GOVERNMENT OF GRENADA

Fiscal Risk Statement

Submitted To

The Parliament

By

The Minister of Finance, Planning, Economic & Physical Development

November, 2018
PURPOSE

This Fiscal Risk Statement is being prepared in fulfilment of Section 12 (1) (e) of the Fiscal Responsibility Law No. 29 of 2015, as amended (FRL), which stipulates that:

“The Minister of Finance shall prepare and submit to Parliament, with the annual Budget Bill, a fiscal risk statement that shall reflect all decisions by Cabinet and the Minister and circumstances that may have a material effect on the economic and fiscal outlook. This statement must contain the following information:

i. the sensitivity of economic and fiscal forecasts to changes in the economic outlook and economic shocks;

ii. the exposure of the Government to contingent liabilities, including guarantees and obligations arising from judicial proceedings in progress;

iii. fiscal risks arising from the financial sector, statutory bodies, state-owned enterprises, public-private partnerships, and any other institutions;

iv. any commitment unaccounted for in the economic and fiscal forecasts;

v. any other circumstance that may have a material effect on the economic and fiscal forecasts and is unaccounted for in the economic and fiscal forecasts; and

vi. any measures implemented by Cabinet, or the Minister, to manage fiscal risks.”
INTRODUCTION

The Government’s fiscal priority and its wider development priorities are framed within the context of the Medium-term Fiscal Framework (MTFF) and its Medium-term Agenda (MTA) respectively, both covering the period 2019-2021.

Debt reduction is the primary fiscal policy objective for the medium term. Accordingly, the Government will continue to deploy revenue and expenditure strategies such that primary surpluses exceeding the FRL’s target are generated to keep public debt on a firm downward trajectory in the MTFF period. Regarding the wider development objectives, the MTA articulates targeted and strategic sectoral priorities with the aim of: (i) accelerating Sustainable and Inclusive Economic Growth; (ii) Enhancing Social Capital and Citizen Well-being; and (iii) Promoting Resilient Governance.

This Fiscal Risk Statement outlines the Government’s assessment of the key risks that can affect the achievement of these objectives in the short-to-medium term. The Risk Assessment is organised into two broad categories: (i) Operational and (ii) Other. The following are deemed to be the most significant operational risks to public finances, and by extension the MTA over the medium term: (i) lower-than-projected economic growth; (ii) lower-than-expected grant receipts and inflows into the National Transformation Fund (NTF); (iii) other liabilities. Other risks include natural disasters.

OPERATIONAL RISKS

Macroeconomic Risks

- Lower-than-Projected Economic Growth

As indicated by the International Monetary Fund in its World Economic Outlook Report that was released in October 2018, global risks are tilted to the downside over the medium term. Projected growth in the economies of Grenada’s main trading partners is tenuous and vulnerable to setbacks. Indeed, risks of protectionism, further increases in global oil prices, and a potential escalation of trade wars in advanced economies, are rising. Furthermore, the medium-term economic prospects for the Euro Area especially are weak given its low productivity growth and ageing population.
These global headwinds pose potential downside risks for Grenada, through lower tourist arrivals, remittances and foreign direct investment, which can significantly affect public finances. Furthermore, the cessation of oil refining by Trinidad’s State-owned company – Pertrotrin, which was the main exporter of fuel to Grenada, can cause short-run disruptions that might increase the local price of fuel, as well as cost of production, with negative consequences for economic activity. Relatedly, the potentially large number of workers to be laid off by Pertotrin can negatively affect Grenada’s tourist arrivals from Trinidad. Trinidad and Tobago accounted for 22.0 percent on average of Grenada’s total Caribbean tourist arrivals in the past decade.

- Lower-than-Expected Grant Receipts and Inflows into the National Transformation Fund

Grant inflows from traditional partners, such as the European Union (EU) could moderate over the medium term as a consequence of Britain’s exit from the EU, with adverse implications for the projected fiscal outrun in the medium term. Grants from the Republic of Venezuela are also likely to decline given the country’s economic challenges. Furthermore, the fiscal outlook can also be adversely affected should inflows to the NTF not be as strong as expected. In this context, continued fiscal prudence will be important to contain discretionary spending, prioritise strategic capital investments and improve revenue administration and collection. Additionally, improving country-readiness systems will be required to reduce the reliance on external resources for the preparation of critical pre-investment work.

- Other Liabilities

Fiscal risks can also materialise should state-owned enterprises (SOEs) fail to remain within their funding constraints or should there be calls on the Central Government’s resources where SOEs cannot service their obligations. Capacity and institutional constraints also pose risks to the execution of the capital budget as envisaged in the MTFF. Pension reform, as well as the implementation of the National Health Insurance (NHI), if not properly managed, can also pose significant risks to public finances.

OTHER RISKS
Natural Disasters

This is an inherent risk that Grenada faces given its vulnerability to natural hazards and environmental shocks. Environmental shocks have the potential to severely affect the productive sectors, with adverse fiscal consequences. Therefore, continued efforts are required to strengthen internal capacity to build resilience to natural hazards, while simultaneously protecting fiscal stability. The NTF Regulations require 40.0 percent of the monthly receipts to be set aside for arrears clearance, debt reduction and natural disaster relief. Given the downward trajectory of the debt stock, this arrangement should allow for a progressively larger share of NTF resources to be available for disaster relief. The inclusion of natural disaster clauses in the debt restructuring agreements, which allow for a specified moratorium in debt service following a qualifying natural disaster, is intended to help preserve fiscal stability in the event of natural disasters. Furthermore, as a member of the Caribbean Catastrophe Risk Insurance Facility, Grenada stands to benefit from insurance payments in the aftermath of a qualifying natural disaster.

The results of a Debt Sustainability Analysis carried out by the Ministry of Finance, illustrated in Figure 1 show how vulnerable the baseline fiscal projections are to a macroeconomic shocks. Based on the illustrative scenarios, the ratio of public debt to GDP increases to 66.0 percent in 2028, which is 36.5 percentages points above the 2028 baseline projection, as a result of a one-standard deviation growth shock that is assumed to occur in 2019. Under the more extreme scenario of a two-standard deviation growth shock, public debt to GDP expands to 114.2 percent in 2028, almost four times the baseline projection.

Figure 1: Illustrative Scenarios for Public Debt
These vulnerabilities call for continued policy resolve to further improve debt dynamics and growth prospects in order to firmly entrench medium-term debt sustainability. The Government will therefore continue to exercise fiscal prudence in adherence to the FRL. Government will also continue to strengthen debt management systems to effectively guide the complete spectrum of debt management operations from contracting to recording. Government will also continue to strengthen its disaster risk financing framework and build resilience to be better able to respond to external shocks including natural disasters.

Table 1 provides a Risk Summary.
<table>
<thead>
<tr>
<th>Risk Type</th>
<th>Risk Description</th>
<th>Source of Risk</th>
<th>Risk Rating</th>
<th>Measures to Manage/Mitigate Risks</th>
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<tbody>
<tr>
<td>Operational</td>
<td>Macroeconomic</td>
<td>Heightened global economic uncertainties, rising trade tensions and international oil prices. Petrotrin’s cessation of oil refining.</td>
<td>High Risk</td>
<td>Continue to implement reforms to build economic resilience, boost competitiveness, productivity and growth. Additionally, continue to build fiscal buffers by strengthening Government’s cash position and increasing savings.</td>
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<td></td>
<td>Lower-than-expected NTF inflows and Grants.</td>
<td></td>
<td>Medium Risk</td>
<td>Continue to exercise fiscal prudence to contain discretionary expenditure, prioritise strategic capital investments and improve revenue administration and collection. Additionally, further strengthen country-readiness systems to enhance the preparation of critical pre-investment work.</td>
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<td></td>
<td>Capacity and institutional constraints affecting project implementation</td>
<td></td>
<td>Medium Risk</td>
<td>Continuous capacity building in project management and greater coordination among implementing ministries should help mitigate this risk.</td>
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<td></td>
<td>Cost associated with pension reform and NHI.</td>
<td></td>
<td>High Risk</td>
<td>The respective ongoing processes must be guided by the parameters of the FRL to prevent any major fiscal fallout. In relation to both initiatives, it is crucially important that they be carried out in a phased and fiscally-sound manner.</td>
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<td>Operations of SOEs.</td>
<td></td>
<td>High Risk</td>
<td>Ensure that up-to-date audited financial statements are submitted in a timely manner and closely monitor management performance within the SOEs to ensure that they pursue their respective stipulated mandates in the most cost-efficient and cost-effective manner.</td>
</tr>
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<td>Other</td>
<td>Natural Disasters</td>
<td>Hurricanes, tropical storms, and flooding.</td>
<td>High Risk</td>
<td>Continue efforts to strengthen internal capacity to build resilience to natural hazards. The NTF Regulations require 40.0 percent of the monthly receipts to be set aside for arrears clearance, debt reduction and natural disaster relief. Given the downward trajectory of the debt stock, this arrangement should allow for a progressively larger share of NTF resources to be available for disaster relief. Additionally, the successful negotiation of the inclusion of natural disaster clauses in the debt restructuring agreements will allow for a specified moratorium in debt service following a qualifying natural disaster. Further, as a member of the Caribbean Catastrophe Risk Insurance Facility, Grenada stands to benefit from</td>
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