of the economy.

To this end, the authorities wish to convey to the Board that a policy response paper has been prepared for Cabinet, which proposes that the 2009 Budget be cut by EC\$30 million (roughly 2 percent of SKN’s GDP). The paper reflects core principles for SKN, including: protection of the most vulnerable; prevention of further deterioration of the fiscal situation; continuation of downward trajectory with respect to debt; concentration on growth enhancing capital projects; and exploring opportunities for development/improvements in the policy framework. The process will involve re-examining short-term and long-term revenue and expenditure measures, and contingency sources of financing.

Nevertheless, the authorities continue to grapple with the immediate impact of Hurricane Omar last fall, which has resulted in the closure of the largest tourism resort, and consequently the largest direct/indirect employer, in Nevis. As the authorities attempt to address the impact of the hurricane, it is recognized that ENDA assistance would make an important contribution to their efforts to contend with the transitory, but significant, balance of payment impact resulting from lower tourism receipts - estimated at 3.5 percent of SKN’s GDP. A favorable response by the Board to their request for 25 percent of their quota (SDR 2.225 million) would be most appreciated.