

Letter of Intent

St. Georges, Grenada
June 25, 2014

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Lagarde,

The Grenadian economy has faced unprecedented challenges over the past decade. In addition to the long-standing problems of low growth and high unemployment, the country has faced its largest natural disaster and the most prolonged recession since independence. This in turn exacerbated its already weak fiscal position, despite our attempts to strengthen it in the context of the previous two IMF-supported programmes. These challenges have been feeding each other in a vicious circle, coming to a head in 2012-13 in a full-blown fiscal crisis. Public debt reached about 110 percent of GDP at end 2013, and the inability to meet financial obligations led to the announcement of a debt restructuring in early 2013.

In the February 2013 elections, the New National Party government took office with a very strong mandate to govern. The Government sees this mandate as an opportunity to fundamentally tackle the challenges facing the Grenadian economy. With this in mind, it has developed a comprehensive home-grown reform programme for 2014-17, as described in the attached Memorandum of Economic and Financial Policies (MEFP). The programme aims to restore macroeconomic stability in the short term and promote strong, sustainable, and inclusive growth in the medium term. The main pillars of the programme include an ambitious fiscal adjustment supported by public financial management reforms and debt restructuring; structural reforms to promote a business-friendly environment, growth and job creation; and measures to strengthen financial system safety and stability.

In support of our economic programme, the Government requests a 36-month arrangement under the Extended Credit Facility from the International Monetary Fund in an amount equivalent to SDR 14.04 million (120 percent of Grenada's quota, about US\$21.9 million at current exchange rates). The ECF arrangement will provide needed financing during the adjustment period and signal our determination to implement sound policies, catalyze additional financial and technical assistance from other international donors, and boost investor and business confidence. Progress in the implementation of our programme will be assessed through semi-annual reviews,

GRENADA

quantitative performance criteria, indicative targets, and agreed structural benchmarks as described in the attached memorandum.

We are confident that the policies set forth in the memorandum are adequate to meet the objectives of the programme. We stand ready to take any additional measures that may become appropriate for this purpose as circumstances change. As is customary under Fund-supported programmes, we will consult with the Fund on the adoption of such measures in advance of necessary policy revisions. We will also provide the Fund staff with all the relevant information required to complete programme reviews and monitor performance.

We consent to the publication of this letter, the attached MEFP and Technical Memorandum of Understanding, and the related staff report.

Sincerely,

/s/

Hon. Keith Mitchell
Prime Minister, Minister of Finance and Energy
Grenada

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES 2014-17

1. In response to significant macroeconomic challenges faced by Grenada over the past several years, the Government has put together a comprehensive programme to restore fiscal sustainability and boost inclusive growth through macroeconomic stabilization and structural reforms. This memorandum sets out Grenada's economic and financial policies for 2014-17, to be supported by the International Monetary Fund (IMF) under a 36-month Extended Credit Facility (ECF) arrangement.

I. ECONOMIC CONTEXT

2. **Grenada faced numerous challenges over the past years and was particularly hard hit by the global recession.** During 2004–05, Grenada suffered severe damage in the wake of two hurricanes (estimated at around 150 percent of GDP, compared to about 20 percent on average for the three most affected countries in the aftermath of the 2004 Asian tsunami), whose economic and fiscal impact triggered a debt restructuring in 2005. Before recovery from these natural disasters could gain ground, the country was hit hard by the global recession. Real activity declined by 8.2 percent from its pre-crisis peak during 2009–12. The unemployment rate stood at 33½ percent in September 2013, with youth unemployment as high as 55.6 percent.

3. **To cushion the effects of the natural disasters and the global crisis, Grenada obtained support from the IMF through two ECF arrangements during 2006-12.** The first arrangement (2006-10)—undertaken by the current Government—was successfully completed, but the second arrangement (2010-12) went off-track after the first review. The hiatus in the programme was caused in part by the very difficult political and economic situation, with a minority government facing a severe economic downturn and general elections. Nevertheless, successive Governments have persevered with several reforms contemplated in the programme, including modernizing customs and tax administration, reinforcing the supervision of the nonbank institutions, and strengthening social safety nets

4. **The protracted recession has exacerbated the macroeconomic imbalances.** Large fiscal financing needs – reflecting high debt and fiscal deficits averaging 5 percent of GDP over the past decade (recently due to a significant decline in revenues) – led to acute financing difficulties during the past few years, culminating in a default in March 2013 and bringing forth the need to restructure existing public debt obligations, which reached about 110 percent of GDP by end-2013. The external current account deficit remains large and has been increasingly financed by debt as FDI flows have receded.

5. **Grenada's economic potential has not been fully realized in the face of weak price and structural competitiveness, a high debt overhang, and vulnerability to external shocks.** Over the past two decades, growth has been too weak to make a meaningful dent in unemployment. Higher and more sustainable growth remains critical to making the country's development more inclusive.

II. MEDIUM-TERM MACROECONOMIC FRAMEWORK

6. **Against this background, the Government's economic programme aims to restore macroeconomic stability, strengthen the fiscal position, and most importantly boost economic growth.** During the programme period, we expect that the resolution of the fiscal crisis will bolster confidence in the country's economic prospects. There are already encouraging signs that growth has resumed after an almost four-year decline, and is estimated to have picked up to at least 1½ percent (market prices) in 2013. With a continued recovery in the tourism and FDI inflows, growth is expected to pick up steadily over the medium-term to about 2½ percent, in line with historical growth over the past twenty years. While the fiscal adjustment effort targeted under the programme (7¾ percent of GDP during three years) will have some dampening effect on growth in the short run, the drag is expected to be limited by the high openness of the economy and is expected to be offset by the resumption of financing flows and the resolution of lingering uncertainty associated with the current crisis. Inflation is projected to remain subdued in the face of a negative output gap and moderate commodity price inflation, and the external imbalances are expected to narrow gradually during the programme period, reflecting the improvement in the fiscal balance and a recovery in exports.

III. ECONOMIC AND FINANCIAL PROGRAMME

7. **The main objective of Government's economic programme is to create conditions for higher economic growth that is sustainable, job-creating and inclusive.** This will require strong policy action to: (i) create conditions for an expansion in private sector activity and employment through the implementation of deep structural reforms, while strengthening the social safety nets to protect the most vulnerable; (ii) return the public sector to solvency, which will support growth prospects through the resolution of the fiscal crisis and the debt overhang; and (iii) ensure the continued stability of the financial sector in the face of a difficult economic environment.

A. Reforms to Boost Growth and Social Protection

8. **Boosting the economy's growth, while strengthening the social safety net, is the main priority of the Government's economic programme.** Raising Grenada's growth potential will require tackling weaknesses in both price and structural competitiveness. Structural reforms will therefore focus on improvements in the business climate, on reducing the cost of doing business (especially relating to electricity and import costs), and on other measures to support activity during the fiscal adjustment process.

9. **Moving the economy to a path of higher and more sustainable growth requires a propitious operating environment for the private sector.** In this context, the Government will move speedily to strengthen the Investment Promotion Act of 2009 and to have the Act acceded

to law. The aim is to improve the business environment and enhance Grenada's attractiveness as an investment destination through: (i) streamlining investment procedures, cutting excess "red tape" and addressing other bottlenecks such as land acquisitions and planning approval; (ii) codifying all the requirements for investment or for opening a business in the legislation; (iii) codifying all tax incentives and the associated qualifying criteria in the law; and (iv) transforming the Grenada Industrial Development Corporation into a functioning one-stop shop for investors to reduce the time and cost of obtaining investment approval. Parliamentary approval of the revised Investment Act in line with these reforms will be a structural benchmark for end-November 2014.

10. **The Government will seek to harness the benefits of Private Public Partnerships (PPPs) in promoting infrastructure development, while protecting the public funds from inherent risks.** The Government is considering PPP-based investments in several areas, such as healthcare, energy and infrastructure, but will engage in them only after ensuring that PPPs bring value for money, have adequate risk transfer and do not undermine the fiscal position. To this effect, the Government will first adopt a PPP policy, followed by a comprehensive PPP legislation to establish the principles and the institutions for assuming and managing contingent liabilities associated with these arrangements (parliamentary approval of this legislation will be sought for end-2014). Technical assistance and advisory support on this will be sought from the World Bank and other donors.

11. **The Government will move to liberalize certain sectors to boost private sector participation and expand capacity.** Opportunities for renewable energy will be created as described below to encourage the transition towards more sustainable and less expensive inputs into electricity production. The Government will support the liberalization of the nutmeg and cocoa sectors, so as to encourage increased efficiency, and boost farmers' incomes.

12. **High electricity costs (among the highest in the world) pose a significant challenge to the country's price competitiveness.** They reflect lack of economies of scale in the diesel-based generation, high fuel costs, and monopoly rents of Grenada's only electricity company, GRENLEC. The Government's strategy in addressing the electricity costs—supported by technical advice from the World Bank—is therefore two-pronged: (i) setting out the path for a transition from fuel-based generation to one based on renewable energy (geothermal, solar and wind) through policy and regulatory changes for renewable energy; and (ii) supporting the establishment of an independent regulatory authority for a more efficient pricing of electricity. To this effect, the Government will amend the Electricity Supply Act and revisit the agreement with GRENLEC by end-December 2014 to (a) enable an effective regulation of the electricity sector by the Eastern Caribbean Energy Regulatory Authority (ECERA); (b) address any cost inefficiencies in GRENLEC through revised tariff-setting mechanisms; (c) set out the roadmap for transitioning electricity generation to renewable energy through necessary regulatory and policy measures for the renewable energy market; and (d) streamline the tax exemptions granted to

GRENLEC. The Government is also supporting efforts to explore the country's geothermal potential, and will seek donor assistance in taking these efforts to fruition.

13. **The Government's recent bid to acquire the majority shares on sale in GRENLEC—in response to the exclusive offer made by the seller to the Government and aimed at facilitating the removal of the very onerous terms of the existing agreement – was deemed too low by the seller.** This bid was made under a contractual arrangement with an interested buyer for the shares from Government. After the expiration of the Government's offer, other investors have expressed interest in purchasing GRENLEC. Under these circumstances, the government is committed not to participate in the bidding moving forward, but will undertake the required reforms in the electricity sector with the private owners.

14. **Pressures on labor costs frequently pose challenges to the economy's competitiveness and policy sustainability.** The main pressures are in the public sector, where wage increases frequently outstrip the Government's capacity to make the payments and drive wage increases elsewhere in the economy, and on labor costs at the main port. On wages, the Government has initiated tripartite discussions under Social Partnership Agreements—with participation of private sector, trade unions and the civil society—to reach understanding on the macroeconomic fundamentals that would underlie collective bargaining agreements, especially during times of weak economic growth. The short-term objective is to reach understandings on the need to set wages in line with macroeconomic fundamentals and in advance of the negotiated triennium (rather than ex-post, as has been the case to date). With regard to port charges, the Government will review the existing labor agreements in ports by end-June 2015, with a view to streamlining labor charges as warranted. The government will also seek to revise the Labor Code, in consultation with its Social Partners, with a view to improving the competitiveness of the overall labor market.

15. **To protect the most vulnerable groups during the period of fiscal adjustment, Government will increase and better target assistance to poor households.** For fiscal year 2014, the Government will increase allocations to the largest targeted social assistance programme Support for Education, Employment, Empowerment and Development (SEED) by 40 percent to EC\$13⅓ million (0.6 percent of GDP), reaching 5,690 households (about a sixth of all households), and will establish a floor on spending on this programme so that any pressure to reduce spending does not affect the targeted social safety nets. The Government will also explore with donors potential support to further expand targeted assistance schemes during the period of fiscal adjustment. In addition, it will improve the targeting and coverage of social assistance programmes, which are currently fragmented across ministries, by compiling an inventory of all social assistance programmes, establishing a registry of beneficiaries of these programmes and introducing proxy means testing as the eligibility criterion for the flagship SEED programme before end-2014, to be subsequently rolled out to other social programmes. The Government will seek technical assistance from the World Bank for these reforms, with a view to developing a coherent social protection strategy, including establishing links between social

assistance programmes and actions that promote human capital. This strategy will serve as the basis for the Poverty Reduction Strategy Paper that the Government intends to finalize in 2014.

B. Restoring Fiscal Sustainability

16. **A lasting reduction in the debt level is needed to restore fiscal sustainability and create a stable macroeconomic environment for growth.** The Government aims to reduce debt from the current about 110 percent of GDP to the ECCU-wide target of 60 percent of GDP by 2020, which would require a combination of fiscal adjustment, debt restructuring, and fiscal structural reforms to ensure durable fiscal discipline going forward.

Fiscal Consolidation

17. **The first pillar of the Government's fiscal programme is a strong fiscal consolidation effort aimed at putting debt on a downward path.** The Government has taken measures already in 2013 to stem the rapid deterioration of the fiscal position, limiting the primary deficit in that year to $3\frac{2}{3}$ percent of GDP, notably below its budgeted target of 4.2 percent of GDP (outcomes consistent with the budget was a prior action). Going forward, a fiscal adjustment effort of $7\frac{3}{4}$ percent of GDP will bring the primary balance into a surplus of $3\frac{1}{2}$ percent of GDP by 2016, which will put debt on a declining path even under reasonable shocks. The adjustment will be frontloaded, to help meet the higher financing requirements early in the programme, with 5.6 percentage points of GDP undertaken during the first two years. To mitigate the impact of this adjustment on the nascent economic recovery and the most vulnerable, the Government will establish a floor on social spending for targeted programmes and will safeguard critical infrastructure programmes by allocating, fiscal space permitting, at least 7 percent of GDP to the public sector investment programme on average during the next three years. For the medium term, our objective is to achieve the ECCU-wide target of 60 percent of debt-GDP ratio by 2020.

18. **The fiscal consolidation will rely on measures that ensure a broader and a more equitable participation in the tax effort, as well as reductions in less productive spending.**

These will include:

- A reduction in the personal income tax threshold—which is among the highest in the world and excludes most income earners from the tax net— from the current EC\$60,000 to EC\$36,000 in 2014. A lower rate of 15 percent will apply to income below EC\$60,000, while the rate for income above EC\$60,000 will remain unchanged at 30 percent.
- Boosting income and withholding tax collection by extending the income tax base to winnings from lotteries and games of chance, to come into effect in 2014.
- An increase in property tax collections through an increase in the property tax rate on buildings and land from 0.1-0.15 percent to double those amounts in 2014, and to an average of 0.5 percent in 2016, as well as through a revaluation of assessed property values to reflect market valuations. Once the primary balance targeted under the

programme (3½ percent) has been achieved, the Government intends to reduce the currently high property transfer taxes to encourage the development of a more vibrant real estate market.

- Streamlining tax exemptions to ensure equitable burden-sharing through: (i) a 50 percent reduction in tax exemptions to GRENLEC, the largest beneficiary of exemptions, statutory bodies, St. George's University and the returning nationals; (ii) reducing the tax rebate to manufacturers by eliminating credits accumulated during 2010-13; allowing the use of the rebate against non-VAT liabilities only; capping the annual fiscal loss to EC\$2.5 million; and discontinue the program fully after 2016; and (iii) reforming the tax incentive regime to ensure the integrity of the tax base going forward (detailed below). The first two measures will be effective from 2014 (excluding St. George's University, which will be effective in 2016).
- The base of the VAT will be expanded by (i) applying VAT to select exempt items (non-basic food, private accommodations); and (ii) applying the full 15 percent rate to construction inputs (from 2014) and utilities provided to St. George's University (from 2016).
- Broadening the base and yield of excises by: (i) introducing a 5 percent excise on luxury goods and on vehicle parts, tires, batteries, and motor oil; and (ii) increasing the excise tax on alcohol and tobacco products by at least 10 percent.
- Other revenue-enhancing measures will include: (i) the introduction of a small business tax regime for firms with sales between EC\$30,000 and the VAT threshold (EC\$120,000), charging a flat rate of 5 percent on gross sales; (ii) the introduction of a 10 percent tax on financial activities (wages and profits of financial institutions); (iii) increased fees on motor vehicle, professional and gun licenses; (iv) fees for new government guarantees on the debt of statutory bodies; and (v) an increase in the customs service charge from 5 to 6 percent.
- The Government also intends to undertake a revenue-neutral simplification of the tax system by way of overcoming resource constraints and improving compliance. Technical assistance on this, and on the introduction of the small business tax regime, was requested from the IMF.
- Increased efforts to collect taxes that are due will also be critical in supporting the fiscal consolidation. The parliament has recently passed a revised Integrity in Public Life law intended to strengthen governance and facilitate higher levels of integrity throughout the government, including in revenue collecting agencies. Going forward, efforts will focus on fully implementing the reform agenda that has already been developed with support from CARTAC that includes: (i) completing institutional reforms to focus on risk management and large tax payers; (ii) eliminating the bonus for tax collectors on interest from tax arrears, with a view to correcting the disincentives to collect on the large stock of existing arrears (prior action); (iii) introducing a strict sanction regime for late payment of taxes due (the relevant tax laws will be revised before end-November 2014); (iv)

connecting the customs and inland revenue information systems and ensuring exchange of information between the two departments; (v) enacting the newly drafted Customs Bill that will modernize the existing legislation and introduce penalties for noncompliance, among other things (by end-June 2014); (vi) establishing an Internal Audit Unit at Customs; and (vii) improving controls and monitoring of customs bonding warehouse, by increasing audits and closing repeated non-compliant warehouses.

- A reduction in central government's nominal wage bill to 9 percent of GDP by 2016, from a projected 10.3 percent in 2013 (excluding retroactive payments). This will be achieved, at the minimum, by capping the nominal wage bill during 2014-16 (including allowances) at May-December 2013 levels (this will bring the wage bill to a projected 9½ percent of GDP by 2016). A further reduction in the wage bill will be achieved through attrition, with only 3 out of 10 departing employees replaced; and through the streamlining in the public sector following the planned public service review (see below). To facilitate the achievement of the wage targets, we will: (a) eliminate at least 100 vacancies a year during 2014-16 (previously used to grant higher salaries to existing staff); and (b) not award performance increments for 2013-16 period, while improving the performance appraisal system. These measures will also be supported by fiscal structural reforms that would restrain public wage growth on a more sustainable basis (see below).
- A 20 percent reduction in spending on goods and services relative to 2012, focused especially on savings in the utilities bill, rental costs, and communication costs, through renegotiation of telephone contracts, switching to energy-saving LED lights and the consolidation of public offices. Other spending on goods and services will be frozen at 2013 levels. Other spending will also be streamlined, including investments of lower social return and reforms of statutory bodies to reduce their drag on public finances (see below).

19. Most measures required for the consolidation will be secured upfront in order to impart additional credibility to the adjustment effort.

- The Government will obtain parliamentary approval of all the fiscal adjustment measures listed in paragraph 18 that require legislative amendments as a prior action, although the implementation of the measures will be staggered in line with the agreed pace of consolidation. The only four exceptions to the ex-ante legislation of measures will be: (i) the new taxes to be introduced in 2015 (financial activities tax and small business tax) will be legislated during 2014 to allow adequate time for their proper design, technical assistance for which will be sought from the IMF; (ii) the second round of property tax increases for 2016 will be legislated after we assess the implementation of the first round of increases; (iii) the fees for the new government guarantees will be enacted soon after the post-restructuring technical assistance on public debt management, which we requested from our international partners; and (iv) the measures associated with the St. George's University will be enacted before mid-2015, after the conclusion of our ongoing renegotiations of the existing arrangements with the university.

- Finally, the parliament approved the 2014 budget in line with the programmed primary deficit target of 2½ percent of GDP. To ensure that primary spending is consistent with the program if budgeted revenues do not materialize, the Government will take additional safeguards to secure execution in line with the program, including: (i) issuing a cabinet conclusion allowing spending commitments only up to the programmed, rather than budgeted, spending; (ii) issuing spending authorizations in line with the programmed spending targets, and only one quarter ahead, to strengthen our ability to control spending commitments; and (iii) revising the Public Finance Management Act, ahead of the planned overhaul of the public financial management legislation, to introduce personal financial penalties for responsible officers committing to spending above budgetary ceilings (items (i) and (ii) are a prior action for the program).

20. **To ensure that our consolidation efforts remain on track in the face of unanticipated events, such as natural disasters, the Government will put in place a number of measures.** In particular:

- It will seek donor assistance to purchase additional natural disaster insurance for the duration of the programme to ensure that Government policies are not derailed by natural disaster shocks. The Government estimates that the cost of this supplementary insurance would be US\$3-5 million per year (0.4-0.6 percent of GDP), providing a substantial level of coverage for Grenada and representing 20 to 30 percent of the estimated average annualized loss for the covered perils.
- The Government has also identified contingent measures for up to 0.7 percent of GDP in 2014 that will be implemented to ensure that the fiscal consolidation does not fall short of the target. These include: (i) reduced (only one-quarter-ahead) expenditure authorizations in the first three quarters of the year compared to the program, with the remaining allocations released once there is evidence that the fiscal programme is on track; and (ii) a further widening of the income tax base to capital gains, dividends, and interest.

21. **The Government plans to clear its existing domestic and external arrears during the programme period.** A clearance framework for the existing stock of Government debt arrears will be agreed on as part of the ongoing debt restructuring, and the Government will not incur additional debt arrears during the duration of the programme outside the restructuring process. Existing supplier arrears will be repaid through a combination of Government paper and cash during the first two years of the program. The Government will not incur additional arrears on membership fees to regional and international organizations from the start of the program, and will seek to regularize these delayed payments in the course of 2015. In the context of public financial management reforms, the Government will also strengthen the monitoring of expenditure commitments to prevent future accumulation of arrears.

Debt Restructuring and Financing Assurances

22. **The second pillar of the fiscal programme is addressing the debt overhang through a comprehensive debt restructuring.** While the fiscal consolidation outlined above would set debt on a firmly downward path, it will not be sufficient to bring a lasting solution to the negative effects of the debt overhang that continue to stifle government finances and the economy. Accordingly, the Government announced on March 8, 2013 that it will undertake a “comprehensive and collaborative” restructuring of the public debt; this will supplement the fiscal consolidation in reducing debt to reach the ECCU-wide debt target of 60 percent of GDP by 2020. The scope of the anticipated debt restructuring will be comprehensive, covering all public and publicly guaranteed debt with the exception of loans from multilateral institutions and Treasury bills issued on the regional government securities market (RGSM) in order to limit the impact on the regional economy. The Government has contracted financial and legal advisors and is working with them and creditors to advance the debt restructuring process.

23. **With the assistance from financial advisors, the Government has developed a strategy for engaging with private and bilateral official creditors to achieve both cash flow relief and materially reduce the overall stock of debt.** The Government has met with the commercial bondholders to begin discussing Grenada’s payment capacity and provide detailed macroeconomic and debt information. The economic program outlined in this memorandum will be the basis for discussions over appropriate restructuring terms, which got underway in March 2014. The Government also plans to request financing assurances from the Paris Club before the IMF’s Executive Board meeting on the program request. We will also continue to engage our bilateral non-Paris Club creditors to regularize existing arrears and restructure debt. In this regard, agreements to reschedule arrears have already been reached with the OPEC Fund and with Kuwait, which enabled them to make new disbursements to finance existing infrastructure projects.

24. **Multilateral creditors will also contribute to support our adjustment program.** In addition to the assistance we are seeking from the IMF, both the World Bank and the Caribbean Development Bank (CDB) are preparing new lending programs for Grenada, with expected cumulative disbursements of US\$30 million each during the three years of the arrangement. The European Union also plans to resume its grant support for Grenada once an IMF program is in place. After accounting for expected financial support from our official creditors, the remaining financing gap is estimated at about US\$350 million in 2014-17. About two thirds of this residual financing gap will be closed through the regularization of existing arrears during the upcoming debt negotiations, with the remaining one third closed through the restructuring of future maturities. Consistent with the financing envelope of the programme, making satisfactory progress in the negotiations with the creditors will be a prior action through: (i) initiating the negotiation phase of the restructuring with private and bilateral official creditors, (ii) seeking agreement on a debt restructuring consistent with closing the financing gap under the program and reducing debt to 60 percent of GDP by 2020; (iii) obtaining financing assurances from the Paris Club; and (iv) developing a credible timetable for advancing the restructuring discussions with private creditors through mid-2014. Before the Board discussion of the program request, we

will also issue a supplementary Letter of Intent with an update on the progress made in the debt restructuring negotiations and will provide adequate financing assurances.

Fiscal Structural Reforms

25. **The third pillar of the fiscal programme will focus on structural fiscal reforms to ensure fiscal discipline going forward.** They will be aimed at imposing meaningful constraints on the conduct of fiscal policies and providing a fiscal anchor to guide policy decisions. Reforms will focus on strengthening five areas: (i) the fiscal policy framework, through the introduction of a rule-based framework and stronger fiscal risk management; (ii) public financial management; (iii) improved management of parastatal entities; (iv) pension reform; and (v) debt management:

- **Fiscal policy framework.** The Government intends to transition to a rule-based fiscal framework that will provide guidance on how fiscal policies would be steered to the medium-term debt target, as well as after its achievement:
 - The rules will cap real spending growth at trend GDP growth (2-2½ percent), while allowing revenues to absorb cyclical fluctuations; this will ensure that—once the desired fiscal target is achieved—it is broadly maintained over the cycle. The fiscal framework will require a decision on the fiscal balance that will be maintained over the medium-term after the programme, consistent with the achievement of the desired debt objectives.
 - The rules will also set caps on personnel spending as a share of tax revenues to ensure the sustainability of the wage outlays; these caps will be consistent with the program targets and will be detailed during the first review, following related technical assistance.
- The fiscal policy framework will also be amended to improve the analysis and management of fiscal risks through: (i) strengthening control over the finances of the rest of the public sector; (ii) widening the scope of public financial management legislation to the general government and producing consolidated public sector accounts; and (iii) strengthening capacity to monitor fiscal risks by creating a Public Investment Unit to monitor and manage risks associated with parastatal entities, PPPs, and other risks. The introduction of umbrella legislation for the fiscal framework in line with these reforms will be a structural benchmark for end-December 2014. To implement this framework, the Government will approve relevant regulations by end-June 2015.
- **Public financial management (PFM) legislation.** To strengthen the budget process, financial discipline, and accountability, the Government will revise the public financial management legislation to: (i) limit the use of executive orders to spend above budget; (ii) require all spending in excess of the originally approved budget for the fiscal year to be appropriated by parliament ex ante through a supplementary budget; (iii) introduce meaningful contingency funds and contingency appropriations within the budget; (iv) strengthen control over expenditure commitments, including through the introduction of

strict personal and institutional penalties; and (v) prohibit implementation of changes to the tax system without parliamentary approval. The revised legislation will also strengthen the capital budgeting process, including through institutional reforms, value-for-money and sustainability criteria in the selection of investment projects, move to multiyear budgeting process and the development of a medium-term strategy plan that will help prioritize government investment projects and guide the multiyear budgeting process. The Government is receiving IMF technical assistance on the revision of the PFM legislation, and intends to obtain parliamentary approval of the revised legislation by end-August 2014 (structural benchmark), with relevant regulations to be approved by end-March 2015. In addition, to identify other reform priorities across the spectrum of PFM functions, the authorities have requested the IMF to carry out a Public Expenditure and Financial Accountability (PEFA) assessment during the coming 12 to 18 months.

- **Statutory Bodies.** Improving the financial performance of the statutory bodies will be an integral part of reforms to secure lasting fiscal discipline, as they represent an important source of contingent liabilities for the Government. After initial diagnosis of the financial situation in the statutory bodies undertaken with technical assistance from CARTAC, the Government will undertake a strategic review of the functions and the rationale of the existing statutory bodies, as well as new statutory bodies being considered (the Printery, the Government Information Service, and Statistics Grenada), and develop a strategic plan for the sector. The plan will: (i) provide up-to-date information on the financial viability of each statutory body, including the sustainability of any long-term pension arrangements; (ii) classify each as being in line for liquidation, privatization, or retention, and provide a time schedule for such action; and (iii) lay out concrete plans to restructure financially weak statutory bodies that have been retained. We will receive technical assistance for this review from CARTAC and the approval of the strategic plan by the Cabinet will be a structural benchmark for end-October 2014. Financial control over the statutory bodies, including strengthened reporting requirements and a unit to monitor their performance, will be dealt with in the context of the revised PFM legislation.
- **Public sector modernization.** In addition to the planned reduction in public sector employment through attrition, the Government will undertake a strategic review of the public sector with a view to ultimately reducing the size of the public sector and making it more efficient. This review will include government functions, public hiring (with a particular attention on refocusing the Department of Public Administration and reforming the Public Service Commission), as well as that of civil service size, composition and remuneration structure. We will seek assistance from our international partners in undertaking such a review, and will develop a strategic action plan on its basis by end-March 2015, conditional on availability of technical assistance resources. Parliamentary approval of revised legislation on government functions, civil service, and public compensation (including the 1969 Public Service Law) is expected within the subsequent six months.

- **Tax incentive regime.** The Government plans to overhaul its process for granting tax incentives in order to prevent the erosion of the tax base and maximize the economic impact of incentives granted. The reforms will aim at revising the relevant legislation to require that all new tax exemptions are codified in legislation, no discretionary exemptions are permitted, and that the beneficiaries of all exemptions file appropriate tax returns and are tax compliant (structural benchmark for end-November 2014); technical assistance for these reforms was provided by the IMF in February 2014 and further assistance will be received in July 2014. Information on the amount of revenue foregone under all tax exemptions will be published annually in the budget presentation to parliament, and reviews of the rationale, cost, and benefits of the existing tax exemptions will be conducted periodically.
- **Pension reform.** The Government intends to reform the current public pension system with a view to consolidating the two different schemes, ensuring more equitable outcomes among different types of beneficiaries, and providing a competitive return to allow the public sector to retain qualify staff. The Government has already formed a working group on pension reform and will also seek technical assistance from CARTAC to assess the fiscal implications of the various pension reform proposals. The Government aims at submitting reform legislation to parliament by March 2016.
- **Treasury Single Account.** To ensure an adequate management of its financial resources and save on interest costs, the Government will aim to transition to an effective treasury single account. We are receiving technical assistance from CARTAC to undertake an assessment of the cost effectiveness of the Government's banking arrangements, facilitate a full audit of the bank accounts, and to develop a strategy for closing bank accounts and moving to a treasury single account (either within the commercial banking system or at the ECCB). We will seek cabinet approval of the strategy by end-July 2014 and aim to fully implement it by end-October 2014.
- **Strengthening debt management** will also be important in managing and monitoring portfolio risks, as well as in ensuring that future financing needs are met at reasonable cost. The Government will seek technical assistance on strengthening debt management, including on guarantee fees, from the IMF and the World Bank.
- **Strengthening public procurement.** The Government will also seek parliamentary approval by end-June 2014 for revised public procurement legislation, aimed at making public procurement more efficient and more transparent.
- **Governance of the National Transformation Fund (NTF).** The Government will ensure a strong and transparent governance of the NTF that will manage the receipts of the recently legislated citizenship-by-investment (CBI) programme. Starting from 2014, the accounts of the NTF will be audited annually by the Director of Audit. The audit report will be submitted to the parliament and will be accessible to the public. To avoid abuse of the programme and ensure its sustainability, the Government will take steps to ensure that: (i) applications are

subject to adequate criminal background checks; and (ii) appropriate AML/CFT measures and oversight are targeted to the new citizens.

C. Financial Sector Policies

26. **The Government will take a proactive approach to ensuring the continued stability of the financial system and will support ongoing regional efforts to strengthen financial regulation and supervision.** It will focus on assessing the impact of the debt restructuring on the financial sector capitalization needs and on strengthening the nonbanking sector regulatory frameworks and financial position, in keeping with points 6-8 of the ECCU's eight-point stabilization and growth program:

- The Government will work with the ECCB to gauge—through stress tests—the potential impact of the debt restructuring on income and capitalization of financial institutions. We will also assess the potential impact of the debt restructuring on the long run solvency of the NIS.
- The Government has been at the forefront of regional efforts to revamp insurance regulation and supervision, and has worked proactively to identify and address weaknesses in the non-bank sector. The Government will continue to promote the consolidation of the credit union sector as a means of strengthening the financial safety net, will support the establishment of the proposed Eastern Caribbean Financial Services Regulatory Commission, and will enact the new uniform ECCU Credit Union Regulations currently being finalized. To further strengthen the regulatory framework for the credit unions, we intend to enhance the supervisor's toolkit by developing, in consultation with the ECCB, options for providing liquidity support to solvent institutions; strengthening the requirements for retaining profits in the context of the new regional regulations; and requiring credit unions to increase capital to assure adequate capitalization over the next three years, based on the stress tests for the debt exchange impact. We will also complete, by end-2014, the move to a full risk-based supervision model for credit unions which was started in 2013.
- In the banking sector, the Government will support regional efforts to strengthen banking regulation and supervision to bolster the ECCB's resolution powers and strengthen the loan classification and provisioning requirements. The authorities will commit to promptly present to Parliament the revised Banking Act and the ECCB agreement once these are approved by the Monetary Council. The Government will also reach understandings with the ECCB on strengthening the financial position of the commercial banks in Grenada, which would include: (i) requirements for retaining profits until the capital and liquidity position of banks meets prudential requirements; (ii) undertaking a comprehensive and independent valuation of the assets of the weak banks before end-December 2014, subject to the loan classification and provisioning requirements to be agreed with the IMF staff and the World Bank, unless such a valuation had already been initiated in the context of the regional efforts before end-September; and (iii) based on the findings of the valuation,

the government will discuss with the ECCB how to address its results within recapitalization or resolution plans.

D. Program Issues

27. **Program monitoring.** The programme will be subject to semiannual reviews and semiannual performance criteria, indicative targets and structural benchmarks, as set out in Tables 1-2 and in the attached Technical Memorandum of Understanding (TMU). In addition to the quantitative targets set therein, a quantitative performance criterion on the wage bill for the period 2015-16 will be set in line with the programmed levels, if the wage objectives for this period are not safeguarded through agreement with the trade unions or the fiscal responsibility legislation before end-2014. We anticipate that the first two reviews would take place September 30, 2014 and March 31, 2015, and will require observance of the continuous performance criteria and of the conditionality for end-June 2014 and end-December 2014, respectively. To facilitate program monitoring, we are committed to providing detailed statistical information as specified in the TMU. Progress in the implementation of the policies under the programme will also be monitored on a quarterly basis through staff visits.

28. **Safeguards.** We will adhere to the safeguards policy in case of Fund budget financing. In accordance with the recommendations of the 2012 safeguards assessment of the ECCB, we will maintain our foreign exchange balances only with the ECCB.

29. **Publication.** The government authorizes the IMF to publish the Letter of Intent, its attachments, and the related staff report.

TECHNICAL MEMORANDUM OF UNDERSTANDING

1. Grenada's performance under the Extended Credit Facility (ECF arrangement), described in the above Memorandum of Economic and Financial Policies, will be assessed on the basis of observance of quantitative performance criteria, indicative targets, as well as compliance with structural benchmarks. This Technical Memorandum of Understanding (TMU) defines the performance criteria and indicative targets for the arrangement under the ECF. It also describes the modalities for assessing performance under the programme and the information requirements for monitoring this performance.

Definitions. For the purpose of the program, *central government* will cover all items included in the government budget. The definition of debt is set out in the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangement Executive Board Decision No. 6230-(79/140), as subsequently amended. *External debt* is defined as central government contracted or guaranteed debt owed to creditors residing outside of Grenada, while *domestic debt* covers central government contracted or guaranteed debt owed to residents of Grenada. For ease of monitoring, all securities issued at the Regional Government Securities Market (RGSM) will be regarded as domestic debt.

IV. PERFORMANCE CRITERIA

A. Cumulative Floor on the Central Government Primary Balance

2. The central government primary balance will be measured from above the line, as: (a) total revenue and grants of the central government, less (b) total non-interest expenditure of the central government:

- Total revenues and grants will record project grants only to the extent that they have been spent.
- Expenditures will be recorded on an accrual basis, with: (a) budget execution data as reported by the Ministry of Finance (MOF); supplemented by (b) data on unprocessed claims to be collected and reported by the MOF.

3. The central government primary balance will also be monitored from below the line, as the negative sum of:

- i. *Net domestic bank financing*, which will be measured by the change in the domestic banking system credit to the central government minus government deposits in the banking system, as reported in the monetary survey. Domestic banking system credit to the central government is defined as the sum of ECCB and commercial banks' financing to the central government.

- ii. *Net nonbank financing*, which will be measured by the: (a) net changes in holdings of government securities by nonbanks; and (b) net borrowing from nonbank institutions. Items (a) and (b) will be reported by the MOF and GARFIN respectively.
- iii. *Net government issuance of securities in the Regional Government Securities Market (RGSM)* excluding holdings by the domestic banking and nonbanking system as captured in point (i) and (ii) above.
- iv. *Net external financing of the central government*, defined as the sum of: (a) net disbursements of project and non-project loans, including securitization; (b) net proceeds from issuance of external debt; and (c) reduction in cash deposits held outside the domestic financial system. The data will be reported by the MOF on a monthly basis.
- v. *The change in the stock of arrears of the central government*, measured as the net change in (a) unpaid checks issued, (b) unprocessed claims, (c) pending invoices, (d) interest payments past due, and (e) other forms of expenditures recorded above the line but not paid, such as contributions to the National Insurance Scheme (NIS). The data will be reported by Ministry of Finance on a monthly basis.
- vi. *Gross receipts from divestment*, defined as proceeds received from any privatization/divestment and sale of assets; and
- vii. *Any exceptional financing* (including rescheduled principal and interest).
- viii. *Less domestic and external interest payments on a due basis.*
- ix. *Less grants received but unutilized.*

If the difference between the primary balance measured from above the line and from below the line is larger than EC\$10 million in 2014, EC\$6 million in 2015 and EC\$3 million in 2016 the MOF will consult with IMF staff.

4. The floor on the central government primary balance will be adjusted as follows:
 - i. Downward (larger deficit)/upward (smaller deficit) by the amount of retroactive wage and pension payments for the 2009-2012 period in excess/shortfall relative to the programmed amounts, as detailed in the table below, with cumulative payment during the programme period not exceeding EC\$26.5 million.

	2013		2014 ¹		2015		2016	
	Dec.	Dec.	Jun.	Dec.	Dec.	Dec.	Dec.	
(EC\$ millions)								
Programmed retroactive wage and pension payments	17.4	26.5	26.5		0		0	

¹ Cumulative from end-2013

- ii. Upward by the amount of fees received (non-tax revenues in the budget) from the recently legislated citizenship-by-investment (CBI) programme.

- iii. In the event that revenues (excluding the fees from the CBI programme) and budgetary grants (grant receipts that are not earmarked for capital outlays) exceed those projected under the programme, the primary balance target will be adjusted upward by one half of the excess during January-June, to allow for additional capital spending while safeguarding compliance with the annual fiscal targets. The following table shows the accumulated projected revenue and budgetary grants for 2014, as well as capital spending, to which the actual outcomes will be compared.

	2013		2014 ¹		2015	2016
	Dec.		Jun.	Dec.	Dec.	Dec.
(EC\$ millions)						
Non grant revenue	440.3	231.1	459.9	504.4	547.4	
Budgetary grants	0	0	0	0	0	0
Capital spending	160.5	97.0	215.6	176.5	151.0	

¹ Cumulative from end-2013

- iv. Upward for any shortfall in the targeted cash transfers (SEED) from their indicative target.
5. The authorities will consult with IMF staff on corrective measures in the event of shortfalls in government revenue and financing. In addition, any funds from the recently legislated citizenship-by-investment programme received by the National Transformation Fund will be saved for contingency financing until a sufficient cushion is built, with the future use of the funds to be addressed during subsequent programme reviews.
6. To operationalize the contingency measures for 2014, the authorities will reduce budget allocations to ministries, relative to the program's primary spending targets, by EC\$9.3 million for the first and second quarter combined, and EC\$14 million for the first, second and third quarter combined, with the withheld allocations being released in the fourth quarter if the programme targets are on track.

B. Cumulative Ceiling on Central Government Primary Spending

7. The primary spending of the central government will be calculated as the sum of revenues and grants that have been utilized minus the primary balance of the central government as measured above in section A. The performance criterion on primary spending will be subject to the same adjustors as applied to the primary balance target as applicable. An additional adjustor would apply to the primary spending target to allow for the full use of available capital grants: the target will be adjusted upward by the full amount of additional capital grants received and spent in excess of programmed levels and will be adjusted downward by half of the shortfall in capital grants compared to the programmed levels to safeguard the fiscal targets (table above).

C. Ceiling on the Stock of Central Government Domestic Arrears

8. Domestic arrears are defined as the sum of: (i) any invoice that has been received by a spending agency from a supplier of goods, services, and capital goods delivered and verified, and for which payment has not been made within the contractual agreed period, or in the absence of a grace period, within 60 days; (ii) unpaid wages, pensions, or transfers (excluding membership fees to regional and international organizations), pending for longer than 60 days to domestic or foreign residents, irrespective of the currency denomination of the liability; and (iii) pending interest and amortization payments on domestic debt beyond the grace period set in the respective loan or debt contracts. Arrears resulting from the nonpayment of debt service for which a clearance framework has been agreed or a rescheduling agreement is being sought are excluded from this definition. The data will be reported by the Accountant General's office.

D. Non-Accumulation of External Debt Arrears (Continuous)

9. The central government will not incur new arrears in the payment of their external obligations (contracted or guaranteed) at any time during the programme. Arrears are defined as a delay in the payment of contractual obligations beyond the grace period set in the respective loan or debt contracts. Arrears resulting from the nonpayment of debt service for which a clearance framework has been agreed or for which the government is actively and in good faith pursuing a debt restructuring are excluded from this definition. The performance criterion will be applied on a continuous basis under the programme.

E. Ceiling on Non-Concessional External Borrowing by the Central Government (Continuous)

10. The ceiling on non-concessional borrowing will be applied to the contracting or guaranteeing by the central government of medium and long-term external debt (maturity greater than one year). Excluded from the ceiling is borrowing from regional financial institutions or markets (Caribbean Development Bank and the RGSM). The contracting and guaranteeing of non-concessional external debt will be monitored and reported to the Fund staff by the DMU, after reconciliation with the Accountant General's office, on a monthly basis. The performance criterion will be applied on a continuous basis under the programme.

11. A debt is non-concessional if the grant element (in net present value relative to face value) is less than 35 percent. The discount rate used for this purpose is 5 percent.

V. INDICATIVE TARGETS

F. Cumulative Ceiling on Net Increase in Debt Contracted or Guaranteed by the Central Government

12. Net increase in debt contracted or guaranteed by the central government is defined as issuance minus repayments of debt contracted or guaranteed by the central government and approved by Parliament by each relevant date. For the purposes of the programme, such debt will be considered to have been contracted as of the date when both: (1) an agreement to provide such a lending facility or guarantee has been concluded and signed; and (2) the proposed borrowing or guarantee has been approved by Parliament, in the case of external debt. The ceiling excludes debt instruments to be issued as part of the process of debt restructuring.

13. In cases where the government facilitates the financing of Public-Private Partnership (PPP) projects by concessionaires, the debt of the central government will be increased by the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

14. The ceiling on the debt contracted or guaranteed by the central government will be adjusted as follows:

- Upward by the amount paid by the government to reimburse the policy holders of the failed regional insurance companies BAICO and CLICO, less the grant-financed share of these payments.
- Upward to a maximum amount of 5 percent of GDP to accommodate PPP related expenditures.

15. The data used to monitor debt contracting will be provided by the DMU, after reconciliation with the Accountant General's office, on a monthly basis.

G. Floor on the Social Spending by the Central Government

16. The social spending of the central government will only include the expenditures incurred by central government towards the SEED programme (support for education empowerment and development). This will be reported by the Ministry of finance on a quarterly basis.

H. Memorandum Item: Wage Bill Target

17. The wage bill of the central government will include the expenditures incurred by the central government towards the payment of wages, salaries and personnel allowances and

excludes one-off retroactive wage payments. This will be reported by the ministry of finance on a quarterly basis.

I. Memorandum Item: Public Employment

18. The public employment of the central government will include the established (permanent) and unestablished (temporary) workers. This will be reported by the ministry of finance on a quarterly basis.

VI. EXECUTION OF PRIOR ACTION

19. All the fiscal adjustment measures that need to be approved as part of the prior action will be approved through the legal instruments specified in the table below:

Table 4. Execution of Prior Actions

Measures	Approved Through
Personal income tax	
Reduce threshold to EC\$36,000, with a marginal rate of 15 percent on income up to EC\$60,000	Ministerial order
Widen the income and withholding tax base to winnings from lotteries and games of chance	Act of Parliament
Corporate income tax	
Reduce tax rebate to manufacturers from 10% to 5% of gross sales, creditable against non-VAT liabilities only	Act of Parliament
Property tax	
Increase rate on both buildings and land to 0.25 percent in 2014 and to 0.5 percent in 2016	Ministerial order
Value-added tax	
Reduce the list of exempt items (non-basic foods, private accommodations)	Act of Parliament
Restore 15 percent rate on construction materials	Ministerial order
Increase VAT paid by St. George's University from 5 to 15 percent	Act of Parliament
Excises	
Excise tax of 5 percent on:	
<i>motor vehicle parts</i>	Act of Parliament
<i>Tires</i>	Act of Parliament
<i>Batteries</i>	Act of Parliament
<i>motor oil</i>	Act of Parliament
<i>luxury goods</i>	Act of Parliament
Increase the excise tax on alcohol and tobacco products (10 percent)	Act of Parliament
Customs exemptions	
Halve customs exemptions to:	
<i>GRENLEC</i>	Act of Parliament
<i>statutory bodies</i>	Act of Parliament
<i>St. George's University</i>	Act of Parliament
<i>returning nationals</i>	Act of Parliament
Other	
Increase in customs service charge from 5% to 6%	Act of Parliament
Increase fees for motor vehicle license, professional licenses, and gun license	Ministerial order
Budget appropriation	
Issue a cabinet conclusion on committing spending only up to the programmed ceilings	Cabinet decision
Issue budgetary ceilings in line with the programmed spending targets and only one quarter ahead	Cabinet decision

VII. PROGRAMME REPORTING REQUIREMENTS

20. Performance under the programme will be monitored from data supplied to the IMF by the Ministry of Finance and the Central Statistics Office as outlined in the table below. The authorities will transmit promptly to IMF staff any data revisions as well as other information necessary to monitor the arrangement with the IMF.

Table 5: Summary of Data to be Reported

Information	Frequency	Reporting Deadline	Responsible
Fiscal Sector			
Central Government budget and outturn	Monthly	30 days after the end of month	AG ^{1/} /Budget Office
Grants	Monthly	Same as above	AG
Budgetary grants	Monthly	Same as above	AG
Project grants	Monthly	Same as above	AG
Spending on SEED program	Monthly	Same as above	AG
Employment data for established and un-established workers	Quarterly	30 days after the end of quarter	AG
Financial statements of all statutory bodies	Annually	Within 12 months after year end	AG
Change in the stock of domestic arrears	Monthly	30 days after the end of month	AG
Unpaid claims	Monthly	Same as above	AG
Interest arrears	Monthly	Same as above	AG
Financial Sector			
Consolidated balance sheet for all credit unions	Monthly	30 days after the end of quarter	GARFIN ^{2/}
Consolidated balance sheet for all insurance companies	Quarterly	By the end of subsequent quarter	GARFIN
Real and External Sector			
Updates on annual National Accounts: by sector	Annually	Within 6 weeks after availability	CSO/MOF ^{3/}
Tier 1 high frequency indicators ^{4/}	Monthly	60 days after the end of month	CSO/MOF
Tier 2 high frequency indicators ^{5/}	Monthly	6 weeks after the end of quarter	CSO/MOF
Balance of Payments data	Annually	Within 3 months after year end	CSO/MOF
Details of exports breakdown	Quarterly	By the end of subsequent quarter	Customs Dept.
Details of imports breakdown	Quarterly	Same as above	Customs Dept.
Details of tourism data	Quarterly	Same as above	CSO
Customs revenue foregone	Monthly	30 days after the end of month	Customs Dept.
CPI	Monthly	Same as above	CSO
Debt			
External and domestic debt and guaranteed debt (by creditor) ^{6/}	Monthly	30 days after the end of month	DMU ^{7/}
Disbursements	Monthly	Same as above	DMU
Amortization	Monthly	Same as above	DMU
Interest payments	Monthly	Same as above	DMU
Stock of external debt	Monthly	Same as above	DMU
Stock of domestic debt	Monthly	Same as above	DMU
Arrears on interest and principal	Monthly	Same as above	DMU
Financial statement of Petrocaribe Grenada	Monthly	Same as above	DMU/AG
Gross receipts from divestment	Monthly	Same as above	Budget Office
Exceptional domestic financing	Monthly	Same as above	DMU
Proceeds from bonds issued abroad	Monthly	Same as above	DMU
Copies of any new loan agreements	As occurring		DMU

1/ Accountant General's Office.

2/ Grenada Authority for the Regulation of Financial Institutions.

3/ Central Statistics Office/Ministry of Finance.

4/ The following are defined as Tier 1 high frequency indicators: retail sales; imports of construction materials; agricultural production; manufactured production; production of water and electricity.

5/ The following are defined as Tier 2 high frequency indicators: building permits; registration of vehicles; cargo and aircraft statistics.

6/ For Central Government and Public Sector Enterprises.

7/ Debt Management Unit.

SUPPLEMENTARY LETTER OF INTENT

St. Georges, Grenada
June 25, 2014

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Lagarde,

The Government continues to make steady progress with its debt restructuring process.

In early March 2014, the Government and its advisors met in Miami with a committee comprising holders of a majority of the US dollar bonds due 2025. The discussions centered around the medium-term macroeconomic framework that lies at the heart of the proposed programme, as well as on the measures that the Government intends to implement in order to address current macroeconomic imbalances. The discussions were productive in clarifying aspects of Grenada's expected payment capacity during the life of the programme and beyond, and since the Miami meetings weekly calls have been held with the committee and its advisors to further discuss technical matters relating to the restructuring.

The Government believes that it has now largely satisfied the committee's data and information requests, and has executed a non-disclosure agreement (NDA) with the committee's advisors to facilitate the exchange of detailed information. The Government has articulated its debt reduction objectives to the committee and its advisors, and in turn the committee has indicated it will soon be in a position to begin discussing the precise terms of the proposed restructuring. To this effect, it is expected that the committee will shortly execute its own NDA with the Government.

In parallel, and in response to bondholder requests, the Government has published indicative restructuring options for its EC dollar bond due 2025, involving face value reductions of 50-60 percent. The feedback received so far by the Government clearly indicates that bondholders – by and large – understand that Grenada's projected payment capacity will not permit the Government to offer softer restructuring terms for its indebtedness. Negotiations over the details of the restructuring package are continuing with increased momentum, and the government has already received indications from some creditors that they would accept the 60 percent haircut option once the offer is formally launched, which we aim to do in the third quarter of 2014.

With regards to the official bilateral debt, the Government has written to the Paris Club in advance of the formal request for financing assurances, and has indicated that Grenada stands ready to approach the Club to negotiate the treatment of its arrears and future maturities as soon as it is invited to do so by the Club following the approval of the proposed programme by the IMF's Executive Board.

The Government has also written to its non-Paris Club official bilateral creditors, updating them on the objectives of the programme and requesting their support through a comprehensive restructuring of their claims. In the specific case of Taiwan, the Government has submitted a restructuring proposal closely mirroring the options for the EC dollar bond due 2025, and is actively discussing the details of the proposed restructuring package with this creditor and its advisors. Both sides remain focused on reaching an amicable and sustainable agreement outside legal channels, though for now the legal process is ongoing.

Separately, the Government has embarked on negotiations with its key domestic creditors, including commercial bank lenders and large holders of Treasury Bills not listed on the Regional Government Securities Market (RGSM). The Government has communicated its intention to apply restructuring terms similar to those proposed for the EC dollar bonds due 2025 to all its domestic obligations other than the overdrafts, RGSM-listed Treasury Bills, and some categories of domestic arrears.

Overall, this progress demonstrates the government's commitment to achieving a comprehensive and collaborative debt restructuring that would help to restore fiscal sustainability and secure needed financing going forward. It also demonstrates its commitment to the principles of good faith negotiations with our creditors and equitable treatment among diverse groups of creditors. We will continue to adhere to these principles to achieve a satisfactory outcome. With the current progress, the government envisages to make significant headway in the debt restructuring by end-2014.

Sincerely,

/s/

Hon. Keith Mitchell
Prime Minister, Minister of Finance and Energy
Grenada