INTERNATIONAL MONETARY FUND

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DOMINICA

2012 ARTICLE IV CONSULTATION

January 2013

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 2013 Article IV consultation with Dominica, the following documents have been released and are included in this package:

- **Staff Report** for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on August 23, 2012, with the officials of Dominica on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on October 25, 2012. 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.
- **Informational Annex** prepared by the IMF.
- **Public Information Notice** (PIN).

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INTERNATIONAL MONETARY FUND

DOMINICA

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

October 25, 2012

KEY ISSUES

Context. Dominica's strong fiscal policy response shored up the economy during the past three years, helping it recover above its pre-crisis peak. However, anemic domestic and external demand are likely to slow the near-term recovery, adding to pressures on the already weakened fiscal position and financial system. Weak demand contributed to a large reduction in the current account deficit and low inflation.

Fiscal consolidation. While conditions are not ideal for unwinding the fiscal policy stimulus, determined policy action is needed to reverse the upward dynamics of debt and steer it towards the union-wide 60 percent of GDP target by 2020. Authorities' intended return to their long-standing primary surplus target would put the debt target well within reach, but will require a notable adjustment effort that should focus on streamlining current spending. A revamped public financial management framework would help underpin the sustainability of the adjustment.

Strengthening the financial sector. Pockets of vulnerability in the financial system need to be decisively addressed to ensure continued stability. Regulatory and supervisory reforms should improve the framework for dealing with financial institution weaknesses, by aligning prudential norms with international best practice, introducing prompt corrective action, and strengthening safety nets.

Structural reforms. As the fiscal stimulus is withdrawn, the prospects for meaningful growth will hinge on how bold and successful structural reforms are in boosting competitiveness and private investment. Reforms should aim at narrowing the infrastructure gap, facilitating the development of property markets, improving the business environment for the private sector, and easing access to finance. Policies should also aim at supporting a shift of productive resources towards the tradable sector, the main viable growth driver going forward.

Approved By
Elliot Harris and Gian Maria Milesi-Ferretti

Discussions took place in Roseau from August 13–23, 2012. The staff team included Ms. A. Cebotari (head), Mr. G. Keim, Mr. X. Li, and Ms. M. Santoro (all WHD). Ms. K. Beaton (OED) participated in the policy discussions.

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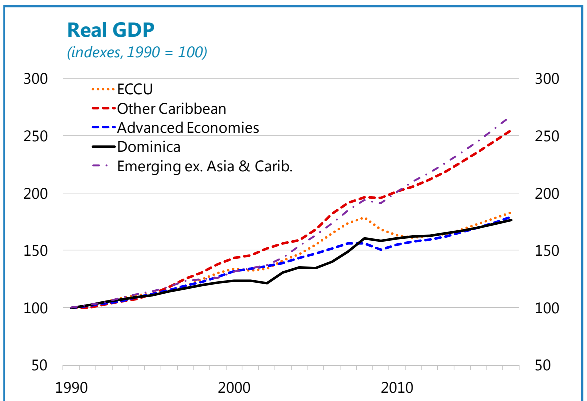
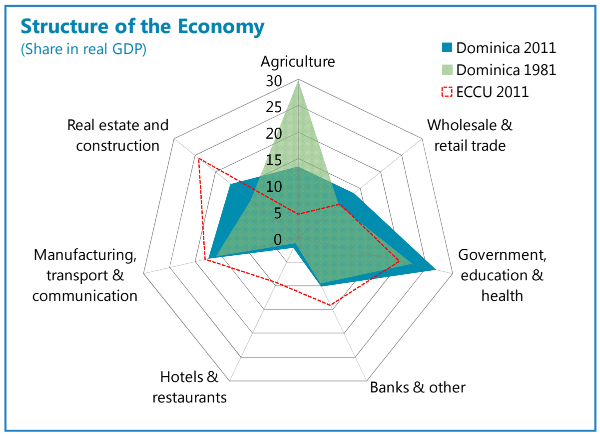
ANNEXES

BACKDROP

1. **Dominica has faced two major challenges during the past two decades: weak competitiveness and low potential growth**. Over the past twenty years, its GDP growth averaged 2⅓ percent—compared to over 3½ percent in the wider Caribbean and non-Asian emerging markets. While many Caribbean countries adjusted to the loss of preferential access to European agricultural markets in the mid-1980s through a relative diversification of their economies (to tourism, mainly), Dominica's transition towards hospitality-based industries has been more difficult than elsewhere in the region—reflecting weak infrastructure, limited air access, and a dearth of sandy beaches—but it has successfully developed an offshore medical education sector. As a result, the structure of Dominica's economy is unique for the Eastern Caribbean region: the contribution of tourism industries to total output is more modest relative to other ECCU members, agriculture remains large, and offshore medical schools boost the share of the education industry relative to other ECCU members. Going forward, the authorities have embarked on promising geothermal energy explorations that have the potential to substantially improve economic performance in Dominica by ensuring energy self-sufficiency, significantly reducing electricity and fuel import costs, and potentially exporting electricity to neighboring islands. However, competitiveness for now remains weak because of high input costs, lack of economies of scale, and low productivity.

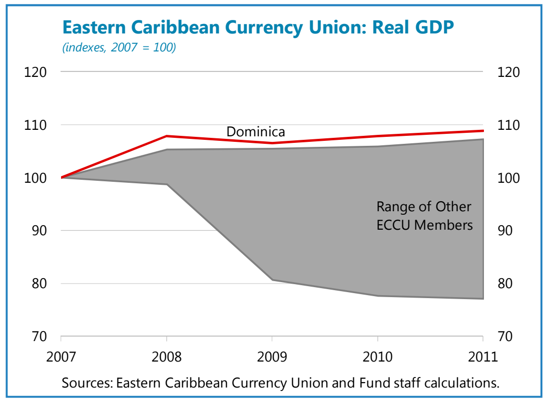


Sources: World Economic Outlook and Fund staff calculations.



2. **While less affected by the global crisis than many of its peers, Dominica's recovery remains fragile**. Following a shallow recession in 2009, growth has averaged about 1 percent in 2010–11. The shallowness of the recession reflected largely two factors: (i) limited spillovers from economic stress in advanced markets due to the relatively modest size of Dominica's tourism

industry (Box 1 and Figure 1); and (ii) the authorities' ability to deploy a significant fiscal policy stimulus following the buildup of solid policy buffers during the past decade.[1] The weak recovery reflects anemic domestic demand, low tourist arrivals,[2] and closure of some manufacturing operations. Employment conditions remain strained: the unemployment rate, most recently recorded at 10 percent in 2009, remains high, and about five percent of the labor force were discouraged workers.[3]



3. In addition to these economic challenges, the country has been facing more frequent natural disasters. Dominica, along with other Caribbean islands, is already prone to natural disasters, and tropical storms are becoming increasingly disruptive due to more frequent flooding, given the country's very mountainous terrain. Flood-related damages to roads and bridges—not covered by the Caribbean Catastrophe Risk Insurance Facility (CCRIF)[4]—are putting significant strains on the already stretched budgets. The authorities have tapped the Fund's emergency financing three times between 2008 and 2012 to deal with the aftermath of major natural disasters (hurricanes Omar and Dean, and severe flooding more recently), and have relatively limited space left for further emergency drawings: as of September 2012, borrowing under emergency programs stands at about 71¼ percent of Dominica's quota, compared to a limit of 100 percent.[5]

4. Context of past surveillance. During the last Article IV (considered on a lapse-of-time basis) and at the time the most recent RCF drawing, Fund advice focused on the need to rebuild fiscal buffers and improve the fiscal policy framework, to remain vigilant against financial stability risks, and to address underlying structural vulnerabilities to enhance competitiveness and growth. The authorities fully share these objectives, although fiscal consolidation efforts have been thwarted by continued economic weakness.

[1] After a debt crisis in 2001–02, a major fiscal retrenchment took place in the context of IMF-supported programs. Primary surpluses averaging 4 percent of GDP during 2004–09 and the debt restructuring in 2004–05, contributed to the decline in debt from 100 percent of GDP in 2002 to 63 percent in mid-2010.

[2] In addition to reduced stayover arrivals, cruiseship tourism—on which the country preponderantly relies—has suffered a setback with the cancellation of all cruiseship calls during the bulk of 2011.

[3] Official statistics include discouraged workers in the unemployment and labor force numbers, reporting the unemployment rate at 14 percent in 2009. Currently, labor force data are collected decennially, as a part of the census, and at infrequent intervals when a country poverty assessment is undertaken by the Caribbean Development Bank (latest in 2009). The authorities have completed a census in 2011, but the full results are not yet available.

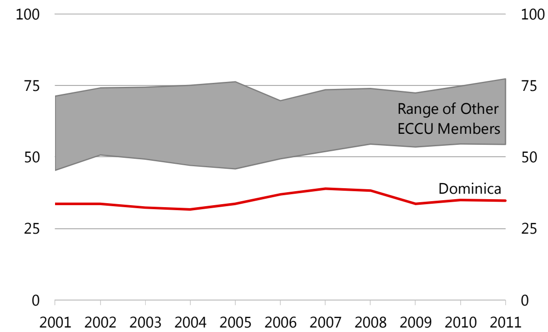
[4] This insurance facility, launched with sponsorship from the World Bank, covers only major hurricanes or earthquakes, with a relatively small payout.

[5] In early 2012, the authorities accessed the IMF's Rapid Credit Facility (25 percent of quota, US$3.2 million or 0.7 percent of GDP), which covered about 40 percent of the flood-related spending to date, with the rest covered by grants (38 percent) and other multilateral and bilateral financing (24 percent).

Box 1: Dominica and the Global Economy

The structure of Dominica's economy renders it less sensitive to spillovers from the world business cycle. The small scale of the tourism industry and the preponderance of stay-over visitors from Caribbean countries make it less vulnerable to the business cycle fluctuations in key tourism markets, as only a third of stay over visitors are from United States, United Kingdom, or Canada – the smallest share in the ECCU. Moreover, a large share of the stay over tourists from the U.S. is accounted for by students at the offshore medical schools, whose decisions to travel to Dominica are less likely to be influenced by economic developments than pleasure tourism. In the agriculture industry, which is much larger than in any other ECCU member both in absolute terms and as a share of GDP, output is mainly influenced by domestic factors such as weather and crop conditions.

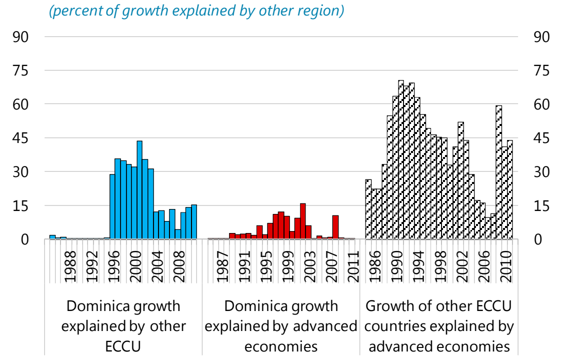
Stay-over visitors from the U.S., Canada and U.K.
(percent of total stay-over visitors)



Sources: Eastern Caribbean Central Bank and Fund staff calculations.

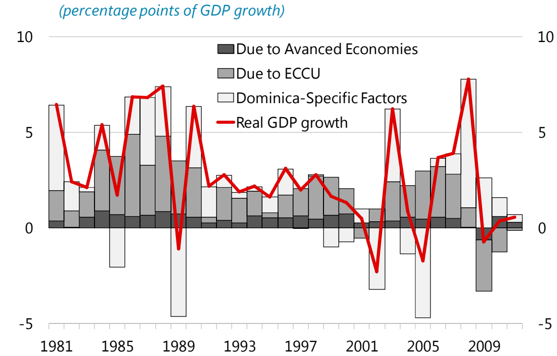
Because of the nature of Dominica's international linkages, local developments tend to influence economic performance relatively more than regional or global ones. In particular, growth in Dominica shows only little correlation with that of advanced economies, significantly less than other ECCU countries that show a tight relationship during most of the past two decades (see chart below and to the left, which shows the percentages of common variation over rolling 15-year periods between Dominica's growth and that of other economies). A closer relationship between growth in Dominica and the rest of the ECCU appears to have existed during the mid 1990s, but has since dissipated. Regression analysis is consistent with these findings (see chart below and to the right, which shows the estimated contributions to Dominica's annual real GDP growth due to regional, advanced economy, and domestic factors). The estimates confirm that most of the growth in Dominica—about 55-60 percent over the past two decades— is explained by country-specific factors rather than direct impact of global or regional developments. They also suggest that regional developments, including common shocks, matter about twice as much for Dominica's economy than developments in large economies: a 1 percentage point decline in ECCU growth would reduce Dominica's growth by about 0.4 percentage points, while a similar decline in advanced economies would lower growth by about 0.2 percentage points. However, growth in the other ECCU countries has a much closer relation to advanced economies, suggesting the possibility of indirect second-round effects of advanced country developments on Dominica's economic performance.

Growth Relations
(percent of growth explained by other region)



Source: Fund staff estimates.

Estimated Contributions to Growth
(percentage points of GDP growth)

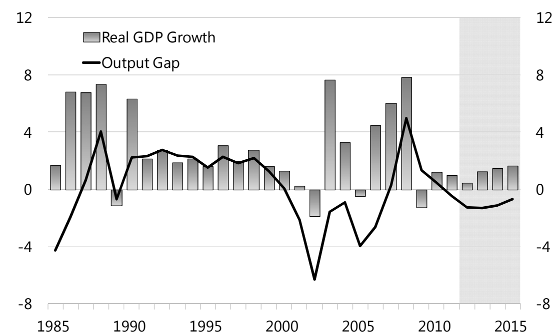


Sources: Fund staff estimates.

RECENT DEVELOPMENTS AND OUTLOOK

5. Economic activity appears to be losing further momentum. Real activity expanded by 1 percent in 2011 (at market prices[6]), supported by major public sector works and a recovery in agriculture following the 2010 droughts. With some of these factors no longer in play in 2012, short−term indicators point to a likely slowdown in activity (Figure 2). Construction is slowing with the winding up of large public infrastructure projects. Banana production, still a major sector of the Dominican economy, has been affected by the outbreak of a banana leaf disease and, despite the authorities' swift action to contain the contamination, production is likely to contract by close to 15 percent. Tourism indicators also point to a likely slowdown: cruise ship calls remain low and tourism receipts in the more lucrative stay-over market are falling with reduced expenditure per tourist, tempering the impact of recovering arrivals. Declines have also been registered in some manufacturing sectors and mining. Recent import volumes have also dipped, suggesting softer household consumption. Overall, staff forecasts that GDP growth will halve in 2012 to about ½ percent, reflecting the apparent slowdown in the first half of the year.

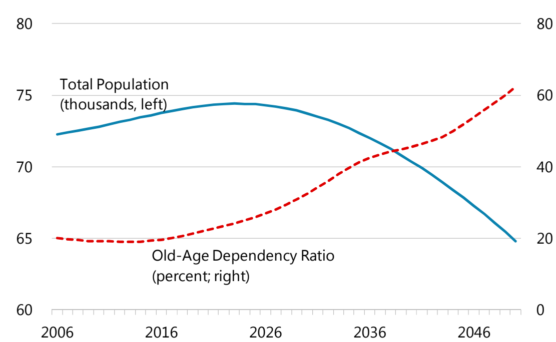
Growth and Output Gap
(in percent)



Sources: Dominican Authorities; and Fund staff estimates.

6. Growth is expected to pick up gradually to its potential rate of close to 2 percent over the medium term, as agriculture recovers to normal production levels, new tourism facilities come on stream, and external demand boosts tourism receipts. Low productivity and weak competitiveness of the country's main growth drivers, together with unfavorable demographic trends—an expected decrease in population and population ageing—weigh on potential growth. The output gap—currently estimated at around one percent—is expected to close by 2017.

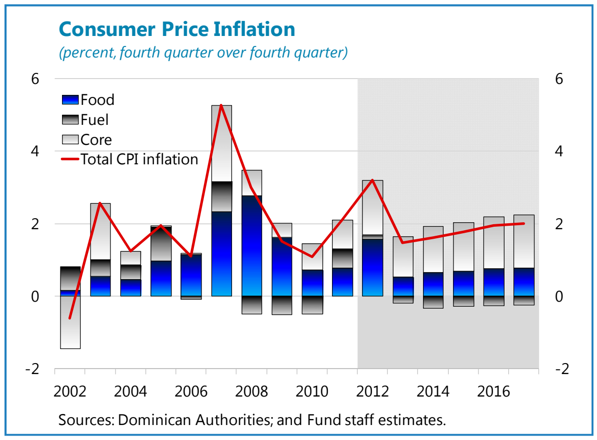
Demographic Projections



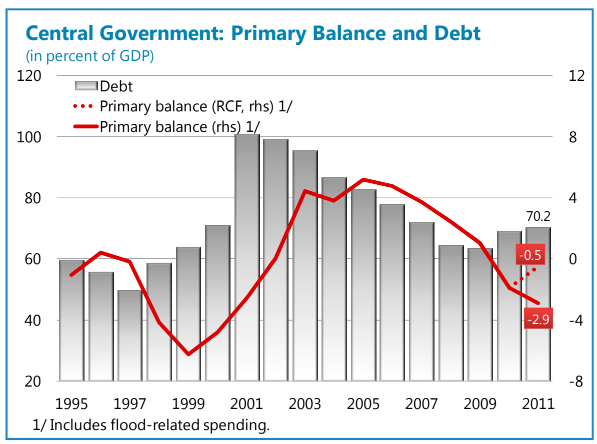
Source: U.S. Census Bureau and Fund staff calculations.

[6] The authorities have recently developed a series for real GDP measured at market prices (the most common measure in international practice), which is used throughout this report and which differs from the factor price GDP measures used in past reports and by the authorities.

7. Price pressures remain subdued on low imported inflation and limited pass-through of world commodity prices. Consumer price inflation hovered between -½ and 2½ percent year-on-year over the past eighteen months, and was just 0.6 percent as of June 2012. While food prices have been rising, averaging some 3¼ percent during 2012, the close relationship between world and Dominican food prices appears to have weakened, and a large portion of the recent international food price increase has not passed through to domestic prices due in part to a strong crop outturn in 2011 following droughts the previous year. In contrast, the passthrough of world crude prices has been stronger, resulting in falling prices for fuel-related products in the first half of 2012. Core prices have been held in check, partly reflecting low imported inflation from the United States. Inflation is expected to remain benign in 2012 and over the medium-term, ranging from 1½ to 2½ percent per year, as the effects of rising world food prices should be temporary, muted by weak demand, and partly offset by easing fuel prices.[7]



8. Weak activity and supportive policies have taken a toll on the fiscal position. Since the beginning of the crisis, the central government's primary balance weakened by 5 percentage points, to a deficit of 2.9 percent of GDP in fiscal year 2011 (that ended in June 2012) (Figure 5). Higher social and infrastructure spending to support the economy and deal with the aftermath of natural disasters have been the main contributors to this deterioration. However, FY2011 saw the first significant drop in tax revenues (1½ percentage points of GDP). The mission welcomed the prompt action taken by the authorities to restrain current spending and contain the ensuing deterioration in the fiscal position, but these efforts—along with higher nontax receipts from the *economic citizenship program*[8]—were not successful in preventing the overall deficit from exceeding the projections at the time of the RCF request by about 2 percentage points of GDP (net of flood-related spending). To meet the higher financing requirements, the authorities took advantage of ample liquidity in regional financial systems and in February 2012 successfully launched a T-bill in the regional securities market (1 percent of GDP) for the first time since the

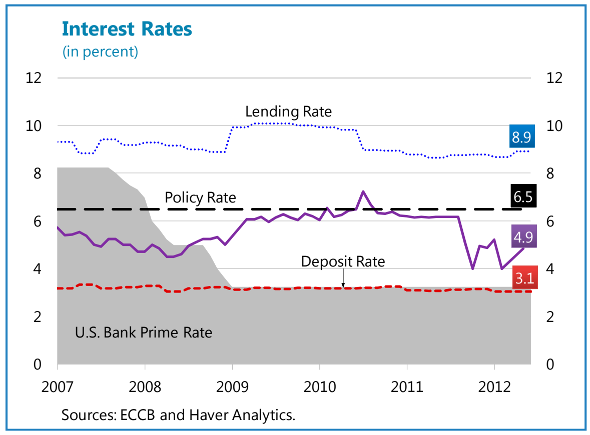


[7] The outbreak of the banana leaf disease is not expected to have much inflationary impact, as bananas that would have been exported may come onto the local market.

[8] The program involves the sale of Dominican citizenship and currently yields some 2 percent of GDP in non-tax revenues.

2004–05 debt restructuring.[9] As a result of the weaker primary balances, public debt increased to 70.2 percent of GDP, almost 7 percentage points above pre-crisis levels.

9. The financial system is highly liquid but monetary conditions have not eased. Firm deposit growth and lack of adequate lending opportunities have boosted liquidity in the financial system, pushing up bank excess reserves at the Eastern Caribbean Central Bank (ECCB) and reducing interbank market rates below the 6½ percent policy rate (Figure 4 and Table 4). Lending rates, however, have not fallen in line with interest rate cuts worldwide, reflecting unchanged monetary policy rates, high costs of funding due in part to the 3 percent interest rate floor on savings deposits,[10] and increased credit risk.



10. Asset quality remains a drag on financial sector income and capitalization. Weak economic conditions continued to push up nonperforming loans, which averaged 9½ percent for the banking system in the second quarter of 2012 and are inching up further. The need for continued provisioning for impaired loans and exposures to the failed regional insurance group *CL Financial*,[11] along with diminishing interest income, have generated losses in a large part of the financial system in 2011 and have reduced capitalization. While the reported capital adequacy remains high—at 13 percent in the commercial banking system and 8½ percent for the credit union sector—capitalization may be overstated as provisions remain low and do not provide adequate coverage for impaired assets. Moreover, in the

Dominica: Selected Financial Soundness Indicators

	2009	2010	2011	2012Q2	*ECCU, 2012Q2*
Capital adequacy ratio	15.1	17.5	11.5	13.2	*18.7*
NPLs	5.5	8.7	9.2	9.6	*14.5*
Provisions % NPLs	20.6	14.2	18.3	17.3	*32.0*
Loan-to-deposit ratio	60.4	63.6	64.3	65.1	*85.2*
Liquidity ratio [1]	44.5	39.8	39.0	38.0	*31.6*
Return on average assets	2.1	1.2	0.0	0.4	*0.5*
Interest spread [2]	3.2	3.2	2.8	2.5	*3.1*

[1] Liquid assets (%) of deposits and liquid liabilities.

[2] Yield on average earning assets less average cost of funds.

[9] They have also concluded negotiations with the last holdout creditor in that restructuring.

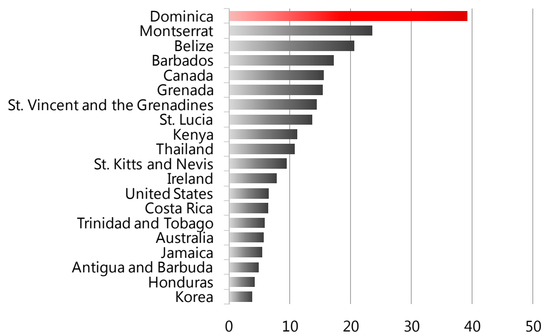
[10] The floor is mandatory only for banks, but—through competition pressures—is applied by credit unions as well. It imposes a notable cost on financing institutions in the current financial environment because they invest their large excess liquidity (that costs them at least 3 percent) into near-zero rate instruments and prevents rates from falling.

[11] Dominica's gross exposure, which totals 11½ percent of GDP, is concentrated in three subsidiaries of the group: (i) *CLICO Trinidad and Tobago* (gross exposures of ¼ percent of GDP), which has recently been resolved and long−term bonds have been issued to holders of its deposit-like obligations ("annuities"); (ii) *CLICO Barbados* (exposures of 5¾ percent of GDP), which will be sold in its entirety (traditional insurance business and annuities) once the ECCU and Barbados governments agree on how to cover its negative equity; and (iii) *BAICO Trinidad and Tobago* (exposures of 5½ percent of GDP), whose traditional insurance business has been recently sold but whose annuity obligations remain to be resolved, as agreement has not been reached on who will bear the losses. The bulk of Dominica's gross exposure (10½ percent of GDP) is in the annuities.

credit union sector, with assets amounting to almost 40 percent of GDP or about 20 percent of financial sector assets—one of the largest levels in the world—the average ratio reflects the better capitalized dominant credit union, while several smaller institutions remain poorly capitalized. In the *offshore banking sector,* a bank has been recently intervened and is under liquidation following the knock-on effect from the failure of its correspondent bank; the bank has no ties to the onshore domestic system.

Credit Union Assets

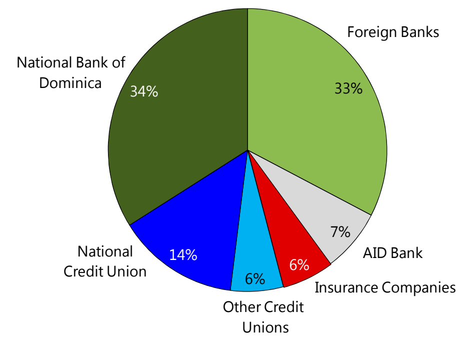
(percent of GDP, 2011; top 20 countries by credit union assets-to-GDP ratio)



Sources: World Council of Credit Unions; WEO; and Fund staff estimates.

Structure of the Dominican Financial System

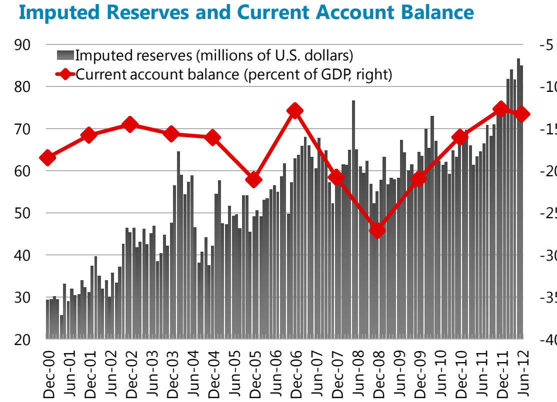
(Total assets; 2011)



Sources: Dominican Authorities; ECCB; Company Reports; and Fund staff estimates.

11. The external position is improving on anemic demand and strong service receipts. The overall balance of payments registered surpluses over the past three years, boosting reserves to 3½ months of imports as of 2011. This reflected in part a significant retrenchment in the current account deficit during the post-crisis period—from 27 percent of GDP in 2008 to 12¾ percent in 2011—due to a demand-driven fall in private imports, a recovery in tourism expenditures during this period[12], and stronger service receipts from the *economic citizenship program* (Figure 3). Financing also held up, with ebbing FDI and grant financing offset in part by increased public borrowing and bank inflows from the ECCU area.[13]

Imputed Reserves and Current Account Balance



[12] Despite the decline in tourist arrivals during 2010–11, a 2010 survey used by the authorities shows a 30 percent increase in daily tourist spending for these years, which resulted in significant revisions to the tourism receipts in the balance of payments for these years. This revision has put tourism receipts at historical highs (23.4 percent of GDP in 2011), raising issues whether the receipts are overstated. A subsequent survey, conducted in 2012, has found that daily tourist expenditures have since fallen.

[13] Commercial banks in Dominica have reduced significantly their exposure to the rest of the ECCU-area banks and have received large inflows of deposits from elsewhere in ECCU during 2011, which have started to reverse in 2012.

12. **Going forward, the balance of payments may be pressured by continued external headwinds**. The recent surge in commodity prices and some weakening in tourism receipts (additional cancellations of cruise line calls in the winter season this year) will renew the pressures on the balance of payments in the near term, with the current account deficit projected to deteriorate slightly to 13⅓ percent of GDP in 2012. Over the medium term, the current account deficit is anticipated to widen further with an expected weakening in inflows from the *economic citizenship program*, but will remain within the range of 13–15½ percent of GDP. While FDI and grants may still be able to finance the bulk of the deficit, public external borrowing is expected to cover the remaining financing needs.

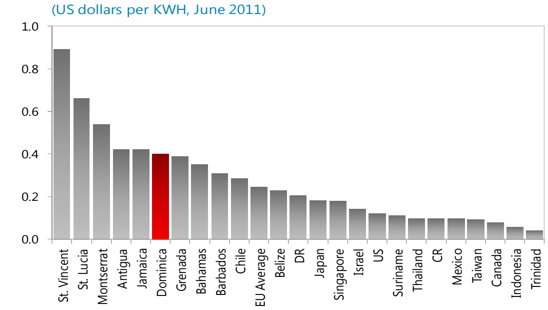
13. **Despite the recent improvement in the external position, a significant competitiveness gap remains**. While the external current account has so far been adequately financed, its sustainability over the medium term is doubtful, as it would lead to a further deterioration in the already large negative net foreign asset position (Box 2). Indeed, the *external sustainability* and the *macro-balance* approaches of the IMF's CGER methodology suggest that the current account deficit remains above norms determined by fundamentals and by the need to stabilize the country's net foreign asset position, with a real exchange rate adjustment of about 20 percent required to align it with the norms (Annex I). Weakening competitiveness is also apparent in rapidly declining market shares of goods and services exports, and more recently the appreciation of the real effective exchange rate (REER) along with the strengthening of the U.S. dollar against other major currencies.

14. **Risks to the macroeconomic outlook are tilted to the downside in the short term, but to the upside in the medium term**.

- *In the near term*, the planned stoppage of flights from American Airlines—the only non-regional carrier servicing the island—in the spring of 2013 is a threat to the further development of the tourism industry, already burdened by lack of easy air access, and to the balance of payments. A further slowdown in advanced economies could directly dampen tourism receipts, FDI, and remittances, and even though this direct effect is estimated to be small, larger spillovers are likely through confidence channels. Finally, there are non-negligible downside risks from events that can adversely impact the balance of payments—such as a higher commodity import bill, natural disasters, weaker tourism receipts, and lower inflows through the *economic citizenship program*—which could lead to tighter monetary conditions (given the quasi-currency board arrangement) and depress growth (Box 3).

- *In the medium term,* the outlook for growth and the balance of payments could be significantly more favorable should the benefits of geothermal energy development and/or the planned opening of new tourism facilities have a larger impact than currently anticipated. In the case of geothermal energy, preliminary results from explorations gauging Dominica's potential to produce and export geothermal energy have been positive, and the authorities are planning to build a geothermal electricity plant over 2013–15 with capacity to fully cover domestic energy consumption. An additional plant for the generation of geothermal energy for export to neighboring islands may be built afterward. In addition to the direct effect on growth, the authorities estimate that geothermal energy would reduce electricity costs—currently among the most elevated in the world—by about 40 percent, boosting price competitiveness economy-wide. The country's external position would also improve significantly due to a lower fuel import bill and potentially higher exports. At the same time, downside risks to growth would arise from a failure to pursue the necessary structural reforms to boost private sector investment and improve the functioning of labor, product, and financial markets.

Household Electricity Tariffs
(US dollars per KWH, June 2011)

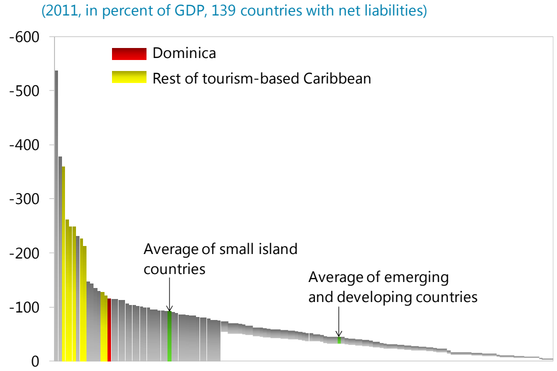


Sources: Utility companies, International Energy Agency, U.S. EIA, Europe's Energy Portal.

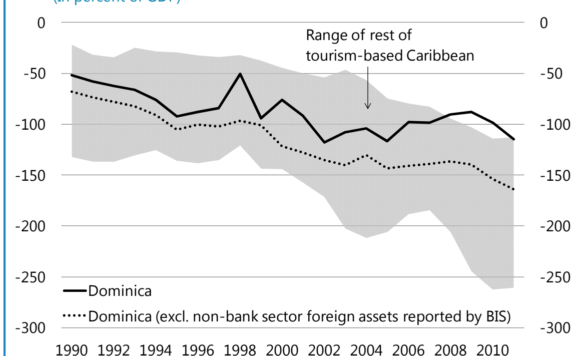
Box 2. Dominica's Net Foreign Asset Position

Dominica has a large negative net foreign asset (NFA) position, albeit stronger than most of its tourism-based Caribbean peers. Its NFA stood at -115 percent of GDP in 2011, compared to a median of −31 percent of GDP for all countries in the world and a median of -219 percent of GDP for the rest of the tourism-based Caribbean.[1] Dominica's NFA has improved substantially during the pre-crisis period, as a result of an increase in non-bank sector assets as reported by the Bank for International Settlements.[2] The NFA position weakened post-crisis, however, with an increase in public sector external debt and a deterioration in commercial banks' net foreign asset position.

World: International Investment Positions
(2011, in percent of GDP, 139 countries with net liabilities)



Caribbean: International Investment Positions
(In percent of GDP)



The main options available to improve Dominica's net foreign asset position include a depreciation of the real exchange rate to induce expenditure switching from non-tradables to tradables, expenditure compression through fiscal adjustment to directly reduce domestic absorption, and finally structural reforms to improve competitiveness. The latter option has significant benefits and should be undertaken regardless of other policy choices.

1/ Estimates are based on an updated and extended version of the *External Wealth of Nations* database described in Lane and Milesi-Ferretti, "*The external wealth of nations mark II: Revised and extended estimates of foreign assets and liabilities, 1970–2004*", Journal of International Economics, November 2007.

2/ The foreign assets of the nonbanking sector are captured from the Bank for International Settlements as it tracks all its reporting banks' foreign liabilities to countries and economic sectors. These banks' liabilities vis-à-vis Dominica's nonbank sector have increased over the past few years and reached 56½ percent of GDP at end-2011, but no details are available on the nature of these liabilities or the subsector in which they are incurred. Excluding these net assets, Dominica's NFA position would stand at -164 percent of GDP in 2011, broadly in line with the median and average of the rest of the tourism-based Caribbean.

Box 3. Dominica – Risk Assessment Matrix

Nature/Source of Main Threats over the next 3 years	Like-lihood	Impact	Policy Response
Stagnation of world or euro area growth. A major global or euro area slowdown could adversely impact receipts from tourism, remittances, FDI, and donor support, and affect confidence more generally. In addition to the direct impact on growth, the weaker external position could further slow growth through tighter monetary conditions given the quasi-currency board arrangement.	Medium to High	Medium	Explore room for relaxing monetary conditions (as discussed below in the report). Accelerate structural reforms to crowd in private investment. In case of a major slowdown, fiscal adjustment could be delayed—financing constraints permitting—with a concomitant strengthening of the fiscal framework.
Increased financial stress in the ECCU or Dominica. The financial situation of many local and regional institutions is weak, with neither a lender of last resort nor a deposit insurance scheme, leaving the financial sector vulnerable to a loss of confidence. Financial instability could adversely impact bank and public sector balance sheets, with a likely retrenchment in credit impairing economic growth.	Medium to High	High	Preemptively step-up financial sector reforms discussed below, including increased monitoring of and contingency planning for liquidity stress in the credit union sector.
Natural disasters and crop diseases. Disasters are occurring with increased frequency, causing substantial damage to the country's infrastructure. Crop diseases would hurt agriculture, which remains a major sector.	High	Medium	Adjust the fiscal framework to include *funded* contingency reserves to deal with disasters (discussed below). Continue collaboration with the World Bank on building climate resilience.
Balance of payments pressures from a higher commodity import bill. A further 10 percent increase in corn and soy prices could increase the current account deficit by ½ percentage point of GDP relative to current projections. Pressures from higher oil prices will also be significant, but somewhat cushioned by increased financing under the Petrocaribe arrangement. Growth will be affected as a result, due to lower income and tighter monetary conditions.	Medium	Medium	Allow full pass-through to prices, but target increased assistance to the vulnerable.

POLICY DISCUSSIONS

15. **The financial crisis brought out the difficulties of managing currency union countries through economic stress and has exposed policy and institutional challenges**. Monetary policy in the union has remained unchanged throughout the crisis—failing to import the significantly eased U.S. monetary policy—and the real effective exchange rate has depreciated only moderately given the hard peg to the U.S. dollar. Thus, fiscal policy has been the only tool to support economic activity, but it is running against the constraints of high debt levels and limited access to markets. The crisis also unveiled weaknesses in financial regulation and supervision—at the union level in the case of banks and at country level in the case of other financial institutions.

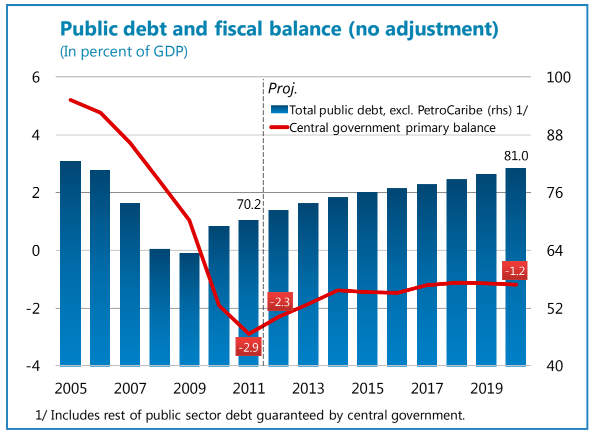
16. The policy discussions therefore focused on ways to strengthen the fiscal position, reduce vulnerabilities in the financial system, and improve growth prospects. The unanticipated weakening in tax revenues brought to the fore the need to start unwinding the fiscal stimulus and contain spending. Staff and the authorities agreed on the fiscal targets going forward, and discussed options for expenditure savings and reforms to the public financial management system to strengthen spending control and anchor near-term fiscal policies. In the financial sector, the immediate challenge is to strengthen weaker nonbank financial institutions. With little policy room to support growth, bold structural reforms are needed to close the competitiveness gap and increase growth potential.

A. Fiscal Policies: Achieving the Consolidation Objectives

17. Absent a strong and early policy response, this year's budget targets may be out of reach and financing pressures may emerge. The budget for FY2012 targets a primary deficit of 0.3 percent of GDP, close to the authorities' commitment under the RCF request.[14] The significant adjustment implied by the budget (some 2½ percentage points of GDP) is predicated on current spending restraint, increased nontax fees and import duties, and a sound recovery in revenues due to robust assumed growth (close to 2 percent). The mission welcomed the authorities' attempts to restrain spending and strengthen revenues, but pointed out that in light of last year's revenue shortfall and the likely weaker-than-budgeted growth, the targets may be out of reach. Staff projects that the primary deficit will likely narrow to only 2⅓ percent of GDP in FY2012. If these projections materialize and if the anticipated below-the-line purchase of shares in the regional airline LIAT (0.6 percent of GDP) goes through, a notable financing gap—about 2½ percent of GDP—might open this fiscal year. The mission advised that early policy action is needed to prevent the widening of the deficit and that consideration should be given to further financing sources to avoid potential liquidity pressures. The authorities were more optimistic on the fiscal outlook for this year, but expressed their readiness to further restrain current spending if budget shortfalls open up, and are also considering further issuances on regional securities markets to cover remaining financing gaps.

[14] Net of flood-related spending, the budgeted primary surplus is about 0.4 percent of GDP, close to the authorities' commitment under the RCF (0.6 percent of GDP). Given last year's revenue shortfall, however, the adjustment effort required to achieve this target is about 2 percentage points of GDP larger than under the RCF.

18. Staff noted that fiscal policy is reaching its limits in terms of its ability to support economic activity. Debt, while largely concessional, is over 70 percent of GDP, above what might be considered prudent for a developing economy. Under current policies, staff projects that the primary deficit will remain at 1¼ to 2 percent of GDP over the medium term, as the factors behind the recent underperformance are assumed to persist, the receipts from the *economic citizenship program* would not be sustained at the current high levels, but some post-flood rehabilitation works would wind up.[15] At these levels the deficit could continue to pose financing challenges, deteriorate the financing mix with increased market financing, and put debt on a rising trajectory, tipping it over 80 percent of GDP by 2020—compared to 60 percent targeted by the ECCU countries for that year (Annex II). The authorities reiterated their commitment to taking the necessary measures that would put debt on a downward path and would help reach the regional debt target by 2020.



19. In staff's view, the balance of risks to the fiscal outlook is broadly balanced. The downside risks stem from: (i) ongoing public sector wage negotiations (covering ex-post the FY2010–12 triennium); (ii) a faster than anticipated decline in receipts from the *economic citizenship program*, which surged in the wake of the Arab Spring and masked the recent tax underperformance; (iii) liquidity pressures from the potential need to take over debt servicing of parastatal entities (some of which are running losses) or of the development bank (whose portfolio suffers from large delinquencies)[16]; and (iv) contingent liabilities from the financial system.[17] On the upside, the eventual cyclical upturn may boost tax revenues to pre-crisis levels, especially if growth surprises on the upside. While the authorities agreed that there are important downside risks, they also believed that the upside risks would prevail as they are somewhat more optimistic about the near-term growth outlook than staff.

20. The authorities shared the staff view that fiscal policies need to focus on achieving more favorable debt dynamics, while mitigating the adverse effects on the fragile recovery. The discussion focused on the deficit targets, the pace and the composition of the adjustment:

[15] Relative to previous reports, staff has relaxed the assumption that large infrastructure projects would not be replaced as they wind up, in part because of the increased likelihood of new projects coming on stream, e.g. those related to geothermal energy exploration.

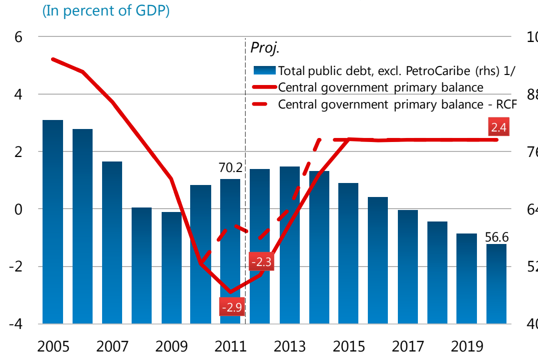
[16] The debts of these institutions are guaranteed by the government and already included in the debt statistics.

[17] The face value of these contingent liabilities is estimated at 9–10 percent of GDP, but their expected cost is smaller in light of the uncertainty about the extent to which the government would need to take them on.

- ***Fiscal targets***. The mission supported the recent policy shift from targeting a 2.4 percent primary surplus every year to targeting it over the cycle. This target is more realistic and will allow cyclical fluctuations to be absorbed by the fiscal balance rather than require policy tightening.[18] Under staff's baseline projections, reaching the 2.4 percent primary surplus will require an adjustment effort of 3½–4⅓ percentage points of GDP, depending on the speed of the adjustment. The mission noted that expenditure restraint alone may not be sufficient to generate a meaningful improvement in the fiscal position, and that specific and credible policy measures to attain the primary surplus target need to be formulated.

- ***Pace of adjustment***. In light of the weaker fiscal outcomes and growth outlook for the near term relative to the time of the RCF discussions, the adjustment path envisaged during the RCF no longer seems feasible. The mission supported the authorities' intent to return to their primary surplus target by 2015–16, when the output gap is expected to be about closed. This would reduce public debt to about 56½ percent of GDP by 2020, comfortably below the regional target of 60 percent of GDP for that year even in the presence of shocks along the path. Still, this will require an adjustment effort of some 4 percent of GDP (about 1⅓ percentage points of GDP during each of the next three years). While the adjustment could temper growth in the short run, staff emphasized that the relatively high share of imported goods in the consumption basket should limit its contractionary effect on domestic demand and that the consolidation will also have significant long-term benefits in terms of macroeconomic stability and improved competitiveness.

Public debt and fiscal balance (adjustment)
(In percent of GDP)



1/ Includes rest of public sector debt guaranteed by central government.

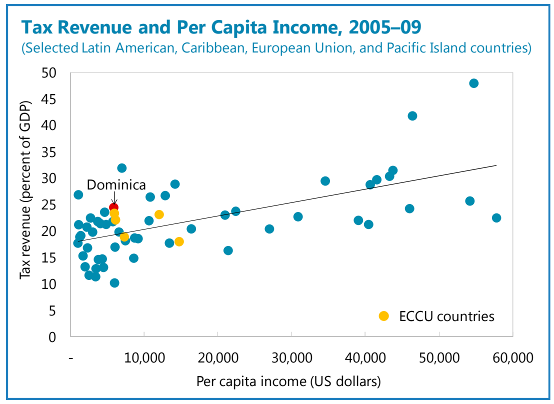
Fiscal Position: Baseline and Adjustment Paths (in percent of GDP)

	2011	2012	2013	2014	2015	2016
Baseline scenario						
Revenue	30.9	29.4	29.2	28.9	28.8	28.6
Primary expenditure	33.8	31.7	31.1	30.3	30.2	30.1
Primary balance	-2.9	-2.3	-1.9	-1.4	-1.4	-1.5
Debt	70.2	72.3	73.7	75.0	76.0	76.9
Adjustment scenario [1]						
Adjustment measures (cumulative)	...	...	-1.3	-2.6	-3.8	-3.8
Primary balance	-2.9	-2.3	-0.5	1.2	2.4	2.4
Debt	70.2	72.3	72.8	71.8	69.3	66.5

[1] The fiscal tightening is assumed to reduce growth by 0.3-0.5 percentage points per year during the consolidation period, based on staff simulations of a DSGE model calibrated to ECCU countries, and consistent with empirical estimates of fiscal multipliers for these economies .

[18] In practice, to make this target operational in the absence of reliable data on the cyclical position of the economy, the mission suggested that real spending be capped at or below potential GDP growth, while allowing revenues to absorb cyclical fluctuations. This rule would ensure that—once the desired fiscal balance is achieved—it is broadly maintained over the cycle.

- ***Composition of the adjustment***. The authorities concur that, with tax revenues relatively high compared to peers, adjustment measures should aim to preserve productive investments and targeted social spending, while focusing on: (i) streamlining current spending, especially on the wage bill, non-essential goods and services, and untargeted social programs;[19] (ii) improving the efficiency of capital spending by strengthening the capital budgeting process, and moving public investment away from consumption-based support (e.g. house renovation) or support for specific industries towards more productive infrastructure; (iii) reconsidering the recent decision to leave the public pension age unchanged at 60 and increase it to 65 to avoid paying pensions that would bridge civil servants to their social security age (1.2 percent of GDP in savings), although the authorities indicated that they do not intend to reopen the issue at this time; (iv) pursuing tax administration reforms, including through the setup of the large and medium taxpayer unit; (v) widening the tax base, including through streamlining the tax incentives regime; and (vi) limiting the accumulation of contingent liabilities, by reforming the operation of loss-making public corporations and curbing credit risk incurred by the development bank through the fast expansion of its loan portfolio.



21. A stronger public financial framework (PFM) will be critical in supporting the adjustment efforts. The current framework was adopted in 1965 and last amended in 1994, and has some weaknesses that make it difficult to control spending commitments and final fiscal outcomes. The mission and the authorities agreed that reforming it in line with best international practice could enhance the government's ability to manage public finances and improve fiscal outcomes. The reforms, which could be considered in the near term, could include the following:

- Adopting *Fiscal Responsibility Legislation* to establish the principles of responsible fiscal management and improve the quality of fiscal reporting. The principles could include, for example: (i) the institutionalization of the objective of reducing debt to prudent levels; (ii) providing guidance on how the government should reconcile current debt and deficit levels with their longer-term objectives—60 percent of GDP debt ratio by 2020 and a 2.4 percent of GDP primary surplus over the cycle—including rules that should guide fiscal policies until these levels are achieved; and (iii) establishing the rule that will be followed once this level is achieved. Increased transparency should involve continued efforts to improve the quality and

[19] The recent cabinet decision to abandon plans for the introduction of a system of targeting and monitoring beneficiaries of social programs, which was being developed with assistance from the World Bank, could set back efforts to streamline social spending. The mission welcomed the authorities' intention to continue improving the current system of tracking beneficiaries and encouraged them to pursue an in-depth assessment of social programs with a view to adopting a more systemic approach to the provision of social support, including potentially through a gradual introduction of universal coverage to targeted groups as an alternative to currently overlapping programs.

frequency of financial reporting, especially in-year reporting, and requiring the production of consolidated public sector accounts.

- *Strengthening control over spending commitments*, as there is no mandated requirement to report these commitments when they are entered into, thereby making it difficult to check their consistency with budget appropriations. Meaningful penalties should also be imposed when transactions are not reported in line with regulations.

- *Restricting the use of contingency warrants*, which are issued throughout the year by the government to authorize unbudgeted spending. These warrants are unfunded and allow a significant amount of spending to bypass initial parliamentary scrutiny and competition with other spending for the scarce fiscal resources. To strengthen the integrity of the budget, public money should be allowed to be spent only if first authorized by parliament; a contingency reserve for unforeseen or emergency spending should be explicitly budgeted to serve as a cushion until a budget amendment can be passed; and the number of budget amendments should be limited and should be allowed only after a mid-year review of the outlook for the revenue, spending, and financing for the year as a whole.

- *Strengthening control over capital expenditure*, by integrating donor-financed project spending into the main transaction processing system.

- *Other amendments to the legislation could include*: (i) institutionalizing the top-down budget preparation process that was developed with recent assistance from CARTAC and applied for the preparation of the FY2012/13 budget; (ii) mandating the internal audit function, as its strengthening would minimize the risk of noncompliance; (iii) widening the scope of the PFM and fiscal responsibility frameworks to the general government; and (iv) introducing meaningful penalties for noncompliance with the provisions of the legislation.

- *Bringing to fruition other reform efforts already being pursued by the government*, such as the modernization of procurement legislation and the consolidation of the government accounts into a Treasury single account to simplify cash management and save on overdraft costs.

B. Monetary and Financial Policies: Ensuring Continued Stability

22. While monetary policy is fully dedicated to maintaining the hard peg to the U.S. dollar, staff saw some scope for relaxing the policy stance, which is under the purview of the Monetary Council.[20] In particular, the 3 percent floor on savings deposits imposes a cost on the financial system and the economy in an environment when most risk-free investments yield near-zero rates. The elimination of this floor at this point in the cycle could help bring rates down and provide a much needed boost to growth. The authorities took note of staff views and agreed to

[20] The Monetary Council consists of the eight Prime Ministers of the ECCU member countries.

examine the issue within the auspices of the Monetary Council along with other governments in the region.

23. Staff expressed concerns on the outlook for the financial sector. Persistent economic weakness and, in the credit union sector, the need for continued provisioning for exposures to the failed regional insurance companies will depress loan performance, profits, and capitalization in the near and medium term.[21] Liquidity pressures in the weaker credit unions are likely to remain high until these are resolved. In the absence of safety-net and lender-of-last-resort type arrangements for the sector, these pressures may expose the financial system to confidence spillover risks, which are already elevated given financial stress in the ECCU financial system outside Dominica. On the positive side, efforts to consolidate the banking system across the ECCU may yield important benefits in terms of increased efficiency, if done on a market basis.

24. The authorities agreed that priority should be given to addressing weaknesses in credit unions and strengthening the prudential and supervisory environment, but preferred a more cautious approach. They noted the recent strengthening of the supervisory toolkit with the approval of regionally harmonized *insurance* legislation that tightens capital and reporting requirements; this follows the approval of similar legislation for *credit unions* in March 2011. Staff concurred, but stressed the need for further forceful reforms:

- *Strengthening the credit unions*. The mission advised a quick resolution to the credit unions with compromised capital adequacy, and that a clear path to full capitalization should be agreed on, monitored, and enforced by the Financial Services Unit (FSU).[22] The authorities noted that while they are engaging with the credit unions on ways to strengthen their capitalization, the extent of their final losses and capital adequacy shortfalls will not be clear until a regional solution for the failed insurance companies emerges. They also pointed to the ongoing merger discussions among several credit unions. The mission urged earlier action, since the capital shortfalls are large in some institutions and the ability to raise capital may be already compromised by weakened income of credit union members. Finally, the mission advised close monitoring of the liquidity position of the weaker institutions and developing early contingency plans for dealing with liquidity shortages if these materialize.

- *Strengthening non-bank regulation and supervision*. To strengthen FSU's enforcement powers, the mission advised: (i) legislative changes to introduce prompt corrective action for supervisors, which would require automatic supervisory response to various degrees of credit union distress; (ii) updating the credit union regulation to make it compatible with the revised legislation; and (iii) introducing penalties for noncompliance with reporting requirements for

[21] The indigenous bank exposure was concentrated in the CLICO of Trinidad and Tobago, and its recent resolution will allow the bank to reverse the provisioning, supporting its near-term income.

[22] Staff estimates that capital increases of ¾ to 2 percent of GDP, depending on the provisioning standards used, would be required to bring capital ratios in line with regulatory requirements.

the development bank, among other needed revisions. The authorities agreed, but argued that the additional discretion in taking regulatory action permitted under current laws allows them a more calibrated and cautious response in the current vulnerable environment.

- *As members of the ECCB's Monetary Council, the authorities have an important role to play in efforts to strengthen the supervision and regulation of the banking system.*[23] Staff suggested that these efforts focus on: (i) taking urgent action to enforce existing prudential norms or decide on resolution strategies if banks are unable to comply; (ii) tightening provisioning requirements, introducing prompt corrective action, and upgrading the legal framework for bank resolution; and (iii) reconsidering the interest rate floor on saving deposits (discussed above).

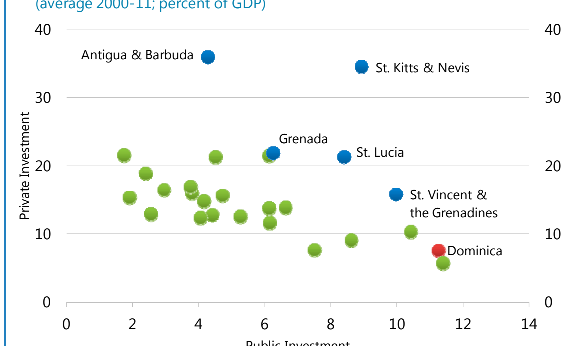
- *Deposit insurance*. Given that the quasi-currency board arrangement in the ECCU limits the lender of last resort function and fiscal resources to bail out banks or credit unions are very limited, staff recommended that authorities pursue regional efforts to strengthen the depositor safety net through preparations for the introduction of a deposit insurance scheme. In addition to improved transparency, deposit insurance would help preserve confidence in the banking system and reduce the risk of systemic banking sector stress. In coordination with these efforts, a similar deposit insurance arrangement could be pursued for the credit unions, given their prominent role in Dominica.

C. Growth and Competitiveness: Moving to a New Growth Strategy

25. A new growth strategy, focused on enhancing private sector investment, is needed to invigorate growth. Under the existing strategy, the public sector has long been an important driver of growth. Public investment averaged 11 percent of GDP over the past decade (among the highest in Western Hemisphere, but with limited growth dividends), while private investment was among the lowest. As the authorities recognize, this is an unsustainable approach given limited scope for further government support to the economy, and the priority moving forward should be engaging the private sector and boosting its competitiveness. To this end, the authorities have recently adopted a *Growth and Social Protection Strategy* for 2012–15, which lays out their plans for strengthening infrastructure and supporting key industries. The mission welcomed the focus on productive infrastructure given the country's large development

Public and Private Investment in LAC and the Caribbean

(average 2000-11; percent of GDP)



Sources: World Economic Outlook and Fund staff calculations.

[23] The Eastern Caribbean Central Bank is responsible for the supervision and regulation of commercial banks in the ECCU.

needs, but argued that other policies need to move away from direct industry support through public transfers or tax incentives as has often been the case so far. Indeed, ensuring sustained future growth--even if the full benefits of the potential geothermal energy sector are realized—would require vigorous structural reforms to improve competitiveness and narrow the infrastructure gap. Specifically, staff emphasized that the new growth strategy needs to focus on:

- *Fostering the development of the tradable sector*, as the only viable growth driver given the small size of Dominica's domestic market. This can be achieved through measures to spur productivity growth in the sector, together with higher external demand triggered by a real exchange rate depreciation. The authorities agreed that among the policy options generally available to achieve a real depreciation (nominal depreciation, fiscal adjustment and/or fiscal devaluation[24]), fiscal adjustment is the most feasible, given that it is also needed to achieve a sustainable medium-term fiscal position.

- *Focusing public investment on productive infrastructure and high-impact social programs to boost employment.* Dominica has a still large infrastructure gap, and there is room for redirecting existing public investment towards road and other productive infrastructure spending. Similarly, redirecting social expenditure from subsistence programs towards schemes that are linked with employment and labor force participation would help create job search incentives and reduce structural unemployment. The mission welcomed authorities' recent budget initiatives to introduce pilot programs to graduate people from unemployment to work and encouraged further efforts in this direction.

- *Removing structural impediments to competitiveness.* While some of these impediments are unavoidable given pervasive lack of economies of scale, structural reforms could help alleviate remaining policy-induced bottlenecks.

26. The authorities agreed with staff that structural reforms to improve the business climate and reduce the cost of doing business should be stepped up. In addition to the likely benefits from geothermal energy exploration already pursued by the authorities, there is scope for:

- *Facilitating the development of property markets,* including by transitioning from property transfer taxes towards recurrent property taxes, and creating a more level playing field for domestic and foreign investors.[25] These reforms could help improve labor mobility, attract foreign investment, increase employment, and support an expansion of agriculture by allowing inefficiently small or abandoned farms to be purchased and consolidated. The transition away from property transfer taxes would in part be helped by the completion of ongoing land

[24] A revenue neutral switch from payroll to consumption taxes.

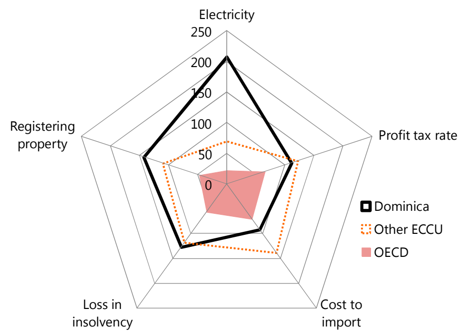
[25] There are no recurrent property taxes in Dominica in part because of deficiencies in property registration. Property taxation relies instead on high transfer taxes applied when properties are sold (about 10 percent), with foreigners charged an additional 10 percent in alien registration fees (on land holdings above three acres), both of which have a cascading effect on property prices as properties are resold.

tenure reforms that aim at identifying all land holdings, developing a land registry, and supporting a land development strategy. The authorities agreed with the desirability of transitioning from transfer to recurrent property taxes, but believe the current system of higher taxation of foreign investors is needed to prevent social dislocation.

- *Deepening free trade agreements* to reduce the cost of international trade and input costs more generally.

Costs of Doing Business

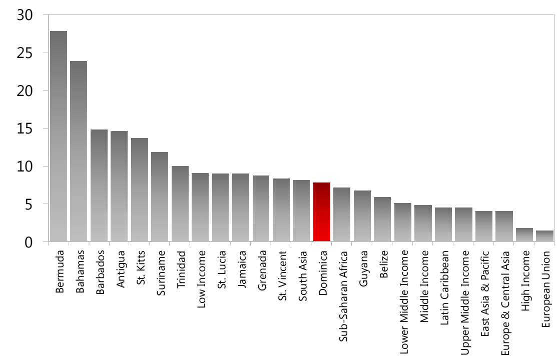
(costs in percent of the average of these three groups)



Sources: World Bank, Doing Business 2012; and Fund staff estimates.

Effective Import Tariff Rates

(Average of all products, latest available)



- *Strengthening the functioning of labor markets,* by updating existing legislation to remove undue restrictions on working hours and improving labor statistics to help guide social and labor market policies through a better diagnosis of the issues.

- *Developing credit markets and easing access to finance*, through the setup of a credit registry and facilitating collateral recovery. The development of a central credit registry would facilitate bank lending decisions through easy access to credit information and increased ability to identify and assess potential credit risks. The legislation regarding financial institutions' rights to seize collateral securing bad debts should be amended to accelerate the lengthy procedures and heavy judicial involvement, and allow power-of-sale clauses in lending agreements to permit easier sale of collateral on defaulted loans.

STAFF APPRAISAL

27. Dominica's economy faces a challenging recovery ahead. Economic activity has reached pre-crisis levels, but short-term indicators and a weakening external environment do not bode well for a strong recovery in the near future. Fiscal policies have provided support to the economy during the post-crisis period, but will now need to address impending liquidity and sustainability constraints. Over the medium term, without a change in the growth strategy, the economy could be facing weak potential growth prospects.

28. While conditions are not ideal for unwinding the fiscal stimulus, failing to do so risks undermining fiscal sustainability. Although still moderate, current deficit levels are stoking financing pressures given the country's only recent access to regional bond markets, and are quickly putting debt on an upward path. Staff welcomes the authorities' efforts to restrain spending in the face of weakening revenues, but believes that a more ambitious consolidation effort will be needed to fend off liquidity and solvency risks. This effort should focus on streamlining current spending and targeting public investment on productivity-enhancing infrastructure. The authorities' intention to achieve a 2.4 percent of GDP primary surplus within about 3 years would provide an appropriate pace of consolidation, allowing them to comfortably achieve their debt target of 60 percent of GDP by 2020, with some room to offset adverse shocks. However, clear consolidation plans need to be formulated to make the authorities' commitment to this target more credible. With the fiscal policy framework now appropriately anchored on maintaining the primary surplus target over the cycle, a rule establishing expenditure ceilings would stand a good chance of achieving fiscal discipline while allowing automatic stabilizers to work.

29. Lasting consolidation should be underpinned by a strengthened fiscal policy framework. The approach could be two-pronged: (i) the overdue modernization of the current PFM framework should be used to improve budgetary control over spending commitments and capital project execution, as well as eliminate unfunded extra-budgetary spending mandates, all of which would help strengthen fiscal discipline during the budget execution process; and (ii) introduce fiscal responsibility legislation to guide fiscal policies toward its medium-term objectives, and increase fiscal transparency across the public sector.

30. Decisively addressing remaining vulnerabilities in the financial system would help contain stability risks and aid the recovery. The main vulnerabilities are concentrated in the credit union sector, and staff sees merit in taking early and decisive regulatory action to strengthen undercapitalized institutions, before liquidity pressures materialize and risk undermining confidence in the system. Although such pressures are not likely in the banking system, which remains very liquid, action to bolster the capital base needs to be taken as well to ensure the system is in a position to support the economic recovery. The regulatory and supervisory framework for bank and nonbank financial institutions should be strengthened, including by aligning provisioning norms with international practice and introducing a prompt corrective action regime to ensure adequate supervisory response to financial sector weakness. Early preparations for the introduction of deposit insurance schemes would permit their timely introduction once the financial system is restored to health and would help address moral hazard concerns by transitioning from the current implicit blanket government guarantees to explicit, but limited, guarantees, in the absence of financial safety nets in the ECCU systems.

31. There appears to be some room for easing the monetary stance, unchanged during the past nine years. In the current environment of very low interest rates, reconsidering the interest floor on savings deposits would reduce banks' funding costs and likely lending rates, providing a much needed support to the recovery.

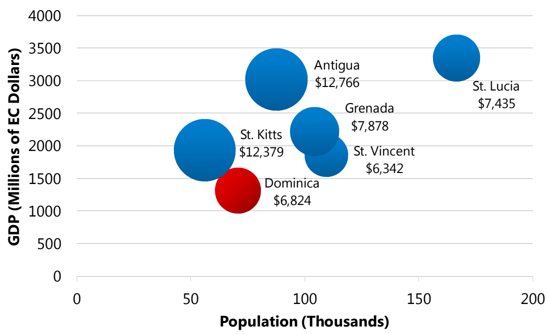
32. Bold structural reforms to boost competitiveness are the main policy lever available to improve growth prospects. The authorities' recent steps to harness geothermal energy potential show significant promise, but there should be no let up in other reforms that would remove structural bottlenecks and place Dominica in a better position to take advantage of a recovery in global demand. These reforms include making space for productive public investment to narrow the infrastructure gap and encourage labor force participation; facilitating the development of property markets; improving the business environment for the private sector; and facilitating access to finance, among others. Other policy options to improve competitiveness are predicated on a real depreciation of the exchange rate to shift productive resources to the tradable sector, with fiscal consolidation—if undertaken—able to generate such a real depreciation.

33. It is proposed that the next Article IV consultation be held on a 12-month cycle.

Figure 1. Dominica in Context

The size of Dominica's population and economy are comparatively small relative to the other ECCU members...

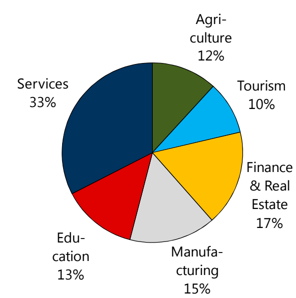
ECCU6: GDP, Population and Per Capita Income [1]
(2011)



[1] Bubble size represents GDP per capita in US Dollars.

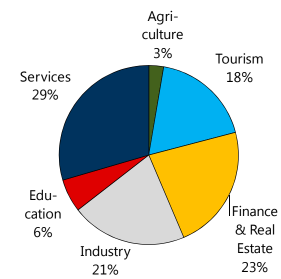
... and the structure of its economy is different than its peers, with agriculture still large and tourism undeveloped, ...

Dominica
(average share in real GDP, 2000-11)*



Sources: CSO, Dominica; and staff ests.
* Excluding FISIM.

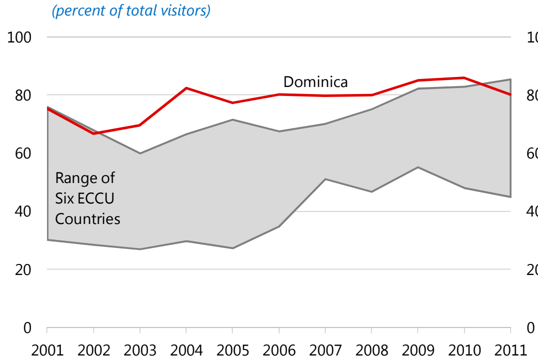
ECCU Excluding Dominica
(average share in real GDP, 2000-11)*



Sources: ECCB and Fund staff estimates.
* Excluding FISIM.

... and largely reliant on cruiseship visitors rather than on the more lucrative stay-over tourism.

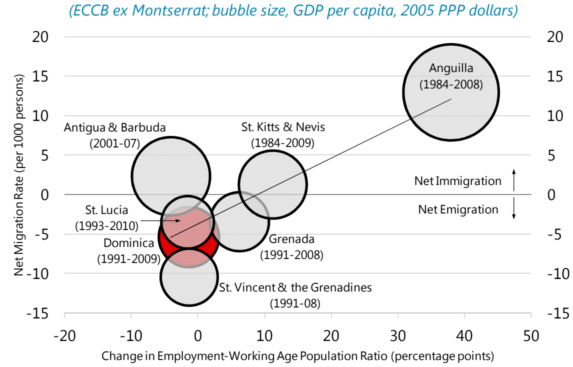
Cruise Ship Visitors
(percent of total visitors)



Sources: Eastern Caribbean Central Bank and Fund staff calculations.

Weak employment prospects over the past decades helped support high rates of outward migration.

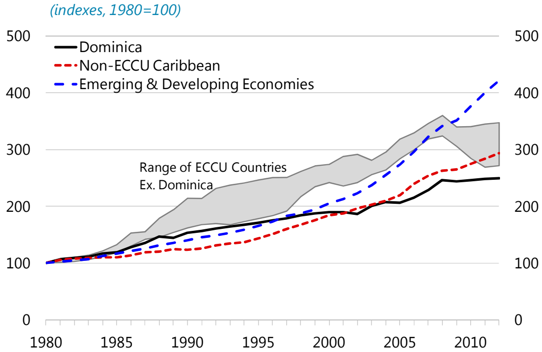
Employment, Migration, and GDP Per Capita
(ECCB ex Montserrat; bubble size, GDP per capita, 2005 PPP dollars)



Sources: ECCB; ILO; U.S. Census Bureau; WDI; WEO; Fund staff estimates.

In part reflecting these challenges, growth has lagged behind other Caribbean and developing economies,...

Real GDP
(indexes, 1980=100)



Sources: World Economic Outlook and Fund staff estimates.

... with absorption supported by large remittances and grants.

Grants and Remittances
(Percent of GDP, 2001-11 average)

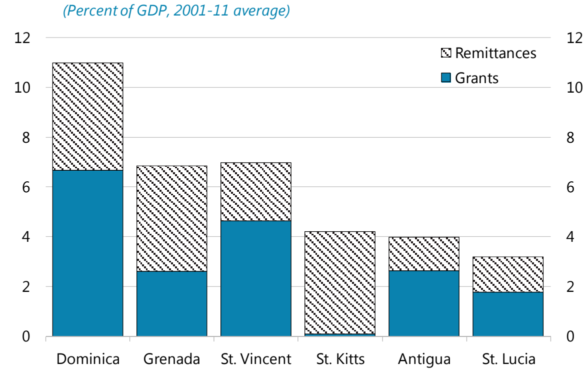
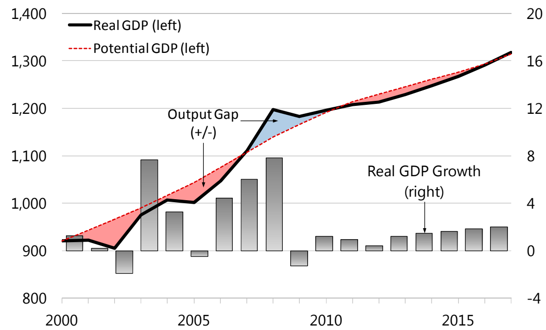


Figure 2. Dominica: Recent Economic Developments

Growth has been moderate over the past two years, but will pick up slowly over the medium term, partly due to an expected firming of the global economy…

Actual and Potential Real GDP

(levels in millions of 2006 EC dollars; growth in percent)

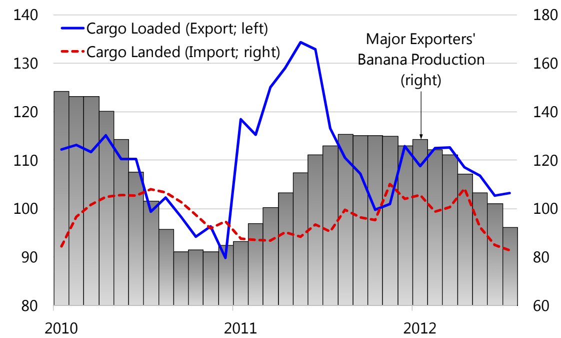


Sources: Dominican Authorities; and Fund staff estimates.

… but, currently, growth appears to be slowing, as suggested by weakening mining and quarrying exports, banana production and household import demand…

Import and Export Indicators

(indexes, 2010=100; 6-mma, seasonally adjusted)

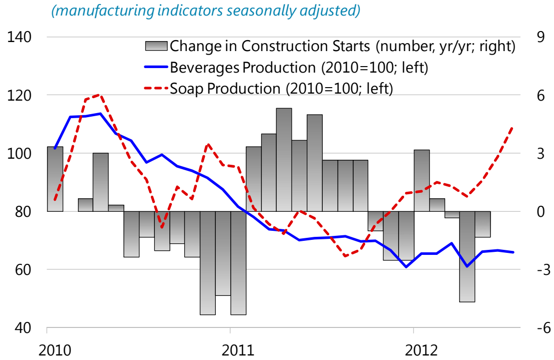


Sources: Central Statistics Office, Dominica; and Fund staff estimates.

… as well as by weakening activity in construction and some manufacturing subsectors.

Short-Term Industrial Indicators

(manufacturing indicators seasonally adjusted)

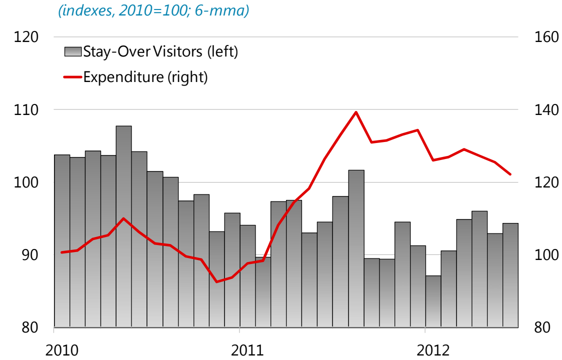


Sources: Central Statistics Office, Dominica; and Fund staff estimates.

Although tourist arrivals are up in 2012, visitors have been cutting back on their expenditures.

Tourism Indicators

(indexes, 2010=100; 6-mma)

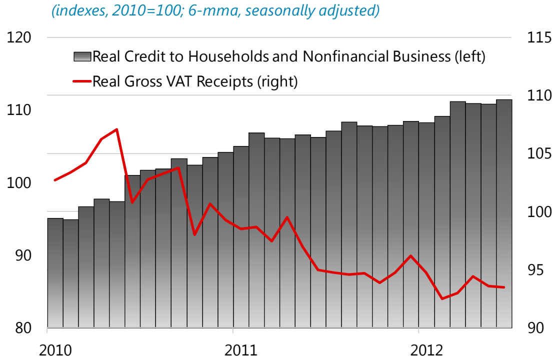


Sources: Eastern Caribbean Central Bank and Fund staff estimates.

Real VAT collections and credit to nonfinancial companies and household have been about flat, consistent with the weak recovery.

Real Credit and VAT Collections

(indexes, 2010=100; 6-mma, seasonally adjusted)

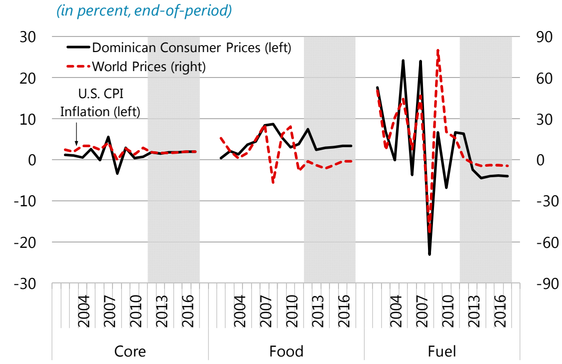


Sources: Dominican Authorities; ECCB; and Fund staff estimates.

Inflation continues to be mild, with modest imported inflation, limited pass-through of world food price hikes, and expected declines in fuel prices.

Inflation

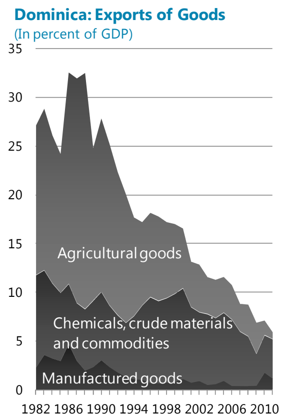
(in percent, end-of-period)

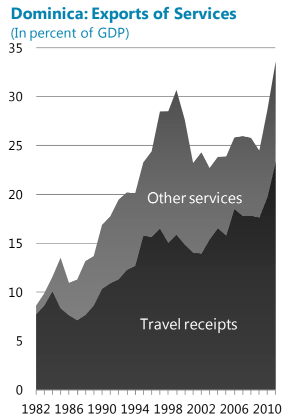


Sources: CSO, Dominica; IFS; WEO; Haver; and Fund staff estimates.

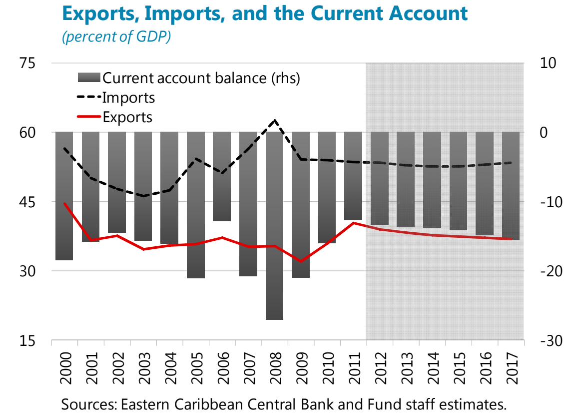
Figure 3. Dominica: External Developments

In line with the changing structure of the economy, exports of services continue replacing the exports of goods.

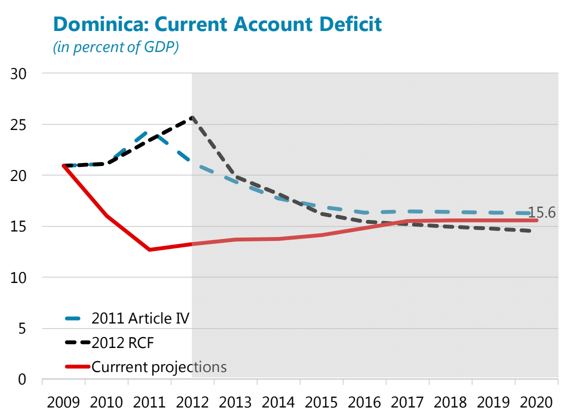




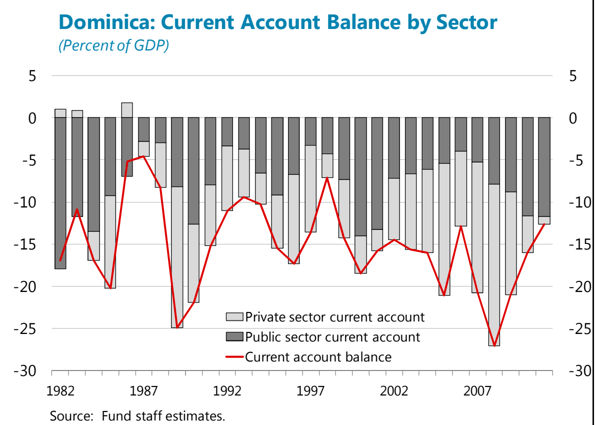
However, the current account deficit has remained large over the years, with only recent retrenchment due to import compression…



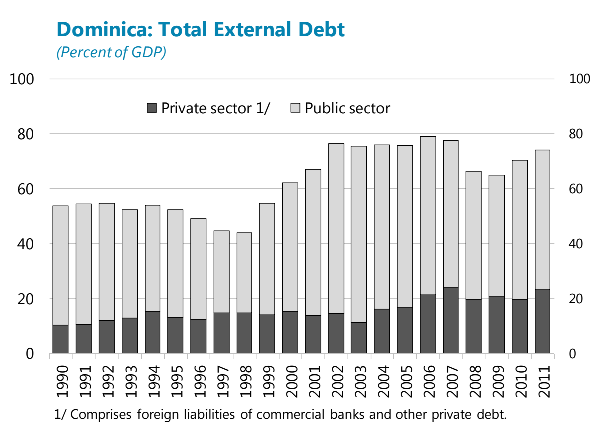
The retrenchment became evident only in the recently revised balance of payments data.



The public sector is now the main driver of external imbalances…



… and accounts for the bulk of the increase in external indebtedness.



An appreciating and overvalued exchange rate appears to be limiting the scope for further external adjustment.

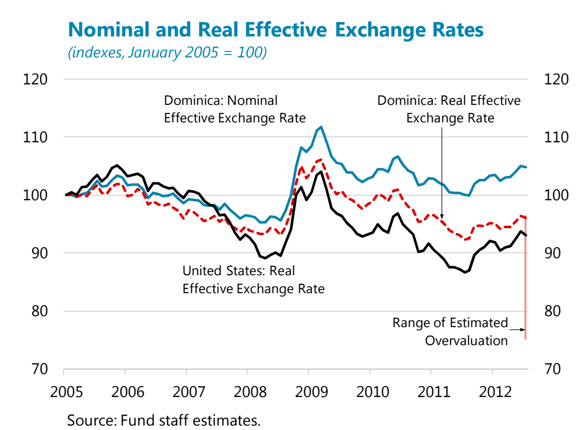
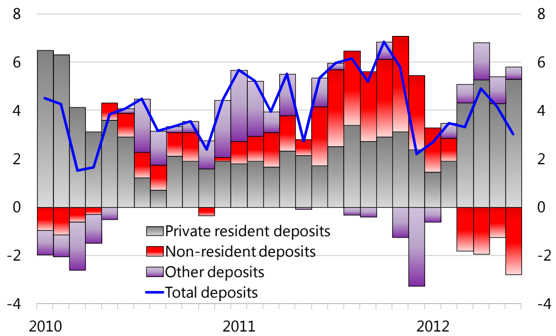


Figure 4. Dominica: Monetary and Financial Developments

Private resident deposits have grown strongly this year…

Contributions to Real Deposits Growth

(in percentage points, yr/yr)

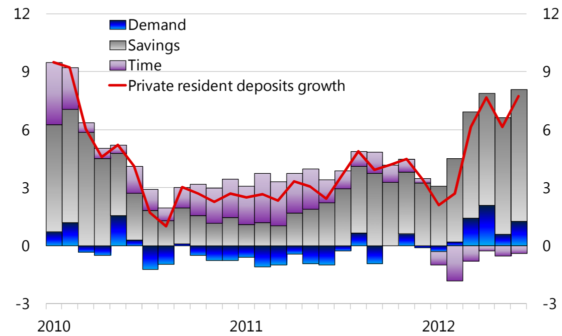


Sources: Eastern Caribbean Central Bank; and Fund staff estimates.

… as savings deposits have risen rapidly…

Contributions to Growth of Private Deposits

(in percentage points, yr/yr)

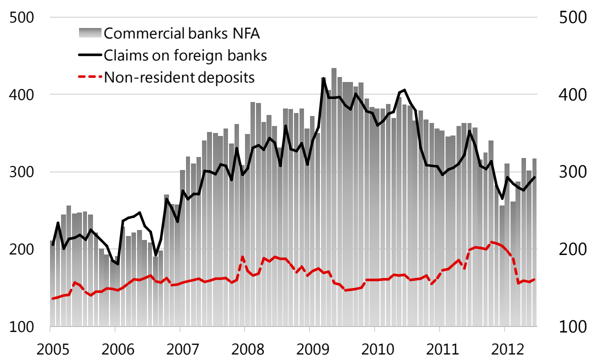


Sources: ECCB; and Fund staff estimates.

… and have offset the withdrawal of non-resident deposits accumulated in 2011. The withdrawal of non-resident deposits has halted the decline in banks' net foreign assets.

Commercial Banks NFA

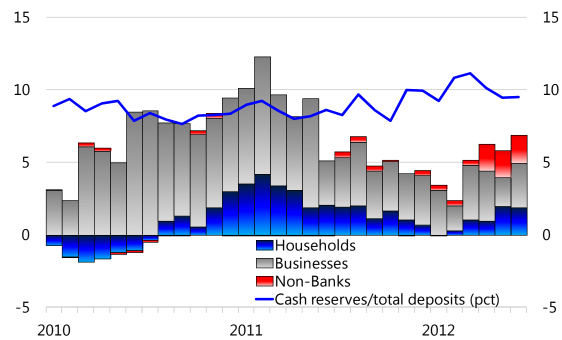
(Millions of EC dollars)



Robust deposit growth pushed up excess liquidity and supported a recent pickup in credit, although the latter in part reflects policy on-lending to the development bank.

Contributions to Real Private Credit Growth

(in percentage points, yr/yr)

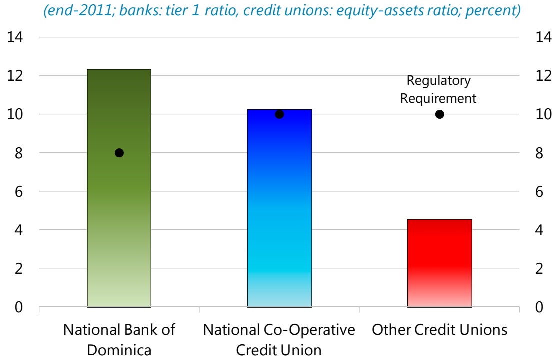


Sources: Eastern Caribbean Central Bank; and Fund staff estimates.

The larger financial institutions report adequate capitalization ratios, but pockets of vulnerability exist …

Capital Ratios in Key Financial Institutions

(end-2011; banks: tier 1 ratio, credit unions: equity-assets ratio; percent)

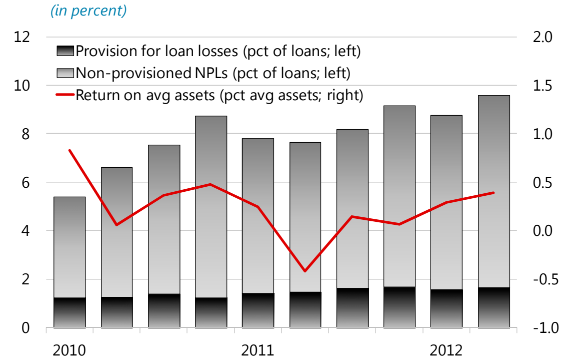


Sources: Company Reports; Dominican Authorities; and Fund staff estimates.

…and provisioning is generally weak, especially by international standards.

Banking System Soundness Indicators

(in percent)

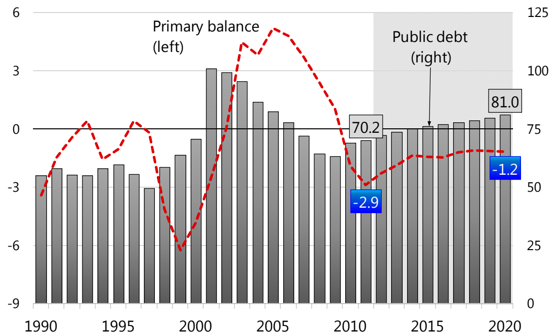


Sources: Eastern Caribbean Central Bank; and Fund staff estimates.

Figure 5. Dominica: Fiscal Developments

The recent weakening in central government's fiscal position is projected to persist on current policies.

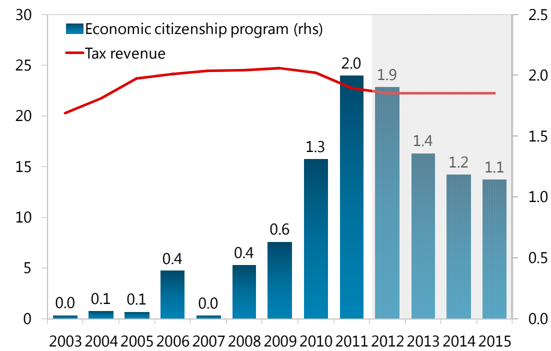
Public Debt and Fiscal Primary Balance
(in percent of GDP)



Source: Fund staff estimates.

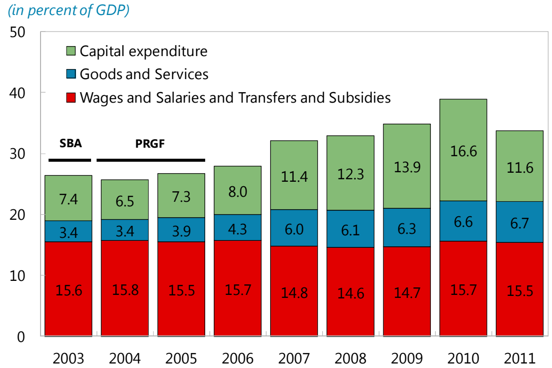
The weakening reflected a recent drop in tax collections, offset by a likely temporary surge in nontax revenues,...

Revenues
(In percent of GDP)



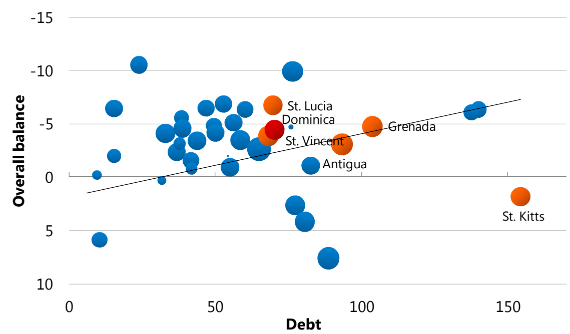
...and a rise in investment to support the recovery over the past few years, but pressures on goods and services also contributed to the spending increase.

Primary Expenditure
(in percent of GDP)



Although neither fiscal balances nor debts are yet excessive compared to emerging markets...

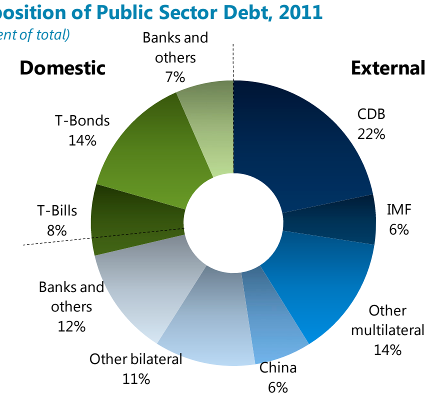
Emerging Economies: General Government Balance and Debt, 2011[1]
(Percent of GDP)



[1] Selected group of countries with data available; bubble size represents three-month treasury bill rates, normalized by adding 6 percentage points to bring all to positive.

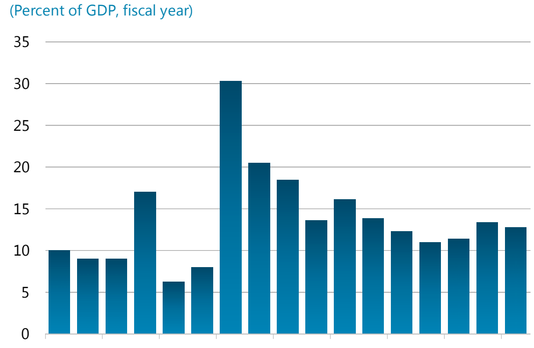
... and concessional multilateral and donor financing makes up the bulk of public debt; future deficits are likely to require increased market-based borrowing, worsening the financing mix.

Composition of Public Sector Debt, 2011
(In percent of total)



In the rest of the public sector, increased borrowing points to a deterioration in the financial position of public corporations.

Debt of Public Corporations 1/
(Percent of GDP, fiscal year)



1/ Includes own debt and debt guaranteed by central government.

Table 1. Dominica: Selected Economic and Social Indicators

I. Social and Demographic Indicators

Area (sq. km.)	754.0	Adult literacy rate (percent, 2004)	88
Population (2011)		Unemployment (including discouraged)	14.0
Total	71,293	Unemployment rate (excl. discouraged)	9.8
Annual rate of growth (percent)	1.0		
Density (per sq. km.)	94.6	Gross Domestic Product (2011)	
Population characteristics		(millions of E.C. dollars)	1,304
Life expectancy at birth (years, 2006)	74.1	(millions of U.S. dollars)	483
Infant mortality (per thousand live births, 2006)	13.0	(US dollars per capita)	6,776

II. Economic Indicators

	2008	2009	2010	2011		2012		2013	2014	2015	2016	2017
				RCF	Est.	RCF	Proj.			Proj.		
	(Annual percentage change, unless otherwise specified)											
Output and prices												
Real GDP 1/	7.9	-1.3	1.2	0.9	1.0	1.5	0.4	1.3	1.5	1.7	1.8	2.0
Nominal GDP	9.6	6.5	-1.5	3.9	0.3	3.5	2.8	4.0	3.1	3.4	3.8	4.1
Consumer prices (end of period)	2.0	3.2	0.1	4.0	2.0	2.0	3.6	1.5	1.6	1.8	1.9	2.0
Consumer prices (period average)	6.4	0.0	2.8	2.4	1.4	2.5	2.3	2.3	1.6	1.7	1.9	2.0
Output gap (percent of potential GDP)	5.0	1.3	0.5	-0.2	-0.5	-0.5	-1.3	-1.3	-1.1	-0.7	-0.1	0.2
Real effective exchange rate												
(period average, depreciation -)	0.9	5.0	-2.8	...	-4.2	...	...	...	...	...	...	...
	(In percent of GDP, unless otherwise specified)											
Central government balances 2/												
Revenue	35.4	36.0	37.0	33.5	30.9	32.3	29.4	29.2	28.9	28.8	28.6	28.7
Taxes	24.5	24.7	24.2	24.4	22.7	24.0	22.2	22.2	22.2	22.2	22.2	22.4
Non-tax revenue	2.0	2.6	3.1	2.4	3.3	2.4	3.2	3.0	2.7	2.6	2.4	2.3
Grants 3/	8.9	8.7	9.7	6.7	4.8	5.9	4.0	4.0	4.0	4.0	4.0	4.0
Expenditure	34.7	36.3	40.5	35.6	35.3	35.6	33.3	32.7	32.0	31.9	31.8	31.7
Current primary expenditure	20.7	21.0	22.3	22.4	22.1	22.4	21.9	21.9	21.9	21.9	21.9	21.9
Interest payments	1.7	1.4	1.6	1.6	1.5	1.6	1.6	1.6	1.7	1.7	1.7	1.7
Capital expenditure	12.3	13.9	16.6	11.6	11.6	11.5	9.8	9.1	8.4	8.3	8.2	8.0
Primary balance	2.4	1.0	-1.9	-0.5	-2.9	-1.7	-2.3	-1.9	-1.4	-1.4	-1.5	-1.2
Overall balance	0.7	-0.3	-3.5	-2.1	-4.4	-3.3	-3.9	-3.5	-3.1	-3.1	-3.2	-3.0
Central government debt (incl. guaranteed) 4/	64.3	63.3	68.9	69.4	70.2	71.0	72.3	73.7	75.0	76.0	76.9	77.7
External	45.2	44.3	50.5	51.0	50.2	52.5	52.4	53.7	54.1	54.8	55.3	55.6
Domestic	19.2	19.0	18.4	18.4	20.0	18.5	19.8	20.0	20.9	21.3	21.6	22.0
Money and credit (annual percent change)												
Broad money (M2)	4.3	10.0	6.1	1.9	0.3	4.4	4.3	3.3	3.1	3.4	3.7	3.7
Real credit to the private sector	6.1	3.6	9.4	6.7	4.4	3.5	0.8	1.5	1.5	1.7	1.8	2.1
Balance of payments												
Current account balance, *o/w:*	-27.1	-21.0	-16.0	-23.5	-12.7	-25.7	-13.3	-13.7	-13.8	-14.2	-14.9	-15.6
Exports of goods and services 5/	35.4	32.0	35.9	32.7	40.4	33.0	39.0	38.3	37.8	37.4	37.2	36.9
Imports of goods and services	62.6	54.1	54.0	57.7	53.6	60.3	53.4	53.0	52.6	52.6	53.0	53.4
Capital and financial account balance	25.7	22.4	19.5	23.8	20.4	25.5	13.1	13.5	13.6	14.0	14.7	15.4
FDI	12.3	8.4	5.1	5.4	3.7	5.7	3.7	4.7	5.2	5.8	6.4	7.1
Capital grants	11.8	8.4	6.3	7.2	3.2	8.1	4.4	4.0	4.0	4.0	4.0	4.0
Other (incl. errors and omissions)	1.6	5.6	8.2	11.2	13.5	11.7	5.0	4.8	4.4	4.2	4.2	4.3
External debt (gross) 6/	64.9	65.3	70.3	82.7	75.1	88.8	74.4	72.8	71.4	70.6	70.0	69.6
Savings-Investment Balance	-27.1	-21.0	-16.0	-23.5	-12.7	-25.7	-13.3	-13.7	-13.8	-14.2	-14.9	-15.6
Savings	-6.0	-1.6	5.2	2.6	7.1	-1.3	2.7	1.6	1.2	0.8	0.5	0.1
Investment	21.1	19.4	21.2	26.1	19.8	24.4	16.0	15.3	15.0	14.9	15.4	15.7
Public	12.8	13.8	16.4	15.2	15.3	12.7	11.8	10.5	9.8	9.4	9.5	9.5
Private	8.3	5.6	4.8	10.9	4.5	11.7	4.2	4.8	5.2	5.5	5.9	6.2
Memorandum items:												
Nominal GDP (EC$ millions)	1,239	1,320	1,300	1,304	1,304	1,341	1,341	1,395	1,439	1,488	1,544	1,607
Net imputed international reserves:												
Months of imports of goods and services	2.3	2.9	3.1	2.9	3.5	2.6	3.3	3.2	3.1	2.9	2.7	2.6
Ratio to demand liabilities	97.5	99.1	99.1	...	99.2	...	98.5	97.9	97.2	96.4	95.6	94.7

Sources: Dominican authorities; Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

1/ Historical data revised with real GDP now measured in market prices instead of basic prices (except for the RCF columns).

2/ Fiscal year (July–June) basis. In this report, the fiscal operations are presented for the first time in the GFSM 2001 format, causing some fiscal data reported here to not be fully comparable to earlier reports.

3/ Does not include grants that were received but not spent.

4/ Excludes debt incurred under the Petro Caribe arrangement with Venezuela (except for the RCF columns).

5/ The numbers from 2010 onward have been recently revised to reflect the results of the latest tourism expenditure survey.

6/ Comprises public sector external debt, foreign liabilities of commercial banks and other private debt.

Table 2. Dominica: Balance of Payments[1/]

	2008	2009	2010	2011		2012		2013	2014	2015	2016	2017
				RCF	Est.	RCF	Proj.			Proj.		
						(In millions of USD)						
Current account balance	**-124.3**	**-102.4**	**-77.1**	**-115.0**	**-61.1**	**-130.3**	**-65.9**	**-70.7**	**-73.5**	**-78.0**	**-84.9**	**-92.5**
Exports of goods and services	162.3	156.6	172.8	160.4	195.1	167.5	193.9	197.7	201.4	206.4	212.6	219.4
Goods	43.9	36.8	34.5	38.1	32.4	40.0	33.4	34.8	35.8	36.9	38.2	39.7
Tourism	81.8	86.1	95.1	89.8	112.8	93.6	107.8	108.9	111.2	114.3	118.2	122.1
Other services	36.7	33.6	43.2	32.5	49.8	33.9	52.7	54.0	54.5	55.2	56.2	57.6
Imports of goods and services	287.3	264.6	260.2	283.1	258.8	306.3	265.2	273.7	280.3	289.8	303.0	317.8
Fuel	43.4	32.4	32.1	45.6	41.5	45.8	45.2	46.2	46.6	47.3	48.2	49.3
Food	32.6	32.3	32.3	45.9	33.2	45.4	34.9	35.4	35.7	36.2	37.1	38.1
Other goods	141.3	133.5	128.1	121.8	118.3	141.3	117.6	122.1	126.1	132.1	140.3	149.5
Services	69.9	66.4	67.6	69.8	65.8	73.8	67.6	70.0	71.8	74.3	77.4	80.9
Net income, *o.w.:*	-18.3	-13.7	-9.4	-10.9	-14.0	-10.7	-13.2	-13.9	-14.5	-15.2	-15.9	-16.7
Interest payments (public sector)	-5.0	-4.7	-4.7	-7.5	-4.7	-7.1	-3.6	-3.8	-4.1	-4.3	-4.5	-4.8
Net current transfers	19.0	19.3	19.7	18.6	16.6	19.2	18.7	19.3	20.0	20.7	21.4	22.7
Capital and financial account	**118.1**	**109.5**	**94.0**	**116.9**	**98.7**	**129.4**	**64.9**	**69.5**	**72.3**	**77.0**	**84.0**	**91.6**
Grants	57.6	44.0	33.5	38.3	19.0	41.3	25.9	24.8	25.6	26.5	27.5	28.5
Public capital transfers	54.3	40.8	30.2		15.7		21.9	20.6	21.3	22.1	22.9	23.7
Private capital transfers	3.3	3.1	3.3		3.3		4.0	4.1	4.3	4.4	4.6	4.8
Public sector flows, o.w.: 2/	5.2	12.9	28.4	27.0	16.7	22.5	26.4	25.1	22.7	20.5	21.6	22.7
PetroCaribe	8.6	4.8	6.1	8.8	6.9	8.6	8.5	8.5	8.2	6.4	6.1	5.9
Foreign direct investment	56.5	41.3	24.3	26.5	17.7	29.0	18.2	24.3	27.8	31.9	36.8	42.5
Commercial banks	-17.6	-10.3	10.0	-22.9	37.5	5.2	-12.5	4.8	4.6	4.3	4.1	4.0
Other private flows 3/	16.3	21.6	-2.3	48.1	7.7	31.4	7.0	-9.5	-8.4	-6.2	-6.0	-6.3
Errors and omissions	**2.9**	**13.7**	**-15.6**	**6.0**	**-31.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**-3.4**	**20.8**	**1.2**	**7.9**	**6.4**	**-0.9**	**-0.9**	**-1.1**	**-1.2**	**-1.1**	**-0.9**	**-1.0**
Overall financing	**3.4**	**-20.8**	**-1.2**	**-7.9**	**-6.4**	**0.9**	**0.9**	**1.1**	**1.2**	**1.1**	**0.9**	**1.0**
Change in ECCB NFA, o.w.: 4/	5.3	-21.7	-1.9	-7.9	-7.9	0.9	0.9	1.1	1.2	1.1	0.9	1.0
IMF reserve liabilities	3.2	4.3	-1.1	-2.9	-2.9	-4.1	-0.8	-2.7	-1.6	-2.2	-1.7	-1.3
Change in Government Foreign Assets	-2.0	0.9	0.7	0.0	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
						(In percent of GDP)						
Current account balance	**-27.1**	**-21.0**	**-16.0**	**-23.5**	**-12.7**	**-25.7**	**-13.3**	**-13.7**	**-13.8**	**-14.2**	**-14.9**	**-15.6**
Exports of goods and services	35.4	32.0	35.9	32.7	40.4	33.0	39.0	38.3	37.8	37.4	37.2	36.9
Goods	9.6	7.5	7.2	7.8	6.7	7.9	6.7	6.7	6.7	6.7	6.7	6.7
Tourism	17.8	17.6	19.7	18.3	23.4	18.4	21.7	21.1	20.9	20.7	20.7	20.5
Other services	8.0	6.9	9.0	6.6	10.3	6.7	10.6	10.4	10.2	10.0	9.8	9.7
Imports of goods and services	62.6	54.1	54.0	57.7	53.6	60.3	53.4	53.0	52.6	52.6	53.0	53.4
Fuel	9.5	6.6	6.7	9.3	8.6	9.0	9.1	8.9	8.7	8.6	8.4	8.3
Food	7.1	6.6	6.7	9.4	6.9	8.9	7.0	6.9	6.7	6.6	6.5	6.4
Other goods	30.8	27.3	26.6	24.8	24.5	27.8	23.7	23.6	23.7	24.0	24.5	25.1
Services	15.2	13.6	14.0	14.2	13.6	14.5	13.6	13.5	13.5	13.5	13.5	13.6
Net income	-4.0	-2.8	-2.0	-2.2	-2.9	-2.1	-2.7	-2.7	-2.7	-2.8	-2.8	-2.8
Interest payments (public sector)	-1.1	-1.0	-1.0	-1.5	-1.0	-1.4	-0.7	-0.7	-0.8	-0.8	-0.8	-0.8
Net current transfers	4.1	3.9	4.1	3.8	3.4	3.8	3.8	3.7	3.7	3.8	3.7	3.8
Capital and financial account	**25.7**	**22.4**	**19.5**	**23.8**	**20.4**	**25.5**	**13.1**	**13.5**	**13.6**	**14.0**	**14.7**	**15.4**
Capital transfers	12.5	9.0	7.0	7.8	3.9	8.1	5.2	4.8	4.8	4.8	4.8	4.8
Public sector flows, o.w.: 2/	1.1	2.6	5.9	5.5	3.5	4.4	5.3	4.9	4.3	3.7	3.8	3.8
PetroCaribe	1.9	1.0	1.3	1.8	1.4	1.7	1.7	1.6	1.5	1.2	1.1	1.0
Foreign direct investment	12.3	8.4	5.1	5.4	3.7	5.7	3.7	4.7	5.2	5.8	6.4	7.1
Commercial banks	-3.8	-2.1	2.1	-4.7	7.8	1.0	-2.5	0.9	0.9	0.8	0.7	0.7
Other private flows 3/	3.6	4.4	-0.5	9.8	1.6	6.2	1.4	-1.8	-1.6	-1.1	-1.0	-1.1
Overall balance	**-0.7**	**4.2**	**0.3**	**1.6**	**1.3**	**-0.2**	**-0.2**	**-0.2**	**-0.2**	**-0.2**	**-0.2**	**-0.2**
Memorandum items:												
Trade balance (percent of GDP)	-37.8	-33.0	-32.8	-35.7	-33.2	-37.9	-33.1	-32.7	-32.4	-32.4	-32.8	-33.1
Services balance (percent of GDP)	10.6	10.9	14.7	10.7	20.0	10.6	18.7	18.0	17.6	17.3	17.0	16.6
Net imputed international reserves:												
Millions of US dollars	55.1	64.5	66.4	68.3	74.5	67.4	73.5	72.4	71.3	70.2	69.2	68.3
Months of imports of goods and services	2.3	2.9	3.1	2.9	3.5	2.6	3.3	3.2	3.1	2.9	2.7	2.6
Ratio to demand liabilities	97.5	99.1	99.1	...	99.2	...	98.5	97.9	97.2	96.4	95.6	94.7
Gross external debt 5/	64.9	65.3	70.3	82.7	75.1	88.8	74.4	72.8	71.4	70.6	70.0	69.6
Public sector	45.2	44.3	50.5	51.0	50.2	52.0	52.4	53.7	54.1	54.8	55.3	55.6
Private sector	19.7	20.9	19.7	31.7	24.9	36.8	22.0	19.1	17.3	15.8	14.7	14.0
GDP (in US$ millions)	459.0	488.9	481.6	490.5	483.1	507.7	496.7	516.8	533.0	551.1	571.9	595.1

Sources: Dominican authorities; Eastern Caribbean Central Bank (ECCB); donor organizations; and Fund staff estimates and projections.

1/ The numbers from 2010 onward have been recently revised to reflect the results of the latest tourism expenditure survey.

2/ Official public flows are adjusted upward by staff estimates of PetroCaribe flows.

3/ Assumed to cover the residual financing needs over the projection period.

4/ 2009 numbers reflect IMF's SDR allocation.

5/ Comprises external public sector debt, gross liabilities of commercial banks and other private debt that covers the projected financing needs.

Table 3a. Dominica: The Statement of Operations of the Central Government[1/ 2/]

	2008	2009	2010	2011		2012			2013	2014	2015	2016	2017
				RCF	Est.	RCF	Budget	Proj.	Proj.				
	(In millions of Eastern Caribbean dollars)												
Revenue	**452.9**	**471.3**	**482.3**	**451.8**	**408.2**	**451.1**	**428.5**	**402.5**	**413.3**	**423.7**	**436.0**	**450.4**	**468.6**
Taxes	313.7	323.3	315.5	329.1	300.8	334.3	316.2	303.9	314.7	325.0	336.7	349.9	365.1
Taxes on income	54.8	60.8	56.8	59.0	55.6	61.0	58.0	55.9	57.9	59.8	61.9	64.3	67.7
Taxes on property	10.9	8.9	7.8	8.1	7.5	8.4	8.4	7.7	8.0	8.3	8.6	8.9	9.4
Taxes on goods and services	179.5	185.2	180.9	187.4	174.0	190.6	181.1	173.3	179.5	185.4	192.0	199.5	208.2
Taxes on international trade and transactions	68.6	68.4	70.0	74.7	63.7	74.3	68.7	66.9	69.3	71.6	74.2	77.1	79.8
Grants 3/	113.8	114.1	126.9	89.9	64.1	82.8	58.7	54.7	56.6	58.5	60.6	63.0	65.2
Other revenue	25.4	33.9	39.9	32.8	43.4	34.0	53.6	44.0	42.0	40.2	38.7	37.6	38.3
Property income	5.1	5.4	4.8	5.8	2.9	...	5.4	3.2	3.4	3.5	3.6	3.7	3.9
Sales, fees and fines	9.7	10.2	9.6	9.2	9.4	...	13.4	9.7	10.1	10.4	10.8	11.2	11.6
Other nontax revenue	10.6	18.3	25.4	17.8	31.1	...	34.7	31.0	28.5	26.3	24.3	22.6	22.8
Expenditure	**443.9**	**475.4**	**527.7**	**479.9**	**466.9**	**497.2**	**452.5**	**455.8**	**462.8**	**468.6**	**483.6**	**500.8**	**516.9**
Expense	**285.9**	**291.8**	**309.3**	**321.7**	**313.1**	**334.0**	**320.6**	**321.2**	**333.4**	**344.9**	**357.7**	**372.0**	**385.7**
Compensation of employees	123.5	126.2	135.0	144.5	135.5	149.6	145.4	139.6	144.6	149.3	154.7	160.7	166.5
Purchase of goods and services	78.1	82.7	86.1	90.2	88.3	93.3	90.1	90.1	93.3	96.4	99.8	103.7	107.4
Interest	21.9	17.8	20.6	21.2	20.4	23.0	19.5	21.7	23.2	24.5	25.8	27.1	28.5
Grants	35.3	36.9	40.8	38.7	39.2	40.1	37.5	40.0	41.4	42.8	44.3	46.0	47.7
Social benefits	28.3	29.7	28.7	29.1	29.9	30.1	28.0	30.1	31.2	32.2	33.3	34.6	35.9
Retirement benefits	22.4	23.3	22.9	22.5	23.3	23.3	21.2	23.3	24.2	25.0	25.9	26.9	27.8
Public assistance and Casual Relief	5.9	6.4	5.8	6.6	6.5	6.8	6.8	6.8	7.0	7.2	7.5	7.8	8.1
Other expense	-1.1	-1.5	-1.9	-1.9	-0.2	-2.0	0.0	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3
Net lending	-1.1	-1.5	-1.9	-1.9	-0.2	-2.0	0.0	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3
Net acquisition of nonfinancial assets	**158.0**	**183.6**	**218.4**	**158.3**	**153.8**	**163.1**	**132.0**	**134.6**	**129.4**	**123.6**	**126.0**	**128.8**	**131.2**
Grant financed capital expenditure	113.8	114.1	126.9	83.9	63.6	82.8	54.7	54.7	56.6	58.5	60.6	63.0	65.2
Non-grant financed capital expenditure	44.5	70.5	93.4	76.3	92.6	82.3	82.3	82.3	75.3	67.7	68.1	68.6	68.9
Capital revenue	-0.3	-1.1	-1.8	-1.9	-2.4	-2.0	-5.1	-2.4	-2.5	-2.6	-2.7	-2.8	-2.9
Gross Operating Balance	**166.9**	**179.5**	**173.0**	**130.2**	**95.2**	**117.1**	**107.9**	**81.3**	**79.9**	**78.7**	**78.3**	**78.4**	**82.9**
Net lending/borrowing (overall balance)	**9.0**	**-4.1**	**-45.4**	**-28.1**	**-58.7**	**-46.0**	**-24.1**	**-53.3**	**-49.5**	**-44.9**	**-47.7**	**-50.4**	**-48.4**
Net financial transactions	**9.0**	**-4.1**	**-45.4**	**-28.1**	**-58.7**	**-46.0**	**-24.1**	**-53.3**	**-49.5**	**-44.9**	**-47.7**	**-50.4**	**-48.4**
Net acquisition of financial assets	**47.6**	**-17.6**	**17.1**	**0.0**	**-32.8**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Currency and deposits	47.6	-17.6	17.1	...	-32.8	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	**-18.1**	**19.1**	**50.9**	**28.1**	**-1.6**	**46.0**	**24.1**	**53.3**	**49.5**	**44.9**	**47.7**	**50.4**	**48.4**
Domestic	-5.5	0.9	-3.2	5.3	-18.9	7.4	...	15.3	14.2	12.9	13.7	14.4	13.9
Securities other than shares	-3.9	-0.6	-9.7	0.6	7.2	0.7	...	9.5	8.8	8.0	8.5	9.0	8.6
Loans	-1.6	-1.7	3.2	4.7	20.5	6.7	...	5.8	5.4	4.9	5.2	5.5	5.3
Other accounts payable	0.0	3.2	3.3	0.0	-46.6	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	-12.6	18.1	54.1	22.8	17.3	38.6	...	38.0	35.3	32.0	34.0	36.0	34.5
Securities other than shares	0.0	0.1	-1.1	...	-5.7	...	...	11.9	9.6	6.2	7.9	8.7	7.4
Loans	-12.6	18.0	55.2	22.8	23.0	38.6	...	26.2	25.7	25.8	26.1	27.3	27.1
Statistical discrepancy	*56.7*	*-32.6*	*11.6*	*0.0*	*27.4*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Memorandum items:													
Primary balance	30.8	13.7	-24.8	-6.9	-38.2	-23.1	-4.5	-31.6	-26.3	-20.3	-21.9	-23.3	-19.8
Central government debt (incl. guaranteed) 4/	823	829	898	935	928	990	...	989	1,045	1,097	1,153	1,211	1,267
Domestic	245	249	239	247	265	258	...	271	284	305	323	340	360
Direct	197	198	195	200	222	207	...	238	252	265	278	293	307
Guaranteed	48	51	45	47	43	50	...	33	32	40	44	47	53
Foreign	578	581	658	688	663	732	...	718	762	792	830	871	908
Direct	465	483	537	560	554	599	...	592	628	660	694	730	764
Guaranteed	113	98	121	127	109	133	...	125	134	133	136	142	144
Nominal GDP fiscal year (EC$ millions)	1,280	1,310	1,302	1,348	1,323	1,395	1,368	1,368	1,417	1,464	1,516	1,575	1,631

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

1/ In this report, the fiscal operations tables are presented for the first time in the GFSM 2001 format, with the view to ensure cross-country comparability in terms of concepts and presentation. This resulted in the reclassification of certain items, causing fiscal data reported here to not be fully comparable to earlier reports.

2/ Fiscal year (July–June) basis. Figures shown for a given calendar year relate to the fiscal year beginning on July 1 of that year.

3/ Does not include grants that were received but not spent.

4/ Direct debt and debt of the parastatal entities guaranteed by the central government, excludes debt incurred under Petro Caribe arrangement with Venezuela (except for the RCF columns).

Table 3b. Dominica: The Statement of Operations of the Central Government[1/ 2/]

	2008	2009	2010	2011		2012			2013	2014	2015	2016	2017
				RCF	Est.	RCF	Budget	Proj.			Proj.		
						(In precent of GDP)							
Revenue	**35.4**	**36.0**	**37.0**	**33.5**	**30.9**	**32.3**	**31.3**	**29.4**	**29.2**	**28.9**	**28.8**	**28.6**	**28.7**
Taxes	24.5	24.7	24.2	24.4	22.7	24.0	23.1	22.2	22.2	22.2	22.2	22.2	22.4
Taxes on income	4.3	4.6	4.4	4.4	4.2	4.4	4.2	4.1	4.1	4.1	4.1	4.1	4.1
Taxes on property	0.8	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Taxes on goods and services	14.0	14.1	13.9	13.9	13.2	13.7	13.2	12.7	12.7	12.7	12.7	12.7	12.8
Taxes on international trade and transactions	5.4	5.2	5.4	5.5	4.8	5.3	5.0	4.9	4.9	4.9	4.9	4.9	4.9
Grants 3/	8.9	8.7	9.7	6.7	4.8	5.9	4.3	4.0	4.0	4.0	4.0	4.0	4.0
Other revenue	2.0	2.6	3.1	2.4	3.3	2.4	3.9	3.2	3.0	2.7	2.6	2.4	2.3
Property income	0.4	0.4	0.4	0.4	0.2	...	0.4	0.2	0.2	0.2	0.2	0.2	0.2
Sales, fees and fines	0.8	0.8	0.7	0.7	0.7	...	1.0	0.7	0.7	0.7	0.7	0.7	0.7
Other nontax revenue	0.8	1.4	2.0	1.3	2.3	...	2.5	2.3	2.0	1.8	1.6	1.4	1.4
Expenditure	**34.7**	**36.3**	**40.5**	**35.6**	**35.3**	**35.6**	**33.1**	**33.3**	**32.7**	**32.0**	**31.9**	**31.8**	**31.7**
Expense	**22.3**	**22.3**	**23.7**	**23.9**	**23.7**	**23.9**	**23.4**	**23.5**	**23.5**	**23.6**	**23.6**	**23.6**	**23.6**
Compensation of employees	9.7	9.6	10.4	10.7	10.2	10.7	10.6	10.2	10.2	10.2	10.2	10.2	10.2
Purchase of goods and services	6.1	6.3	6.6	6.7	6.7	6.7	6.6	6.6	6.6	6.6	6.6	6.6	6.6
Interest	1.7	1.4	1.6	1.6	1.5	1.6	1.4	1.6	1.6	1.7	1.7	1.7	1.7
Grants	2.8	2.8	3.1	2.9	3.0	2.9	2.7	2.9	2.9	2.9	2.9	2.9	2.9
Social benefits	2.2	2.3	2.2	2.2	2.3	2.2	2.0	2.2	2.2	2.2	2.2	2.2	2.2
Retirement benefits	1.7	1.8	1.8	1.7	1.8	1.7	1.5	1.7	1.7	1.7	1.7	1.7	1.7
Public assistance and Casual Relief	0.5	0.5	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Other expense	-0.1	-0.1	-0.1	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	-0.1	-0.1	-0.1	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net acquisition of nonfinancial assets	**12.3**	**14.0**	**16.8**	**11.7**	**11.6**	**11.7**	**9.6**	**9.8**	**9.1**	**8.4**	**8.3**	**8.2**	**8.0**
Grant financed capital expenditure	8.9	8.7	9.7	6.2	4.8	5.9	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Non-grant financed capital expenditure	3.5	5.4	7.2	5.7	7.0	5.9	6.0	6.0	5.3	4.6	4.5	4.4	4.2
Capital revenue	0.0	-0.1	-0.1	-0.1	-0.2	-0.1	-0.4	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Gross Operating Balance	**13.0**	**13.7**	**13.3**	**9.7**	**7.2**	**8.4**	**7.9**	**5.9**	**5.6**	**5.4**	**5.2**	**5.0**	**5.1**
Net lending/borrowing (overall balance)	**0.7**	**-0.3**	**-3.5**	**-2.1**	**-4.4**	**-3.3**	**-1.8**	**-3.9**	**-3.5**	**-3.1**	**-3.1**	**-3.2**	**-3.0**
Net financial transactions	**0.7**	**-0.3**	**-3.5**	**-2.1**	**-4.4**	**-3.3**	**-1.8**	**-3.9**	**-3.5**	**-3.1**	**-3.1**	**-3.2**	**-3.0**
Net acquisition of financial assets	**3.7**	**-1.3**	**1.3**	**0.0**	**-2.5**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Currency and deposits	3.7	-1.3	1.3	...	-2.5	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	**-1.4**	**1.5**	**3.9**	**2.1**	**-0.1**	**3.3**	**1.8**	**3.9**	**3.5**	**3.1**	**3.1**	**3.2**	**3.0**
Domestic	-0.4	0.1	-0.2	0.4	-1.4	0.5	...	1.1	1.0	0.9	0.9	0.9	0.8
Securities other than shares	-0.3	0.0	-0.7	0.0	0.5	0.1	...	0.7	0.6	0.5	0.6	0.6	0.5
Loans	-0.1	-0.1	0.2	0.4	1.5	0.5	...	0.4	0.4	0.3	0.3	0.3	0.3
Other accounts payable	0.0	0.2	0.3	0.0	-3.5	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	-1.0	1.4	4.2	1.7	1.3	2.8	...	2.8	2.5	2.2	2.2	2.3	2.1
Securities other than shares	0.0	0.0	-0.1	...	-0.4	...	...	0.9	0.7	0.4	0.5	0.5	0.5
Loans	-1.0	1.4	4.2	1.7	1.7	2.8	...	1.9	1.8	1.8	1.7	1.7	1.7
Statistical discrepancy	*4.4*	*-2.5*	*0.9*	*0.0*	*2.1*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Memorandum items:													
Primary balance	2.4	1.0	-1.9	-0.5	-2.9	-1.7	-0.3	-2.3	-1.9	-1.4	-1.4	-1.5	-1.2
Central government debt (incl. guaranteed) 4/	64.3	63.3	68.9	69.4	70.2	71.0	...	72.3	73.7	75.0	76.0	76.9	77.7
Domestic	19.2	19.0	18.4	18.4	20.0	18.5	...	19.8	20.0	20.9	21.3	21.6	22.0
Direct	15.4	15.1	15.0	14.8	16.8	14.9	...	17.4	17.8	18.1	18.4	18.6	18.8
Guaranteed	3.8	3.9	3.4	3.5	3.2	3.6	...	2.4	2.2	2.8	2.9	3.0	3.2
Foreign	45.2	44.3	50.5	51.0	50.2	52.5	...	52.4	53.7	54.1	54.8	55.3	55.6
Direct	36.3	36.9	41.2	41.6	41.9	42.9	...	43.3	44.3	45.1	45.8	46.3	46.8
Guaranteed	8.8	7.5	9.3	9.4	8.3	9.6	...	9.2	9.5	9.1	9.0	9.0	8.8
Nominal GDP fiscal year (EC$ millions)	1,280	1,310	1,302	1,348	1,323	1,395	1,368	1,368	1,417	1,464	1,516	1,575	1,631

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

1/ In this report, the fiscal operations tables are presented for the first time in the GFSM 2001 format, with the view to ensure cross-country comparability in terms of concepts and presentation. This resulted in the reclassification of certain items, causing fiscal data reported here to not be fully comparable to earlier reports.

2/ Fiscal year (July–June) basis. Figures shown for a given calendar year relate to the fiscal year beginning on July 1 of that year.

3/ Does not include grants that were received but not spent.

4/ Direct debt and debt of the parastatal entities guaranteed by the central government, excludes debt incurred under Petro Caribe arrangement with Venezuela (except for the RCF columns).

Table 4. Dominica: Summary Accounts of the Banking System

	2008	2009	2010	2011	2012	2013
					Proj.	
	(In millions of Eastern Caribbean dollars, end of period)					
Net foreign assets	504.1	557.3	535.0	456.7	488.0	471.9
Central Bank	120.8	138.7	137.9	168.4	166.4	170.8
Commercial Banks (net)	355.4	383.3	355.7	255.7	289.5	276.4
Assets	599.8	659.4	612.4	559.5	544.7	528.6
Liabilities	-244.4	-276.1	-256.8	-303.8	-255.2	-252.1
Net domestic assets	376.9	412.0	493.3	574.7	588.2	640.2
Public sector credit, net	-73.3	-87.5	-86.0	-55.3	-56.5	-58.9
Central Government	10.6	4.9	0.4	22.6	23.6	24.5
Other public sector	-83.9	-92.5	-86.4	-77.9	-80.1	-83.4
Private sector credit	611.9	654.3	716.2	763.4	797.1	820.9
(real terms)	636.8	660.1	722.0	754.1	760.0	771.4
Other items (net)	-161.6	-154.8	-137.0	-133.4	-152.4	-121.9
Money and quasi-money (M2)	881.1	969.3	1028.2	1031.4	1076.2	1112.1
Money	183.4	198.4	205.3	187.2	195.4	201.3
Currency outside banks	43.9	50.7	46.5	47.0	49.1	50.5
Demand deposits	139.5	147.7	158.9	140.2	146.4	150.7
Quasi-money, *of which:*	697.6	771.0	822.9	844.2	880.7	910.9
Time deposits	208.9	236.3	254.1	256.2	264.0	275.7
Savings deposits	473.3	520.5	533.9	564.2	589.1	606.7
Foreign currency deposits	15.5	14.2	29.6	23.8	24.9	25.6
	(12-month percentage change)					
Net foreign assets	7.0	10.6	-4.0	-14.6	6.9	-3.3
Net domestic assets, *of which:*	1.0	9.3	19.7	16.5	2.3	8.9
Public sector credit, net	-4.1	-19.4	1.8	35.6	-2.2	-4.1
(real terms)	-2.0	-15.7	1.9	36.9	1.4	-2.6
Private sector credit	8.3	6.9	9.5	6.6	4.4	3.0
(real terms)	6.1	3.6	9.4	4.4	0.8	1.5
Broad money	4.3	10.0	6.1	0.3	4.3	3.3
NFA contribution	3.9	6.0	-2.3	-7.6	3.0	-1.5
NDA contribution	0.4	4.0	8.4	7.9	1.3	4.8
Money	-6.6	8.1	3.5	-8.8	4.4	3.0
NFA contribution	-7.7	9.7	-0.4	14.8	-1.1	2.3
NDA contribution	1.1	-1.6	3.9	-23.7	5.5	0.7
Quasi-money	7.6	10.5	6.7	2.6	4.3	3.4
Broad money (real terms)	2.3	6.6	6.0	-1.7	0.7	1.8
	(In percent of GDP)					
Net foreign assets	40.7	42.2	41.1	35.0	36.4	33.8
Net domestic assets	30.4	31.2	37.9	44.1	43.9	45.9
Public sector credit, net	-5.9	-6.6	-6.6	-4.2	-4.2	-4.2
Private sector credit	49.4	49.6	55.1	58.5	59.4	58.8
Broad Money	71.1	73.4	79.1	79.1	80.2	79.7
Money	14.8	15.0	15.8	14.4	14.6	14.4
Quasi-money	56.3	58.4	63.3	64.7	65.7	65.3
Interest rates (percent per year) 1/						
ECCB policy rate	6.50	6.50	6.50	6.50	6.50	n.a.
US policy rate	2.08	0.13	0.13	0.13	0.14	n.a.
Interbank market rate	5.01	6.21	6.22	4.88	4.85	n.a.
Time deposit rate	4.91	4.63	4.76	4.49	4.62	n.a.
Demand deposit rate	0.93	0.70	0.71	0.53	0.54	n.a.
Weighted average lending rate	8.88	9.99	8.95	8.77	8.92	n.a.

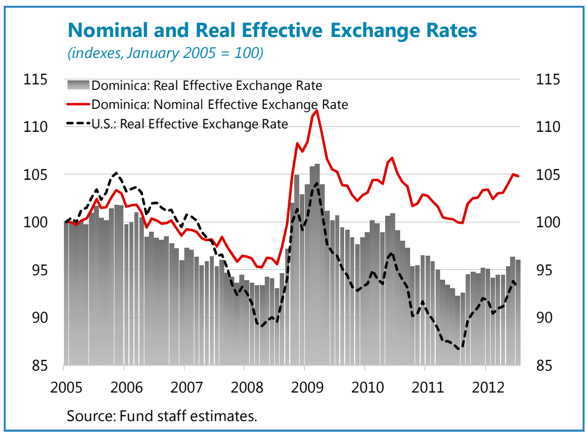
Sources: Eastern Caribbean Central Bank (ECCB); and Fund staff estimates and projections.

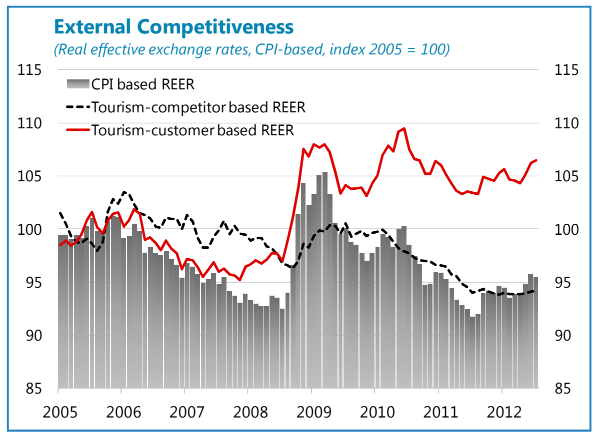
1/ End-of-period rates; 2012 latest available.

ANNEX I. REAL EFFECTIVE EXCHANGE RATE AND EXTERNAL COMPETITIVENESS

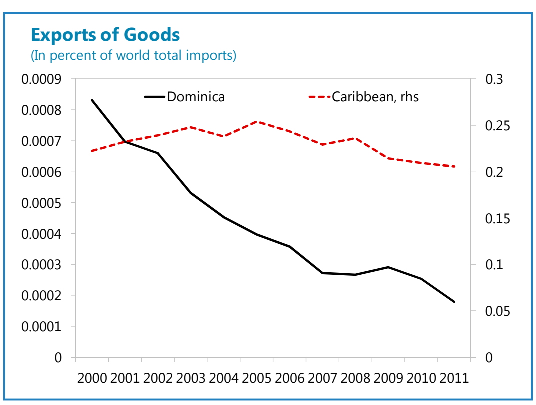
Recent indicators suggest that the long-standing challenges with external competitiveness may be intensifying.

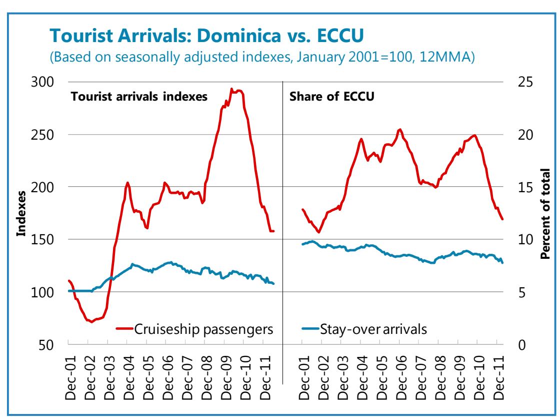
- The real effective exchange rate (CPI-based) reversed its two-year long depreciation trend and has been appreciating since August 2011 along with the strengthening of the US dollar vis-à-vis the euro. Measured relative to Dominica's tourism customers, however, the appreciation has been larger over the past two years, since the tourism customer countries (mostly advanced economies) had significantly lower inflation than Dominica's other trading partners.





- Dominica's share in the exports of goods and services has also declined significantly. In the case of goods, a number of manufacturing facilities have closed over the years, unable to cope with the high costs of production, especially electricity. In tourism, stay-over arrivals have declined over the past few years, potentially due to limited air access, and visitors from cruiseships have plunged since the cancellation of cruiseship calls in the summer season of 2011. Reflecting these





developments, the Dominica's share of tourist arrivals in the ECCU has fallen from a peak of about 16½ percent in 2004 to 10.4 percent in 2012.

Traditional CGER methodologies suggest the existence of a significant current account gap, pointing to an overvalued real effective exchange rate.

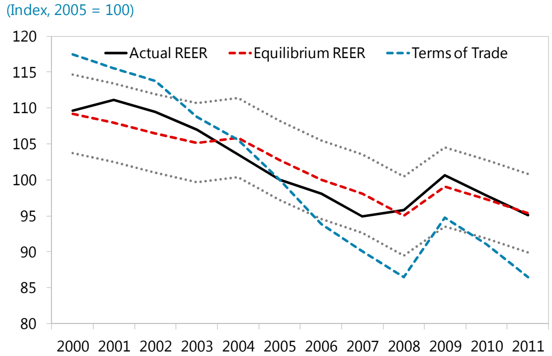
- Two of the three methodologies point to a 4 to 4½ percent of GDP current account gap, implying an overvaluation in the range of 18–21 percent.[1] In particular, the *macroeconomic balance approach* suggests that over the past four years the current account deficit has been above the savings-investment norm determined by fundamentals, with the projected deficit over the medium-term implying an overvaluation of 21 percent. The *external stability approach* suggests that stabilizing Dominica's net foreign asset position would require a real exchange rate depreciation of about 18 percent relative to the 2011 average, although a larger depreciation would likely be required to strengthen the net foreign asset position relative to current levels.[2] While the *equilibrium real effective exchange rate approach* shows no misalignment, staff places less emphasis on this methodology in light of the implications of such an assessment for external sustainability, including rapidly rising net external liabilities.

CGER Exchange Rate Assessment Results

2017	Methods: Macro Balance	External Stability	Equilibrium Real Exchange Rate
CA norm [1]	-11.0	-11.7	...
Misalignment (%) [2]	21.0	17.8	-0.4
Memorandum:			
Underlying CA [1]	-15.6	-15.6	...
CA gap	4.6	3.9	...
CAB/RER elasticity	-0.22	-0.22	...

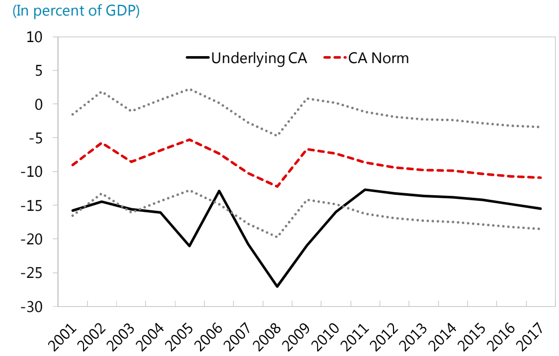
[1] In percent of GDP.
[2] "–" indicates undervaluation.

Dominica: CGER ERER Approach
(Index, 2005 = 100)



Note: Dotted gray lines indicate 90 percent confidence interval.

Dominica: CGER Macro Balance Approach
(In percent of GDP)



Note: Dotted gray lines indicate 90 percent confidence interval.

[1] The estimates are based on Dominica's net foreign asset position as discussed in Box 2.

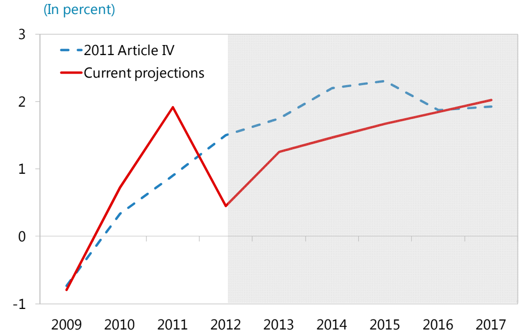
[2] Unlike the CGER methodology, we do not assume that capital account transfers are zero, since these are important financing source for Dominica's public sector.

ANNEX II. DEBT SUSTAINABILITY ANALYSIS: UPDATE

The fiscal outlook has deteriorated since the previous reports on weaker outturns and robust investment projections, setting public debt on an upward path under unchanged policies. While the risk of public external debt distress was maintained at "moderate", the odds of a "high" risk of distress are increasing as a result of the deterioration in debt dynamics and the ensuing breach of some debt and debt service thresholds in the baseline and stress scenarios.

Background. The macroeconomic and fiscal outlook for Dominica has weakened relative to the 2011 Article IV consultations and the 2012 Rapid Credit Facility (RCF) arrangement. This reflects signs of slowing economic activity in 2012 that is expected to affect the near-term outlook; weaker fiscal outcomes in fiscal years 2010–11; and a weaker fiscal outlook in staff's medium-term projections due to a stronger public investment assumption. The assumptions used in the DSA are as follows:

- *Macroeconomic assumptions***.** Growth is projected to slow to about ½ percent in 2012, and to pick up only gradually over the medium term to a potential of close to 2 percent. The potential growth is similar to the one estimated in previous reports, but the near-term prospects are weaker in light of the faltering demand at home and abroad. Inflation is projected to remain around 2 percent over the near and medium-term, similar to the previous reports.

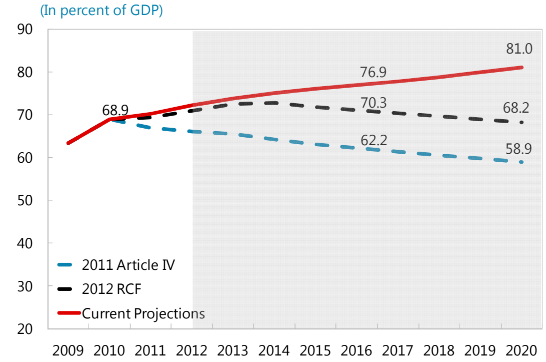


[1] Measured at factor costs.

- *Fiscal assumptions*. In staff's baseline scenario, the primary balance improves somewhat over the medium term, due to the compression in infrastructure spending with the winding down of some of the post-flood rehabilitation work. A stronger improvement, however, is held back by (i) a likely fading of non-tax receipts from the *economic citizenship program,* which surged in recent years following unrest in the Middle East; and (ii) the new assumption that large ongoing infrastructure projects would be replaced by new spending once they wind up rather than reduce capital spending *pro tanto*, as in previous reports. Concessional lending and grants are expected to continue playing a major role in financing the overall fiscal deficit in line with Dominica's long-standing policy, with the grant element of new external financing expected at about 27 percent in the coming years, broadly in line with the previous assumptions. The discount rate used to derive the net present value of debt stocks is set to 3 percent, compared to 4 percent previously.

Public debt outlook. The debt outlook has deteriorated since the 2011 Article IV consultation and the RCF request, reflecting both the weaker fiscal position and the downward revision of the near-term growth. Public debt is now projected to remain on an upward path under unchanged policies, compared to a slight decline in previous reports. It increases from 70.2 percent of GDP in FY2011 to above 80 percent by FY2020, away from the ECCU target of 60 percent (Figure A1 and Tables A1-A2). A return to the authorities' primary surplus target of 2.4 percent of GDP—which is also in line with historical primary surpluses achieved over the past decade—would significantly improve the debt outlook, setting it on a rapidly declining path and allowing the authorities to meet the ECCU target even in the presence of plausible macroeconomic shocks.

Dominica: Public Sector Debt (baseline scenario)
(In percent of GDP)



External debt outlook. The outlook for the external debt, on the other hand, has improved notably over the near and medium-term because of large revisions to the external current account balance, which show a narrower deficit for 2010–11.[1] As a result of these revisions, near-term external debt is projected to be significantly lower than at the time of the RCF, although growing public debt will put external indebtedness on an upward path over the long-term (Table A3). Bound tests show that under the current baseline scenario one of the five thresholds applicable to public external debt is breached (present value of debt-to-GDP), with the other ratios below the thresholds for the entire projection horizon (Figure A2). Under alternative scenarios, the country appears vulnerable to the possible deterioration in the terms of new borrowing, which leads to a breach of another threshold (debt service to exports). In practice, however, the vulnerability is muted by the fact that most of the financing is not on market terms and hence unlikely to be subject to term revisions.

Debt distress rating. Staff has maintained its assessment of a "moderate" risk of public external debt distress, but the odds of a "high" risk of distress are increasing as a result of the deterioration of the debt outlook, the breach of a threshold under the no-policy-change scenario (external public debt-to-GDP ratio), although this is expected only in the long-term, and the breach of additional thresholds under the stress scenarios (external public debt-to-GDP ratio and debt service to export ratio).

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[1] A recent tourism expenditure survey by the authorities conducted in August 2010 and used to estimate tourism receipts for the period 2010–11, found a 26 percent increase in tourism spending relative to the previous survey. This, together with a revision in other service receipts, resulted in a 3½ percentage points of GDP reduction in the current account deficit for 2010. This revision, and a less-than-anticipated impact of food and fuel prices on the balance of payments, reduced the current account estimate for 2011 from 23½ percent of GDP at the time of the RCF request to 12¾ percent of GDP currently.

Table A1. Dominica: Public Sector Debt Sustainability Framework, Baseline Scenario, 2009–2032

(In percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2009	2010	2011			2012	2013	2014	2015	2016	2017	2012-17 Average	2022	2032	2018-32 Average
Public sector debt 1/	63.3	68.9	70.2			72.3	73.7	75.0	76.0	76.9	77.7		83.5	95.7	
o/w foreign-currency denominated	44.3	50.5	50.2			52.4	53.7	54.1	54.8	55.3	55.6		57.5	66.1	
Change in public sector debt	-1.0	5.6	1.3			2.1	1.5	1.2	1.0	0.8	0.8		1.2	1.3	
Identified debt-creating flows	-0.9	6.1	3.9			2.1	1.5	1.2	1.0	0.8	0.8		1.2	1.3	
Primary deficit	-1.5	4.3	3.0	-2.3	3.5	2.5	2.0	1.5	1.6	1.6	1.4	1.8	1.4	1.7	1.5
Revenue and grants	42.9	43.9	37.8			36.4	36.1	35.9	35.7	35.5	35.7		35.5	35.2	
of which: grants	8.7	9.7	4.8			4.0	4.0	4.0	4.0	4.0	4.0		4.0	4.0	
Primary (noninterest) expenditure	41.4	48.2	40.8			38.9	38.1	37.4	37.3	37.2	37.0		36.9	36.9	
Automatic debt dynamics	0.6	1.8	0.8			-0.4	-0.5	-0.3	-0.6	-0.8	-0.5		-0.2	-0.5	
Contribution from interest rate/growth differential	1.8	0.9	0.8			0.3	-0.3	-0.4	-0.6	-0.8	-0.8		-0.7	-0.9	
of which: contribution from average real interest rate	1.0	1.6	1.5			0.6	0.5	0.7	0.6	0.6	0.7		0.8	0.8	
of which: contribution from real GDP growth	0.8	-0.8	-0.7			-0.3	-0.9	-1.1	-1.2	-1.4	-1.5		-1.5	-1.7	
Contribution from real exchange rate depreciation	-1.2	1.0	0.0			-0.7	-0.2	0.1	0.1	0.0	0.3		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
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	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-0.1	-0.5	-2.6			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other Sustainability Indicators															
PV of public sector debt	...	...	60.8			62.4	63.5	65.2	65.7	66.0	67.3		73.7	85.0	
o/w foreign-currency denominated	...	...	40.7			42.6	43.4	44.3	44.4	44.5	45.3		47.7	54.8	
o/w external	...	...	40.7			42.6	43.4	44.3	44.4	44.5	45.3		47.7	54.8	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	3.5	8.9	9.2			9.0	7.9	8.5	7.9	7.9	7.6		10.8	12.3	
PV of public sector debt-to-revenue and grants ratio (in percent)	…	…	160.7			171.7	175.7	181.5	183.9	185.8	188.7		207.5	241.7	
PV of public sector debt-to-revenue ratio (in percent)	…	…	184.3			192.8	197.6	204.2	207.1	209.4	212.5		233.8	269.4	
o/w external 3/	…	…	123.5			131.6	135.3	138.9	140.0	141.0	142.9		151.4	175.9	
Debt service-to-revenue and grants ratio (in percent) 4/	11.7	10.6	16.3			17.9	16.3	19.5	17.7	17.7	17.5		26.5	30.2	
Debt service-to-revenue ratio (in percent) 4/	14.7	13.6	18.7			20.1	18.3	21.9	19.9	20.0	19.7		29.8	34.0	
Primary deficit that stabilizes the debt-to-GDP ratio	-0.5	-1.3	1.8			0.4	0.5	0.3	0.6	0.8	0.5		0.2	0.5	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	-1.3	1.2	1.0	2.8	3.6	0.4	1.3	1.5	1.7	1.8	2.0	1.4	1.8	1.9	1.9
Average nominal interest rate on forex debt (in percent)	3.1	2.0	1.8	3.1	1.0	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Average real interest rate on domestic debt (in percent)	0.3	4.8	5.0	3.6	2.5	2.3	3.2	3.8	3.6	3.4	3.9	3.4	3.9	3.9	3.8
Real exchange rate depreciation (in percent, + indicates depreciation)	-2.6	2.2	0.0	0.7	2.1	-1.5	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	3.7	-1.8	0.6	1.3	2.1	3.0	2.3	1.8	1.9	2.0	1.5	2.1	1.1	1.3	1.2
Growth of real primary spending (deflated by GDP deflator, in percent)	0.0	0.2	-0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grant element of new external borrowing (in percent)	...	...	...	…	…	26.5	27.0	26.3	25.4	24.7	24.4	25.7	24.8	24.4	...

Sources: Country authorities; and staff estimates and projections.

1/ Gross debt of the central government, including nonfinancial public sector debt guaranteed by the central government, but excluding debt incurred under the Petrocaribe arrangement with Venezuela. Revenues and expenditures include imputations for the rest of the public sector.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table A2. Dominica: Sensitivity Analysis for Key Indicators of Public Debt 2012–2032

	Projections							
	2012	2013	2014	2015	2016	2017	2022	2032
PV of Debt-to-GDP Ratio								
Baseline	62	63	65	66	66	67	74	85
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	62	58	56	52	48	46	33	9
A2. Primary balance is unchanged from 2012	62	64	67	68	69	71	83	103
A3. Permanently lower GDP growth 1/	62	64	67	69	71	74	93	153
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	62	65	70	72	74	76	90	114
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	62	63	64	65	65	66	73	84
B3. Combination of B1-B2 using one half standard deviation shocks	62	61	61	62	63	64	72	86
B4. One-time 30 percent real depreciation in 2013	62	81	83	83	83	84	91	106
B5. 10 percent of GDP increase in other debt-creating flows in 2013	62	73	75	75	76	77	83	94
PV of Debt-to-Revenue Ratio 2/								
Baseline	172	176	181	184	186	189	208	242
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	172	162	156	146	137	129	95	26
A2. Primary balance is unchanged from 2012	172	177	185	190	194	200	235	293
A3. Permanently lower GDP growth 1/	172	178	186	192	198	206	260	426
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	172	181	194	201	206	213	251	323
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	172	174	179	181	183	186	205	239
B3. Combination of B1-B2 using one half standard deviation shocks	172	169	170	174	176	180	202	243
B4. One-time 30 percent real depreciation in 2013	172	225	231	232	233	235	255	301
B5. 10 percent of GDP increase in other debt-creating flows in 2013	172	202	208	211	212	215	233	266
Debt Service-to-Revenue Ratio 2/								
Baseline	18	16	19	18	18	18	26	30
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	18	16	19	16	16	16	15	6
A2. Primary balance is unchanged from 2012	18	16	20	18	18	18	29	36
A3. Permanently lower GDP growth 1/	18	16	20	18	18	18	30	48
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	18	17	20	19	19	19	31	39
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	18	16	19	18	18	17	26	30
B3. Combination of B1-B2 using one half standard deviation shocks	18	16	19	17	17	17	25	30
B4. One-time 30 percent real depreciation in 2013	18	18	25	22	22	22	38	52
B5. 10 percent of GDP increase in other debt-creating flows in 2013	18	16	20	19	18	18	32	33

Sources: Country authorities; and staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.
2/ Revenues are defined inclusive of grants.

Table A3a. Dominica: External Debt Sustainability Framework, Baseline Scenario, 2009–2032[1/]

(In percent of GDP, unless otherwise indicated, fiscal year basis)

	Actual			Historical Average [2/]	Standard Deviation [2/]	Projections									
	2009	2010	2011			2012	2013	2014	2015	2016	2017	2012-2017 Average	2022	2032	2018-2032 Average
External debt (nominal) 1/	68.2	72.8	71.1			73.9	72.8	71.6	71.1	70.7	70.0		71.3	78.5	
o/w public and publicly guaranteed (PPG)	44.3	50.5	50.1			52.4	53.7	54.1	54.8	55.3	55.6		57.5	66.1	
Change in external debt	1.3	4.6	-1.6			2.7	-1.1	-1.2	-0.5	-0.4	-0.6		0.5	0.7	
Identified net debt-creating flows	11.0	11.3	7.7			9.1	7.9	7.4	7.0	7.0	6.9		7.1	6.1	
Non-interest current account deficit	19.2	14.6	11.0	15.3	4.5	11.7	12.1	12.2	12.5	13.2	13.9		13.9	13.0	13.9
Deficit in balance of goods and services	22.3	18.1	13.0			14.1	14.5	14.5	14.9	15.5	16.3		16.4	17.1	
Exports	32.3	35.8	39.8			38.3	37.7	37.2	36.8	36.4	36.3		36.8	37.5	
Imports	54.5	53.9	52.8			52.3	52.1	51.7	51.6	51.9	52.6		53.3	54.6	
Net current transfers (negative = inflow)	-4.0	-4.1	-3.4	-4.3	0.6	-3.7	-3.7	-3.7	-3.7	-3.7	-3.8		-4.0	-4.6	-4.2
o/w official	-0.1	-0.1	0.4			0.0	0.0	0.0	0.1	0.1	0.1		0.1	0.0	
Other current account flows (negative = net inflow)	0.9	0.6	1.4			1.3	1.3	1.3	1.3	1.3	1.4		1.5	0.5	
Net FDI (negative = inflow)	-8.5	-5.0	-3.6	-7.2	2.5	-3.6	-4.6	-5.1	-5.7	-6.3	-7.0		-7.0	-7.0	-7.0
Endogenous debt dynamics 3/	0.3	1.8	0.3			1.0	0.5	0.3	0.2	0.1	0.0		0.2	0.2	
Contribution from nominal interest rate	1.9	1.4	1.5			1.3	1.3	1.4	1.4	1.4	1.4		1.4	1.6	
Contribution from real GDP growth	0.8	-0.8	-0.7			-0.3	-0.9	-1.0	-1.2	-1.3	-1.4		-1.3	-1.4	
Contribution from price and exchange rate changes	-2.4	1.2	-0.4			…	…	…	…	…	…		…	…	
Residual (3-4) 4/	-9.8	-6.8	-9.3			-6.4	-9.0	-8.6	-7.6	-7.4	-7.5		-6.6	-5.4	
o/w exceptional financing	-9.1	-6.9	-3.9			-5.1	-4.7	-4.7	-4.7	-4.7	-4.7		-4.7	-4.7	
PV of external debt 5/	...	...	61.8			64.1	62.5	61.8	60.8	59.8	59.7		61.5	67.8	
In percent of exports	...	...	155.1			167.5	166.0	166.3	165.3	164.2	164.3		167.2	180.7	
PV of PPG external debt	...	...	40.7			42.6	43.4	44.3	44.4	44.5	45.3		47.7	55.4	
In percent of exports	...	...	102.3			111.4	115.3	119.2	120.8	122.1	124.7		129.7	147.6	
In percent of government revenues	...	...	123.5			131.6	135.3	138.9	140.0	141.0	142.9		151.4	177.8	
Debt service-to-exports ratio (in percent)	13.5	9.9	10.8			11.7	10.0	13.0	11.2	24.5	24.6		32.5	20.4	
PPG debt service-to-exports ratio (in percent)	11.9	8.6	9.4			10.4	8.8	11.8	9.9	9.9	9.6		17.4	19.1	
PPG debt service-to-revenue ratio (in percent)	11.3	9.0	11.4			12.3	10.3	13.8	11.5	11.4	11.0		20.3	23.0	
Total gross financing need (Billions of U.S. dollars)	0.1	0.1	0.1			0.1	0.1	0.1	0.1	0.1	0.1		0.1	0.1	
Non-interest current account deficit that stabilizes debt ratio	17.9	10.0	12.6			9.0	13.2	13.4	13.0	13.6	14.5		13.4	12.2	
Key macroeconomic assumptions															
Real GDP growth (in percent)	-1.3	1.2	1.0	2.8	3.6	0.4	1.3	1.5	1.7	1.8	2.0	1.4	1.8	1.9	1.9
GDP deflator in US dollar terms (change in percent)	3.7	-1.8	0.6	1.3	2.1	3.0	2.3	1.8	1.9	2.0	1.5	2.1	1.1	1.3	1.2
Effective interest rate (percent) 6/	2.9	2.0	2.0	2.9	0.8	1.9	1.9	1.9	2.0	2.0	2.0	2.0	2.1	2.1	2.1
Growth of exports of G&S (US dollar terms, in percent)	-3.5	10.4	12.9	5.1	6.6	-0.6	2.0	1.9	2.5	3.0	3.2	2.0	3.3	3.3	3.3
Growth of imports of G&S (US dollar terms, in percent)	-7.9	-1.7	-0.5	5.0	10.2	2.5	3.2	2.4	3.4	4.5	4.9	3.5	3.2	3.5	3.4
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	26.5	27.0	26.3	25.4	24.7	24.4	25.7	24.8	24.4	24.7
Government revenues (excluding grants, in percent of GDP)	34.2	34.2	33.0			32.4	32.1	31.9	31.7	31.5	31.7		31.5	31.2	31.4
Aid flows (in Billions of US dollars) 7/	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
o/w Grants	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
o/w Concessional loans	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			5.5	5.3	5.3	5.1	5.1	5.2		5.7	6.1	5.9
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			56.6	60.1	59.6	60.9	60.4	58.3		52.2	48.0	50.9
Memorandum items:															
Nominal GDP (Billions of US dollars)	0.5	0.5	0.5			0.5	0.5	0.5	0.6	0.6	0.6		0.7	1.0	
Nominal dollar GDP growth	2.4	-0.6	1.6			3.4	3.6	3.3	3.6	3.9	3.6	3.6	3.0	3.2	3.1
PV of PPG external debt (in Billions of US dollars)			0.2			0.2	0.2	0.2	0.2	0.3	0.3		0.3	0.5	
(PVt-PVt-1)/GDPt-1 (in percent)						2.6	1.8	1.8	1.3	1.4	1.9	1.8	1.2	1.9	1.7
Gross workers' remittances (Billions of US dollars)	…	…	…			…	…	…	…	…	…		…	…	
PV of PPG external debt (in percent of GDP + remittances)	...	...	40.7			42.6	43.4	44.3	44.4	44.5	45.3		47.7	55.4	
PV of PPG external debt (in percent of exports + remittances)	...	...	102.3			111.4	115.3	119.2	120.8	122.1	124.7		129.7	147.6	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	9.4			10.4	8.8	11.8	9.9	9.9	9.6		17.4	19.1	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt. Revenues include imputations for the rest of the public sector.
2/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
3/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
4/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
5/ Assumes that PV of private sector debt is equivalent to its face value.
6/ Current-year interest payments divided by previous period debt stock.
7/ Defined as grants, concessional loans, and debt relief.
8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table A3b. Dominica: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012–2032

(In percent)

	Projections							
	2012	2013	2014	2015	2016	2017	**2022**	2032
PV of debt-to GDP ratio								
Baseline	43	43	44	44	44	45	**48**	55
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	43	44	45	47	48	50	**56**	70
A2. New public sector loans on less favorable terms in 2012-2032 2/	43	44	46	46	47	48	**55**	75
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	43	44	46	46	46	47	**50**	58
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	43	45	48	48	48	49	**52**	58
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	43	45	47	47	47	48	**51**	59
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	43	43	45	45	45	46	**48**	56
B5. Combination of B1-B4 using one-half standard deviation shocks	43	43	44	44	44	45	**48**	56
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	43	61	63	63	63	64	**68**	78
PV of debt-to-exports ratio								
Baseline	111	115	119	121	122	125	**130**	148
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	111	116	122	127	132	137	**152**	186
A2. New public sector loans on less favorable terms in 2012-2032 2/	111	117	123	126	129	134	**151**	201
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	111	115	119	121	122	125	**130**	148
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	111	123	139	141	142	145	**151**	166
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	111	115	119	121	122	125	**130**	148
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	111	115	120	122	123	126	**130**	148
B5. Combination of B1-B4 using one-half standard deviation shocks	111	112	114	115	117	119	**124**	144
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	111	115	119	121	122	125	**130**	148
PV of debt-to-revenue ratio								
Baseline	132	135	139	140	141	143	**151**	178
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	132	137	142	147	152	157	**178**	225
A2. New public sector loans on less favorable terms in 2012-2032 2/	132	137	143	146	149	153	**176**	242
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	132	138	145	146	147	149	**158**	186
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	132	140	151	153	154	155	**164**	187
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	132	140	147	148	149	151	**160**	188
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	132	135	140	141	142	144	**152**	179
B5. Combination of B1-B4 using one-half standard deviation shocks	132	134	138	139	140	142	**151**	181
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	132	191	196	198	200	202	**214**	252

Table A3b. Dominica: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012–2032 (continued)

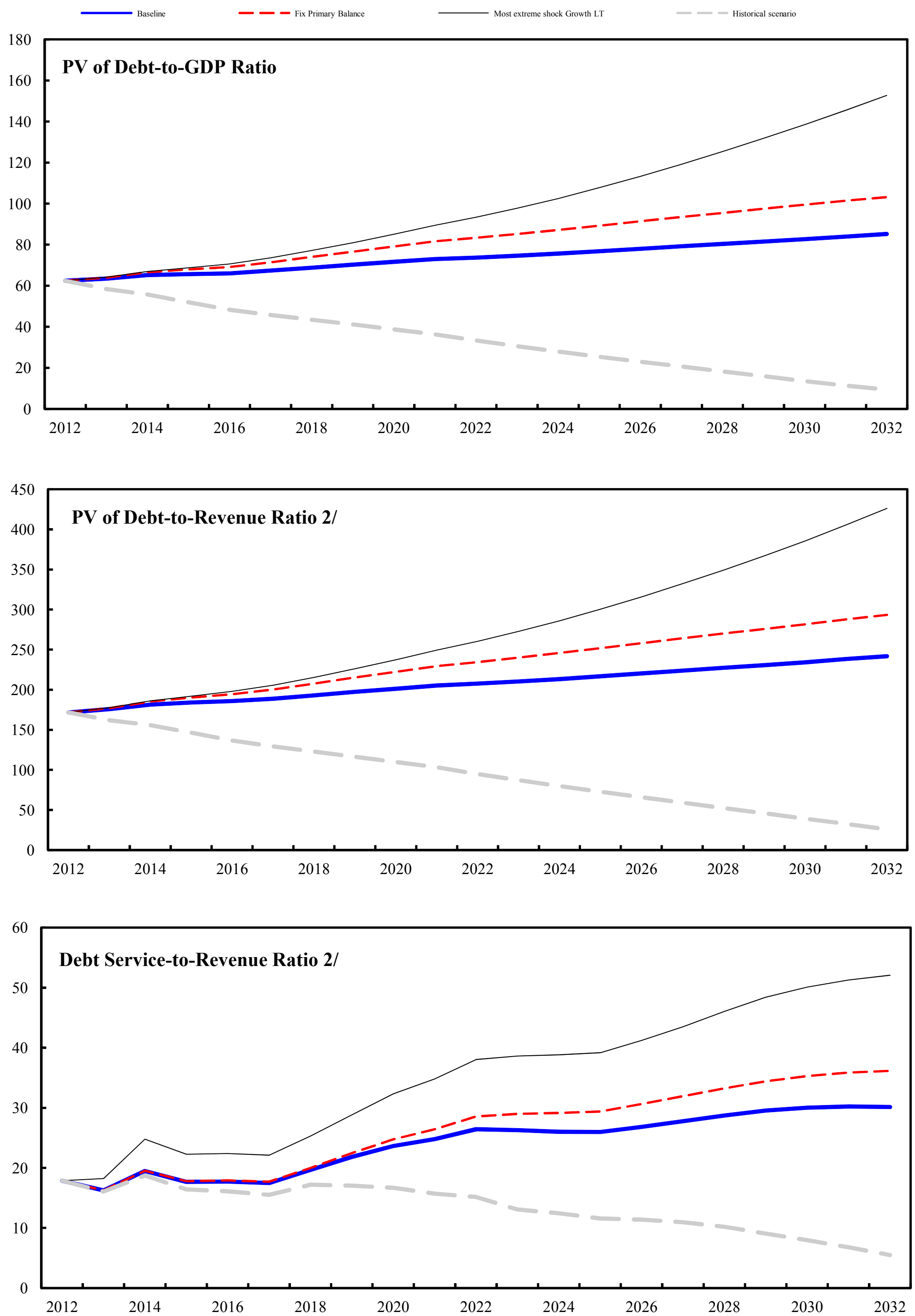
(In percent)

	Projections							
	2012	2013	2014	2015	2016	2017	**2022**	2032
Debt service-to-exports ratio								
Baseline	10	9	12	10	10	10	**17**	19
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	10	9	9	10	10	10	**17**	19
A2. New public sector loans on less favorable terms in 2012-2032 2/	10	9	9	10	10	11	**20**	29
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	10	9	9	10	10	9	**17**	19
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	10	9	10	11	11	10	**19**	21
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	10	9	9	10	10	9	**17**	19
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	10	9	9	10	10	9	**17**	19
B5. Combination of B1-B4 using one-half standard deviation shocks	10	9	9	10	10	9	**17**	19
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	10	9	9	10	10	9	**17**	19
Debt service-to-revenue ratio								
Baseline	12	10	14	12	11	11	**20**	23
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	12	10	11	11	11	11	**19**	23
A2. New public sector loans on less favorable terms in 2012-2032 2/	12	10	10	11	11	13	**23**	35
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	12	11	11	12	12	11	**21**	24
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	12	10	11	12	12	11	**20**	24
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	12	11	11	12	12	11	**21**	25
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	12	10	11	11	11	11	**20**	23
B5. Combination of B1-B4 using one-half standard deviation shocks	12	11	11	12	11	11	**20**	24
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	12	15	15	16	16	15	**28**	33
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	-7	-7	-7	-7	-7	-7	**-7**	-7

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Figure A1. Dominica: Indicators of Public Debt Under Alternative Scenarios, 2012–2032[1/]

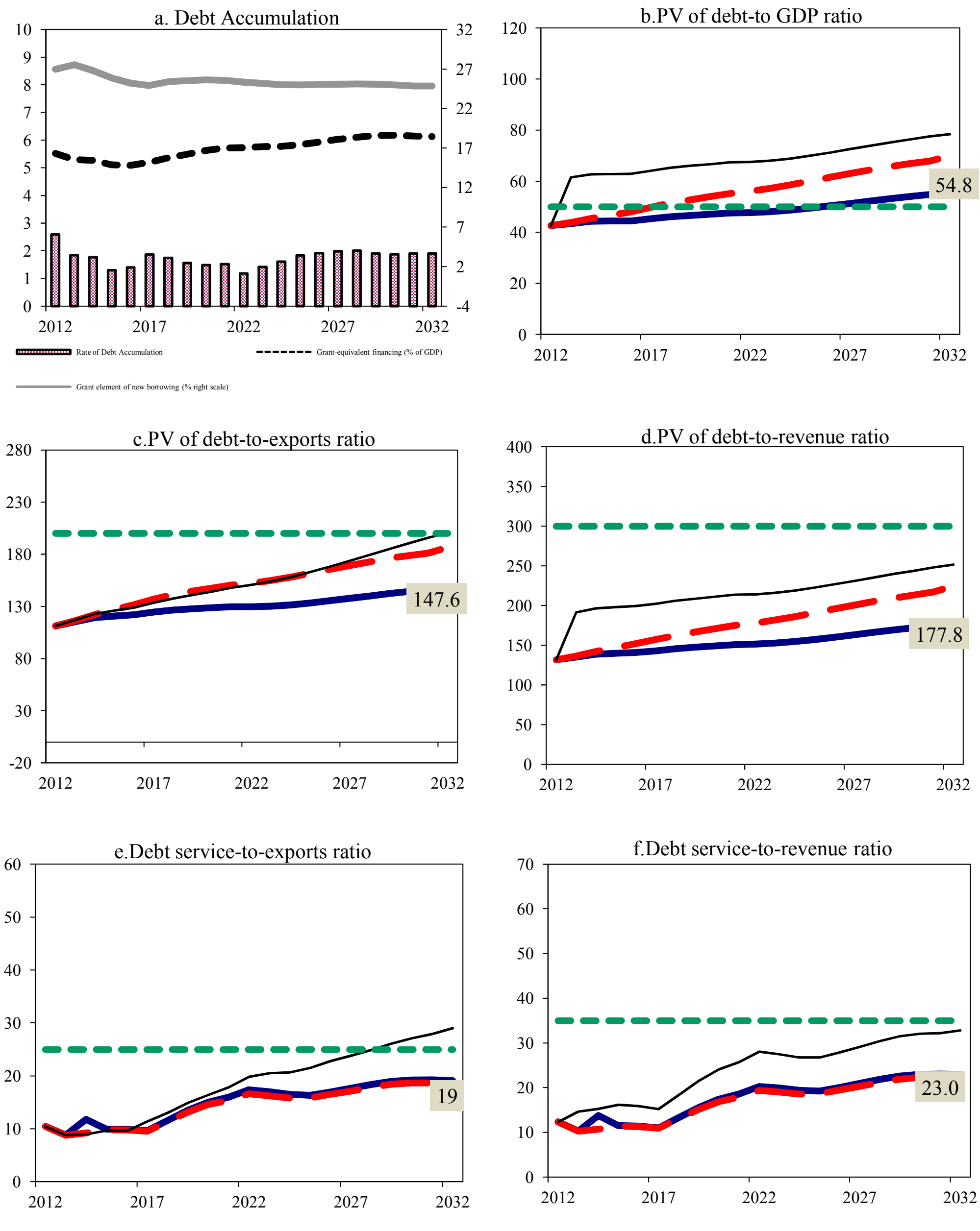


Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2022.

2/ Revenues are defined inclusive of grants.

Figure A2. Dominica: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2012–2032[1/]



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2022. In figure b. it corresponds to a One-time depreciation shock; in c. to a Terms shock; in d. to a One-time depreciation shock; in e. to a Terms shock and in figure f. to a One-time depreciation shock

INTERNATIONAL MONETARY FUND

DOMINICA

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

October 25, 2012

Prepared By: The Western Hemisphere Department (in collaboration with other departments).

CONTENTS

ANNEX I. DOMINICA: FUND RELATIONS

(As of August 31, 2012)

I. **Membership Status** Joined 12/12/78; Article VIII

II. **General Resources Account**	**SDR Million**	**Percent of Quota**
Quota	8.20	100.00
Fund holdings of currency	8.70	106.15
Reserve position in Fund	0.01	0.11

III. **SDR Department**	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	7.84	100.00
Holdings	2.64	33.72

IV. **Outstanding Purchases and Loans:**	**SDR Million**	**Percent of Quota**
Emergency Assistance [1/]	0.51	6.25
RCF Loans	2.05	25.00
ESF RAC Loan	3.28	40.00
ECF Arrangements	4.48	54.62

[1/] Emergency Assistance may include ENDA, EPCA, and RFI.

V. **Latest Financial Arrangements:**

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn**
ECF	12/29/03	12/28/06	7.69	7.69
Stand-By	08/28/02	01/02/04	2.97	2.97
SAF	11/26/86	11/25/89	2.80	2.80

VI. **Projected Payments to the Fund on an Obligation Basis (SDR Million)[1/]:**

			Forthcoming		
	2012	**2013**	**2014**	**2015**	**2016**
Principal	0.88	1.79	1.04	1.48	1.12
Charges/Interest	0.00	0.01	0.02	0.02	0.02
Total	**0.88**	**1.81**	**1.06**	**1.49**	**1.14**

[1/] Based on existing use of resources and present holdings of SDRs.

VII. **Exchange Rate Arrangement:** Dominica is a member of the Eastern Caribbean Currency Union, which has a common central bank (the Eastern Caribbean Central Bank) and currency (the Eastern Caribbean dollar). Since July 1976, the Eastern Caribbean dollar has been pegged to the U.S. dollar at the rate of EC$2.70 per U.S. dollar. Dominica has accepted the obligations of Article VIII, Sections 2, 3 and 4, and maintains an exchange rate free of restrictions on the making of payments and transfers for current international transactions.

VIII. **Safeguards Assessment**: Under the Fund's safeguards assessment policy, the Eastern Caribbean Central Bank (ECCB), of which Dominica is a member, is subject to a full safeguards assessment under a four year cycle. The most recent assessment was completed in November 2011, and concluded that the ECCB continues to have appropriate control mechanisms in place. Its control systems are well developed and supported by robust external and internal audit mechanisms; the published financial statements are comprehensive; and safeguards exist to protect the autonomy of the ECCB. Some improvements in the legal framework and internal audit mechanism were recommended, including securing the hierarchy of the ECCB Act in case of conflicting national or supranational regulations and enhancing ECCB Board autonomy. The next assessment will take place in 2015.

IX. **Article IV Consultation**: The last Article IV consultation was concluded by the Executive Board on July 22, 2011 on a lapse of time basis; the relevant document is IMF Country Report No. 10/261. Dominica is on a 12-month cycle.

X. **Technical Assistance:** Dominica has received significant technical assistance from Caribbean Regional Technical Assistance Center (CARTAC) and the IMF. Technical assistance missions focused on tax reform, revenue administration, expenditure rationalization, financial sector, and Public Financial Management (PFM):[1/]

[1/]The most recent assessment of Dominica’s AML/CFT regime has been conducted by the Caribbean Financial Action Task Force (CFATF) in 2009.

Tax Reforms and Revenue Administration

- January/February 2009 (FAD): customs and tax administration reforms, including capacity building, organizational restructuring, and revenue authority options
- September 2007 (FAD): tax policy aspects of the value-added (VAT) and excises, and other reform options
- January 2007 (FAD-CARTAC): revenue administration and tax policy
- 2005 (FAD): tax policy and administration
- 1999 (FAD): VAT implementation
- 1997 (FAD): urban property taxation

Expenditure Rationalization

- January/February 2011 (FAD): regional project on public expenditure issues, including expenditure trends, policies, and expenditure rationalization options
- 2010 (CARTAC): pension reforms
- 2005 (FAD): social security and pension reform options
- 2004 (FAD): fiscal responsibility laws
- 1995 (FAD): expenditure control

PFM Reforms

- July 2012 – reforming chart of accounts and continued development of bank reconciliation
- January 2012 – building further depth and capacity in budget preparation and accountant general department
- October 2011 – improve bank reconciliation processes
- September 2011 – strengthening budget preparations, debt sustainability assessment and macro-economic projections
- May 2011 – building capacity in the Accountant General department
- 2010 (CARTAC): strengthening budget preparations
- October 2009 (MCM): improving debt management capacity of the government

Financial Sector

- 2010 (CARTAC): regional initiatives to strengthen regulation and supervision of non-bank financial institutions (NBFIs)
- 2006 (MCM): drafting an action plan for AID Bank

2005 (MCM): strengthening the supervisory framework for Anti-Money Laundering/Countering Financing of Terrorism (AML/CFT) in the nonbank sector

National Accounts

- December 2009 and August 2009 (CARTAC): National Income Accounts Statistics aimed at rebasing the GDP constant price estimates to 2006

Macroeconomic Programming and Analysis

- In January 2011 and January 2012, CARTAC's MAC Programme provided assistance to the Macro Policy Unit, Ministry of Finance, to strengthen and update the medium-term fiscal framework to feed into the budget preparation process.

FSAP**:** A joint IMF/World Bank team performed an assessment of the financial sector of the member states of the ECCU, in two missions—September 1–19 and October 20–31, 2003. The principal objective of the missions was to assist the authorities in assessing the development needs and opportunities for the financial sector and identifying potential vulnerabilities of financial institutions and markets to macroeconomic shocks, as well as the risks to macroeconomic stability from weaknesses and shortcomings in the financial sector. A detailed assessment of the AML/CFT regimes of Dominica was conducted in September 2003 by the Caribbean Financial Action Task Force (CFATF). The Financial System Stability Assessment (FSSA) was discussed by the Executive Board on May 5, 2004, and subsequently published on the IMF's external website, including the Report on the Observance of Standards and Codes (ROSC) on Banking Supervision.

ANNEX II. DOMINICA: RELATIONS WITH THE WORLD BANK GROUP

The World Bank Group's Management presented to its Board the Organization of the Eastern Caribbean States (OECS) Regional Partnership Strategy (RPS) on June 8, 2010. The RPS covers the five year period July 2009—June 2014[1]. In May 2012 a Progress Report on the OECS RPS has also been presented to the Board, which confirmed that the interventions proposed under the RPS remained valid and have targeted critical vulnerabilities that the countries face. These two papers set forth the terms of engagement of the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA) and the International Finance Corporation (IFC) with the countries of the Eastern Caribbean, sub-regional organizations and other development partners in pursuit of the following strategic objectives: (a) building resilience; and (b) enhancing competitiveness and stimulating growth over the medium term.

To help build resilience, the Bank Group supports interventions aimed at promoting fiscal and debt sustainability, protecting and improving human capital—particularly social safety nets, education and health—and strengthening climate resilience.

To help enhance competitiveness and stimulate sustainable growth, it focuses its support on two critical areas: strengthening the countries' domestic financial sectors and improving access to quality services to create more competitive business environments. The Strategy is aimed at providing remedial measures to address the crippling effects of the global and regional crises, while supporting key policy reforms that establish a platform for growth in the medium term.

The planned program of support will entail new commitments totaling up to about US$120 million on IBRD terms for the six OECS countries over the RPS period (FY10–14) and up to US$73 million (SDR 48 million) of IDA financing[2] for the four OECS "blend" countries[3].

A. Projects

Dominica participates in one active regional Bank's project (EGRIP). The **OECS E-Government for Regional Integration Program** (EGRIP) is a regional program (including Dominica, Grenada, St. Lucia and St. / Vincent and the Grenadines) which was approved by the Board in May 2008, including an US$2.3 million IDA Credit to Dominica. The program is designed to promote the

[1] While the OECS comprises six independent countries and three British Overseas Territories, this Strategy covers only the six independent countries, namely: Antigua and Barbuda; Dominica; Grenada; St. Kitts and Nevis; Saint Lucia; and St. Vincent and the Grenadines. Excepting St. Vincent and the Grenadines which did not join IFC, all are members of the World Bank Group.

[2] About SDR$ 33 million, as of September 7, 2012, for the remaining IDA-16 period.

[3] Dominica, Grenada, St. Lucia; and St. Vincent and the Grenadines are also eligible to IDA resources.

efficiency, quality, and transparency of public services through the delivery of regionally integrated e-government applications that take advantage of economies of scale. The program is structured in phases. Phase 1 focuses on cross-sectoral e-government issues, as well as on specific applications in the public finance area (including Public Financial Management, tax, customs and procurement), and also includes an e-government pilot project in health (possibly together with preparatory and complementary activities in other social and productive sectors). Subsequent phases are expected to deepen the assistance provided under Phase 1, while expanding the program to cover other sectors, in particular education, agriculture, and tourism, among others. The project is expected to close in August 2013. As of today, the project has disbursed US$ 0.73 million, and the undisbursed balance is US$ 1.57 million.

In June 2012, a World Bank team visited Dominica to carry out an identification and preparation mission for a project currently in pipeline, a proposed Disaster Vulnerability Reduction Project, which would also benefit from the concessional resources of the Pilot Program for Climate Resilience (PPCR).

Under the climate change pillar of the RPS, the Bank and IFC are engaging with Dominica to provide advisory services for the exploitation of its geothermal resources. The objective is the identification of a coordinated set of activities where the World Bank Group could bring its global expertise in developing geothermal renewable resources that would complement the assistance being provided by other development partners, taking into account the Government's priorities.

B. Economic and Sector Work

The Bank has completed a series of analytical products 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 Dominica.

The Bank's program in Dominica is further supported by a comprehensive series of completed 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 titled "Caribbean—Accelerating Trade Integration: Policy Options for Sustained Growth, Job Creation and Poverty Reduction" (2009); a study on the Nurse Labor & Education Markets in the English-Speaking CARICOM: Issues and Options for Reform (2009); and Caribbean Regional Electricity Supply Options: Toward Greater Security, Renewable and Resilience (2011).

Financial Relations

(In millions of U.S. Dollars)

Operation	Original Principal	Available[1]	Disbursed[1]
The OECS E-Government for Regional Integration Program	2.40	1.58	0.73
Total	**2.40**	**1.58**	**0.73**

1/ 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)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012*
Total disbursements	0.5	1.5	2.8	3.9	1.6	0.0	1.3	1.3	0.6	1.6	0.7	0.6
Repayments	0.1	0.1	0.3	0.6	0.7	0.8	1.0	1.3	1.2	0.9	0.9	0.9
Net disbursements	0.4	1.4	2.5	3.4	0.9	-0.8	0.2	0.2	-0.6	0.6	-0.2	-0.3
Interest and fees	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.2	0.2

ANNEX III. DOMINICA: RELATIONS WITH THE CARIBBEAN DEVELOPMENT BANK (CDB)

(As of September 11, 2012)

The CDB has played a significant role in Dominica's development process. Bank support has been provided through the provision of investment loans and technical assistance grants, as well as special economic stabilization loans during a crisis in 2003–2004. The Bank has also extensively utilized its Basic Needs Trust Fund for poverty reduction interventions. These resources have gone towards boosting the productive capacity of the economy, strengthening human resource development and, in particular, improving economic management systems, expanding agricultural output, improving critical economic infrastructure, upgrading ecotourism sites, promoting shelter development and supporting development in the territory reserved for Dominica's indigenous people, the Kalinago. Disaster rehabilitation works have also been a frequent element of interventions.

Total loans and grants approved over the period 1970–2011 amounted to USD212 million, making Dominica the seventh largest beneficiary among the Bank's 18 borrowing members. At end-2011, CDB's loan exposure to Dominica was USD74.1 million, which represented 11.2percent of CDB's total disbursed debt outstanding.

Following unusually high disbursements in 2003 and 2004, which represented CDB's support to Dominica during the crisis period, lending to the country stagnated, with net resource flows turning negative from 2006 though 2008 (Table). This downtrend reflects some caution on the part of the Dominican government to borrow after a debt restructuring in 2004, particularly as efforts to maintain prudent fiscal policies and enhance debt sustainability have been facilitated by strong inflows of grant resources in recent years. However, positive net resource flows from CDB to Dominica have resumed since 2010, amid reduced grant inflows. Disbursements been high, mainly reflecting the implementation of key interventions programmed in CDB's Country Strategy Paper for Dominica for the period 2010 to 2012, a line of credit for productive sector development and an education enhancement project.

Dominica: Loan Disbursement, Service and Resource Flow

(In millions of U.S. dollars)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Net disbursement	3.66	8.46	10.39	3.99	0.91	-1.07	-1.5	0.32	2.99	8.63	4.3
Disbursement	6.25	11.26	20.61	6.34	2.14	2.36	3.2	4.23	7.11	10.61	7.0
Amortization	2.59	2.8	10.22	2.35	1.23	3.43	4.7	3.93	4.12	1.98	2.7
Interest and charges	1.9	2.03	2.25	2.44	1.54	2.95	2.2	2.23	2.13	1.51	1.7
Net resource flow	1.76	6.43	8.14	1.55	-0.63	-4.02	-3.7	-1.91	0.86	7.12	2.6

ANNEX IV. DOMINICA: STATISTICAL ISSUES

Data provision has notable shortcomings due to capacity constraints, but is broadly adequate for surveillance. There are weaknesses in coverage, accuracy, frequency, and timeliness of data that continue to hamper more effective economic analysis and policy formulation. Priority should be given to compilation and dissemination of national accounts at a quarterly basis, and to tourism, agriculture and labor statistics. Despite progress, significant weaknesses remain in the compilation of fiscal accounts and the balance of payments. Dominica participates in the General Data Dissemination System. However the metadata for national accounts, external sector and government finance statistics have not been updated since December 2002.

A. Real Sector

Nominal GDP data are compiled using the production and the expenditure approaches only annually. Beginning 2011, estimates are compiled using 2006 as the new base year. GDP estimates are available about four months after the end of the year and are usually finalized with a two-year lag. CPI data are compiled on a monthly basis. The weights are based on the 2008/09 Household Income and Expenditure Survey (HIES) with a base period June 2010.There is a program to develop export and import price indices (XMPIs), but a shortage of staff working on price statistics limits developments in CPI methodology and the likelihood that XMPIs will be developed in the near future. Data on employment are limited and there are no official data on producer prices. A new census was conducted in 2011, but detailed results have not yet been finalized

B. Government Finance

Statistical capacity problems affect the timely production of quality government finance statistics. Monthly data can be obtained but they show some shortcomings. In particular, the data are subject to frequent revisions stemming in part from omissions and misclassifications. Capital expenditure data reported in the public sector investment program (PSIP) are not timely. Delays in the reporting the PSIP data stem from reporting delays from line ministries. Ongoing initiatives to strengthen expenditure management should help minimize the extent of this problem. A new automation technology, mandatory for all ministries and suppliers of goods and services, was installed in all line ministries in 2005 and is the basis for the reporting.

Although progress has been made in improving the measurement of the government debt, data show shortcomings and are not tracked continuously. Very limited financing data are available. The authorities do not provide consolidated nonfinancial public sector data. Data for the rest of the public sector—Dominica Social Security and the public enterprises—are obtained directly from each entity with frequent delays and omissions. No government finance data are reported to STA for publication in the *International Financial Statistics* (*IFS)* or the *Government Finance Statistics* (*GFS) Yearbook*.

C. Monetary Statistics

Monetary statistics are compiled and reported to the Fund by the ECCB on a monthly basis based on a standardized report adopted in 2006. The institutional coverage of monetary statistics needs to be improved by including the accounts of mortgage companies, building societies, credit unions, and insurance companies. The lack of data on credit unions is a serious shortcoming as the sector is large in Dominica. In this respect, close coordination between the ECCB and the single regulatory unit (which supervises financial corporations other than those licensed under the Banking Act) is crucial.

D. Balance of Payments

Balance of payments data are compiled by the ECCB on an annual basis. Although recent data comprise a more detailed breakdown of goods than in the past, in other areas they do not provide sufficient detail to enable publication of the full classification used in the fifth edition of the Balance of Payments Manual. Annual data up to 2011 are published in the IFS. In general, enhanced data resources and better compilation procedures are needed to improve the accuracy and timeliness of balance of payments statistics. Efforts should also be made to compile quarterly balance of payments statistics and the annual international investment position statement, which is currently unavailable owing to capacity constraints. However, the Fund’s Statistics Department is scheduled to provide assistance to Dominica and the ECCB to collect the necessary information to produce IIP data. To improve the quality of tourism data, the authorities are conducting a visitor expenditure survey on a half yearly basis. Starting 2013, they plan to conduct the survey on a quarterly basis to improve the availability of information in this area.

E. External Debt

The Ministry of Finance maintains a database on public and publicly-guaranteed external loans that provides detailed and reasonably current information on disbursements, debt service, and debt stocks, while the Treasury maintains the data on bonds placed abroad. Data from the two databases are not consolidated, requiring further adjustments to measure total debt stock. In addition, information on payments by creditor (actual and scheduled) should be available to the compilation agencies at least on a monthly basis, in order to produce timely debt stock data. Data on private external debt stocks are not available, other than from the monetary survey in the case of commercial banks

Dominica: Table of Common Indicators Required for Surveillance

(As of September 30, 2012)

	Date of latest observation	Date Received[7]	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates[1]	Fixed Rate	NA	NA	NA	NA
International Reserve Assets and Reserve liabilities of the Monetary Authorities [1,2]	July 2012	9/20/2012	M	M	M
Reserve/Base Money	July 2012	9/20/2012	M	M	M
Broad Money	July 2012	9/20/2012	M	M	M
Central Bank Balance Sheet	July 2012	9/20/2012	M	M	M
Consolidated Balance Sheet of the Banking System	July 2012	9/20/2012	M	M	M
Interest Rates[3]	July 2012	9/20/2012	M	M	M
Consumer Price Index	June 2012	8/16/2012	M	M	M
Revenue, Expenditure, Balance, and Composition of Financing[4] – Central Government[5]	June 2012	8/16/2012	M	M	A
Stocks of Central Government and Central Government- Guaranteed Debt[6]	June 2012	8/16/2012	M	M	A
External Current Account Balance	2011	8/16/2012	A	A	A
Exports and Imports of Goods and Services	June 2012	8/16/2012	M	A	A
GDP/GNP	2011	9/24/2012	A	A	A
Gross External Debt	2011	8/16/2012	M	M	A

[1] Dominica is a member of the Eastern Caribbean Currency Union, in which the common currency of all member states (E.C. dollar) is pegged to the U.S. dollar at US$1 = EC$2.70.

[2] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

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

[4] Foreign, domestic bank, and domestic nonbank financing.

[5] The general government consists of the central government and state and local governments.

[6] Currency and maturity composition are provided annually.

[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA); Not Applicable (n.a.).

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IMF Executive Board Concludes 2012 Article IV Consultation with Dominica

On November 7, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Dominica.[1]

Background

The economic recovery continues, but is losing momentum. Over the past two years, Dominica's economy grew at a tepid rate of about 1 percent, supported by a notable fiscal stimulus, and output recovered to its pre-crisis peak. The pace of activity has been decelerating so far this year with weakening external and domestic demand, and staff forecasts growth of about ½ percent of Gross Domestic Product (GDP) in 2012. Weak demand has kept price pressures subdued and, along with a recovery in service receipts, contributed to a significant adjustment in the external current account deficit. While rising world food prices may contribute to a modest pickup in inflation and weigh on the balance of payments in 2012, pressures are expected to subside later next year. Downside risks to the near-term outlook have intensified with heightened global uncertainty and the planned stoppage of flights from the only non-regional carrier servicing the island. Geothermal energy development or the opening of new tourist facilities could strengthen the long-term outlook.

Weak growth and the earlier failure of regional insurance companies have weakened the resilience of the financial sector in some areas. While the system as a whole remains highly

[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. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

liquid, nonperforming loans and exposures to the failed insurance companies remain a drag on financial sector's income and capitalization, especially in the large credit union sector.

Monetary conditions have not eased meaningfully. With policy and lending rates stable throughout the crisis—as monetary policy in the Eastern Caribbean Currency Union remains fully committed to maintaining the hard peg to the U.S. dollar—Dominica has not benefited from the significantly eased U.S. monetary policy rates. Moreover, the real effective exchange rate has depreciated only moderately, strengthening recently with the appreciation of the U.S. dollar vis-à-vis major currencies. Expansionary fiscal policy has thus been the only tool to support economic activity, but strains on the fiscal position have been mounting with subdued growth and the need to respond to natural disasters. The overall central government deficit widened to about 4½ percent of GDP in fiscal year 2011–12 and pushed debt to over 70 percent of GDP, almost 7 percentage points above pre-crisis levels. To meet the increasing financing requirements, the authorities successfully launched a T-bill in the regional securities market for the first time since the 2004–05 debt restructuring. With fiscal policies reaching the limits of their ability to support economic activity, the authorities have budgeted a strong retrenchment for fiscal year 2012–13, although weakening economic conditions may undermine its feasibility.

Executive Board Assessment

Executive Directors noted that supportive policies have helped the Dominican economy weather the effects of the global financial crisis. However, worsening external and internal environments have weakened the forward momentum and amplified risks to macroeconomic stability. Continued prudent macroeconomic policies, enhanced vigilance in the financial sector, and accelerated structural reforms remain key to stronger growth prospects.

Noting that the room for countercyclical fiscal support has narrowed considerably, Directors welcomed the authorities' intention to return gradually to their pre-crisis primary surplus target. They agreed that the proposed pace of fiscal adjustment strikes a right balance between the need to rebuild fiscal buffers over time and the need to support the flagging recovery. Directors supported the authorities' efforts to contain spending in the face of weakening revenues. However, consolidation plans need to be clearly specified and additional measures may need to be taken to achieve the fiscal targets by streamlining current expenditures and directing capital spending to infrastructure and other productivity-enhancing investments.

Directors agreed that reinforcing the framework for public financial management should be an important plank of the authorities' fiscal strategy. Strengthening budget preparation and execution and introducing fiscal responsibility legislation would underpin the government's ability to rationalize spending and provide an important fiscal anchor in the medium term.

Directors emphasized that maintaining financial stability is an immediate priority. They encouraged the authorities to address pockets of vulnerability in credit unions to maintain confidence in the financial system at large. Decisive action is also needed to upgrade supervision, regulation, and the crisis management framework for all financial institutions, including by tightening loan loss provisioning requirements. Directors agreed that a lower interest rate floor on savings deposit would reduce banks' funding costs and help support the economic recovery. Achieving compliance with international standards against money laundering and the financing of terrorism is also important.

Directors stressed that revamping the structural reform agenda is necessary to foster private sector-led growth and boost competitiveness. They welcomed efforts to harness the country's geothermal energy potential, which could boost potential growth, and stressed the importance of accelerating reforms to improve the investment and business environment, narrow the infrastructure gap, and improve social outcomes.

Dominica: Selected Economic Indicators

	2008	2009	2010	Est. 2011	Proj. 2012
	(Annual percentage change)				
Output and prices					
Real GDP 1/	7.9	-1.3	1.2	1.0	0.4
Consumer prices (end of period)	2.0	3.2	0.1	2.0	3.6
Consumer prices (period average)	6.4	0.0	2.8	1.4	2.3
Output gap (in percent of potential GDP)	5.0	1.3	0.5	-0.5	-1.3
Real effective exchange rate					
(period average, depreciation -)	0.9	5.0	-2.8	-4.2	…
Central government operations 2/	(In percent of GDP)				
Revenue 3/	35.4	36.0	37.0	30.9	29.4
Expenditure	34.7	36.3	40.5	35.3	33.3
Primary balance	2.4	1.0	-1.9	-2.9	-2.3
Overall balance	0.7	-0.3	-3.5	-4.4	-3.9
Central government debt (incl. guaranteed) 4/	64.3	63.3	68.9	70.2	72.3
External	45.2	44.3	50.5	50.2	52.4
Domestic	19.2	19.0	18.4	20.0	19.8
Money and credit	(Annual percentage change)				
Broad money (M2)	4.3	10.0	6.1	0.3	4.3
Real credit to the private sector	6.1	3.6	9.4	4.4	0.8
Balance of payments	(In percent of GDP)				
Current account balance	-27.1	-21.0	-16.0	-12.7	-13.3
Exports of goods and services	35.4	32.0	35.9	40.4	39.0
Imports of goods and services	62.6	54.1	54.0	53.6	53.4
Capital and financial account balance	25.7	22.4	19.5	20.4	13.1
FDI	12.3	8.4	5.1	3.7	3.7
Capital grants	11.8	8.4	6.3	3.2	4.4
Other (incl. errors and omissions)	1.6	5.6	8.2	13.5	5.0
External debt (gross) 5/	64.9	65.3	70.3	75.1	74.4
Savings-Investment Balance	-27.1	-21.0	-16.0	-12.7	-13.3
Savings	-6.0	-1.6	5.2	7.1	2.7
Investment	21.1	19.4	21.2	19.8	16.0
Memorandum items:					
Nominal GDP at market prices (EC$ millions)					
Calendar year	1,239	1,320	1,300	1,304	1,341
Net imputed international reserves					
Millions of U.S. dollars, end-of-period	55.1	64.5	66.4	74.5	73.5
Months of imports of goods and services	2.3	2.9	3.1	3.5	3.3

Sources: Dominican authorities; Eastern Caribbean Central Bank (ECCB); and IMF staff estimates.

1/ Historical data revised with real GDP now measured at market prices, instead of basic prices.

2/ Fiscal year (July–June) basis. In this report, the fiscal operations are presented for the first time in the GFSM 2001 format, causing some fiscal data reported here to not be fully comparable to earlier reports.

3/ Does not include grants that were received but not spent.

4/ Excludes debt incurred under the Petro Caribe arrangement with Venezuela.

5/ Comprises public sector external debt, foreign liabilities of commercial banks and other private debt.