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St. Kitts and Nevis: 2011 Article IV Consultation and Request for Stand-By Arrangement—Staff Report; Staff Supplements; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for St. Kitts and Nevis.

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2011 Article IV consultation with St. Kitts and Nevis and Staff Report for the 2011 Article IV Consultation and Request for Stand-By Arrangement, the following documents have been released and are included in this package:

- The staff report for the 2011 Article IV Consultation and Request for Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on June 3, 2011 with the officials of St. Kitts and Nevis on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 20, 2011. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A supplement on the debt sustainability analysis.
- A supplement on the Assessment of the Risks to the Fund and the Fund's Liquidity Position.
- A Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its July 27, 2011 discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.
- A statement by the Executive Director for St. Kitts and Nevis.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

ST. KITTS AND NEVIS

Staff Report for the 2011 Article IV Consultation and Request for Stand-By Arrangement

Prepared by the Western Hemisphere Department
(In Consultation with Other Departments)

Approved by David Vegara and Jan Kees Martijn

July 20, 2011

Executive Summary

Context and Key Issues. Following a contraction both in 2009 and 2010, St. Kitts and Nevis' tourism-dependent and highly indebted economy has begun a slow recovery in 2011. With a public debt-to-GDP ratio of about 200 percent at end-December 2010, the country faces difficult economic challenges, including a large exposure of banks to the government and accumulation of external arrears. Given that the government is faced both with financing and debt sustainability difficulties, decisive actions are needed to put public debt on a firmly downward trajectory, thereby creating a virtuous cycle of lower debt and higher economic growth.

Policy Framework. The authorities' reform agenda encompasses a three-pronged approach. The first priority is fiscal consolidation—allowing revenues to rise upfront and containing spending increases, while at the same time, making efforts to protect the most vulnerable groups. The second priority is a comprehensive debt restructuring to address the debt overhang. The third priority is to further strengthen the financial sector, including through the establishment of a Banking Sector Reserve Fund as a backstopping mechanism for liquidity support, if needed. The authorities have also outlined a structural reform agenda to help strengthening fiscal management, improving the effectiveness and efficiency of the public sector, and removing obstacles to growth.

Request for a SBA. In the attached letter, the authorities are requesting a 36-month SDR 52.5 million (590 percent of quota) Stand-By Arrangement involving exceptional access. An initial purchase of SDR 22.2 million becomes available upon Board Approval of the arrangement, and the remainder phased thereafter, subject to quarterly reviews. The program entails risks given the prolonged period of relatively high primary fiscal surplus targets and weaknesses in implementation capacity. However, these are mitigated by signs of strong policy ownership, the fact that the bulk of the fiscal measures have already been implemented, and that technical assistance, including from CARTAC, will accompany the authorities' policy implementation.

Fund Relations. The last Article IV consultation was concluded on July 7, 2010. St. Kitts and Nevis has accepted the obligations of Article VIII, Sections 2, 3 and 4, and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions. Data provision is adequate for surveillance and for program monitoring, although significant areas for improvement remain. As part of the authorities' communications strategy, Fund staff (WHD and EXR) have reached out to various stakeholders to explain aspects of the economic program. Additional outreach—with EXR support—is planned once the program has been approved.

Discussions. A staff team comprising Messrs A. Schipke (head), K. Nassar and Ms. S. Ogawa (all WHD); Ms. A. Holland (MCM) and Ms. S. Jahan (SPR) visited St. Kitts and Nevis during May 16–June 3, 2011.The mission met with the Prime Minister/Finance Minister, the Cabinet, the ECCB Governor and staff, as well as other senior government officials and representatives of the private sector. Mr. W. Samuel (Regional Resident Representative) and Mr. M. Sajkunovic (OED) participated in the discussions.

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I. Background and Recent Developments

1. **St. Kitts and Nevis' tourism-dependent and highly indebted economy is recovering slowly from a two year-long recession, mainly due to a rebound in tourism.** St. Kitts and Nevis is one of 8 members of the ECCU, which has a quasi-currency board. Activity is estimated to have declined both in 2009 and 2010, due to a fall in tourism receipts and FDI-related construction activities. A mild recovery is underway in 2011, driven primarily by the outlook for the United States[1] (St. Kitts and Nevis' major export market) and the reopening of the Four Seasons Hotel in Nevis.[2] Inflationary pressures, which remained subdued in 2009 due to the output gap, have begun to intensify towards the end of 2010, as a result of oil and food price increases.

2. **Faced with increasing fiscal imbalances in 2010, the authorities started to implement a strong fiscal adjustment program at the end of the year.** As a result of the recession, the overall fiscal deficit widened from 3.8 percent of GDP in 2009 to 9.4 percent of GDP in 2010 and arrears accumulated on oil imports from Venezuela. In response to these developments the authorities implemented their home-grown reform program, which was in line with the 2010 Article IV recommendations. The yields from these revenue reforms and expenditure cuts have started to materialize in 2011. It was important for the authorities to demonstrate that they could implement the recommendations of the 2010 Article IV consultations prior to the start on any program discussion to show ownership. Demonstrating ownership was important to overcome the still very strong stigma in the society concerning Fund adjustment programs. On the revenue front, a VAT and excise tax reforms were implemented in November 2010. Other measures implemented include streamlining import duty exemptions, strengthening auditing and monitoring of duty free shops and introduction of an environmental levy on new vehicles. They also changed the structure of the Housing and Social Development Levy and

St. Kitts and Nevis: Fiscal Measures Already Implemented, 2010-11

	Implementation date
Implementation of VAT and excise tax	Nov-10
Imiplementation of unincorporated business tax	Nov-10
Streamline import duty exemptions	Nov-10
Increased auditing and monitoring of duty free shops	2010
Introduce environmental levy on new vehicles	2010
Change the structure of the housing and social development levy	Jan-11
Increase electricity tariff	Jan-11

Source: St. Kitts and Nevis authorities.

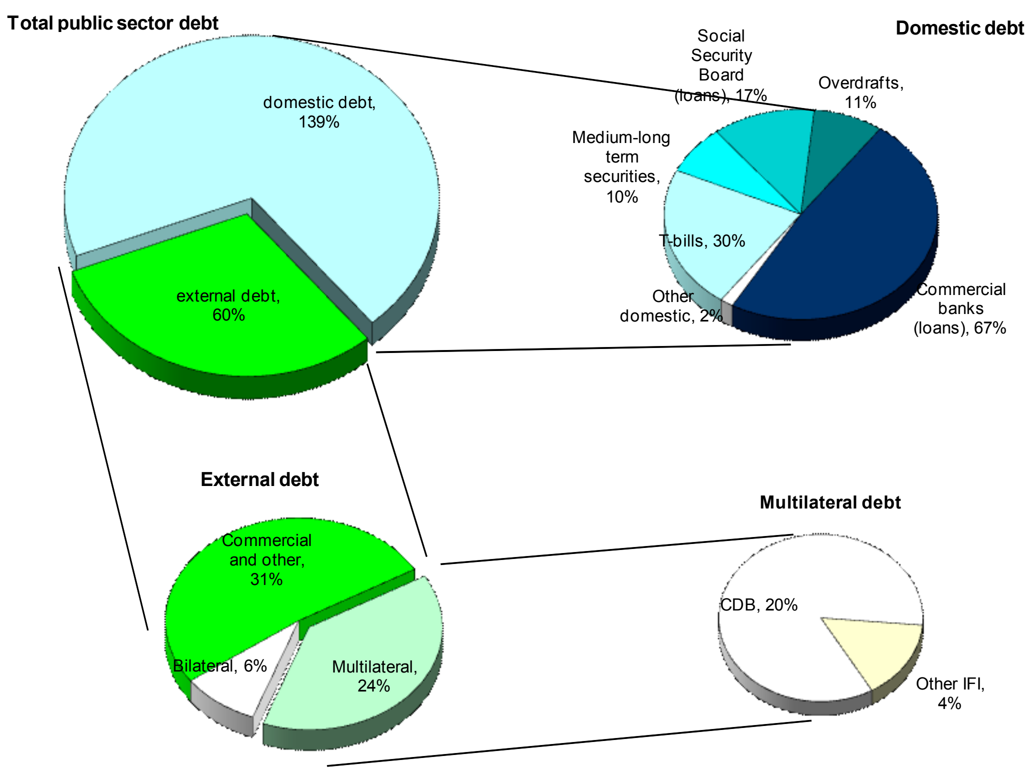
[1] According to the April 2011 *World Economic Outlook*, growth is expected to remain sluggish in the United States faced with household, fiscal, and financial sector balance sheet problems and still-high unemployment.

[2] The national accounts of the ECCU member states have been rebased with a base year of 2006. For St. Kitts and Nevis, this will result in a 28 percent increase in the 2009 nominal GDP, mainly reflecting a broader coverage of financial, communication, and offshore education services. Box 1 shows how the rebased GDP series will impact a number of key ratios. The rebasing exercise was accompanied by CARTAC technical assistance.

increased electricity tariffs by about 80 percent in January 2011. On the expenditure side, the authorities froze public wages, but increased capital expenditure to acquire two new electricity generators in order to stem island-wide black outs.

3. **Already high public debt levels increased further, elevating the vulnerability of the country and the broader ECCU.** St. Kitts and Nevis is one of 8 members of the ECCU and debt sustainability issues in any one country can spill over to other members of the union. Several factors contributed to the rapid accumulation of public debt, including fiscal deficits, assumption of both liabilities but also assets (mostly land) of the former state-owned sugar company, and exogenous shocks (mainly natural disasters). The authorities increasingly sought recourse to domestic financing, which has further increased the exposure of the banking sector to the government. Of the total public debt estimated at US$1.05 billion (about 200 percent of GDP), the banking sector held about 46 percent at end-December 2010. In addition to some cross-border holdings of bank assets and liabilities in the ECCU, there is a risk of spillovers since a fiscal crisis in one country could result in a general loss of confidence in the banking system and disruption in the interbank market. The Nevis Island Administration has been able to successfully rollover its 365-day T-bills in June on the Regional Government Securities Market (RGSM), following the authorities' announcement of their intention to restructure the public debt.

St. Kitts and Nevis: Public Sector Debt, Dec 2010
(In percent of GDP)



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

4. **Reflecting the recession, the external current account deficit improved in 2010.** Available data suggest that, while exports of goods and nonfactor services remained broadly stable, imports of goods and nonfactor services declined by about 6 percentage points of GDP. As a result, the external current account imbalance is estimated to have narrowed by about 6½ percentage points of GDP. The deficit was financed by official inflows, FDI, commercial banks, and a further accumulation of arrears on fuel imports from PetroCaribe (Venezuela).

5. **Available financial sector indicators at end-December 2010 point to a well-capitalized banking system, but some banks are highly exposed to the government.** The banking sector in St. Kitts and Nevis, with 352 percent of GDP in assets, is the third largest in the ECCU accounting for 20 percent of the total assets of the ECCU banking system. The banking system in St. Kitts and Nevis consists of seven commercial banks, two are indigenous banks (St. Kitts-Nevis-Anguilla National Bank (SKNA) and Bank of Nevis (BON), and the rest are branches of foreign banks and locally incorporated subsidiaries/branches of regional banks.[3] The banking sector's capital adequacy ratio, at 46 percent, remained well above ECCB's regulatory requirement of 8 percent. However, the high CAR might overstate the strength of the banks since some banks are highly exposed to the government and government debt is zero risk weighted. NPLs increased marginally to 5.5 percent, while provisioning for NPLs declined to 42 percent. At the same time, return on average assets (profitability) declined from 2.1 percent in 2009 to 1.1 percent in 2010, in part, reflecting both the recession and loss of a part of international banking business. The net liquid assets ratio of the overall banking sector declined slightly from 44 percent of total deposits at end-December 2009 to 42 percent at end-December 2010, but was still significantly above Eastern Caribbean Central Bank's (ECCB's) prudential guidelines of 20–25 percent.

St. Kitts and Nevis: Banking Sector, End-December 2010
(In percent of GDP)

	Number	Assets	Loans	Deposits
Banks	7	352	173	221

Source: ECCB

6. **Regulation of the non-bank financial sector has been strengthened, but continued efforts are needed to ensure effective supervision.** In addition to banking, St. Kitts and Nevis has a large non-bank financial sector comprising of one offshore bank, four credit unions (assets of EC$186 million or 10.2 percent of GDP), 16 insurance companies (assets of EC$815 million or 44.4 percent of GDP), nine money services companies, one development bank as well as a finance and mortgage company. The authorities have moved forward in strengthening the single regulatory unit for non-banks and, except for credit unions and cooperatives, implemented the harmonized ECCU legislation.

[3] They are branches of foreign incorporated Bank of Nova Scotia, Royal Bank of Canada, and CIDB First Caribbean International Bank; and locally incorporated foreign owned RBTT Bank (SKN) and RBTT Bank Caribbean (SKN).

7. **St. Kitts and Nevis has been very receptive to Fund's policy advice in recent years.** The authorities have actively sought Fund advice, particularly in the areas of fiscal policy, debt management, and the financial sector regulatory framework. Also, the authorities implemented all key fiscal revenue measures of their home-grown program, in line with the 2010 Article IV recommendations, including introduction of a VAT, implementation of an excise tax and electricity tariff reform. They have also actively sought CARTAC technical assistance in the areas of tax policy and administration, public expenditure management, and statistics. In addition, MCM fielded TA missions which have contributed to a strengthening of St. Kitts and Nevis' debt management unit.

II. Policy Discussions and Program for 2011/14

8. **Discussions focused on the overriding objective of achieving fiscal and debt sustainability and further strengthening the financial sector.** There was agreement that fiscal and debt sustainability needs to be restored through a combination of: (i) an ambitious medium-term fiscal consolidation, which the authorities have already begun to implement; (ii) a comprehensive debt restructuring to address the debt overhang; and (iii) further strengthening the financial sector. At the same time, the authorities intend to implement structural reform measures to underpin the fiscal efforts and boost confidence for private sector investment. The discussions, therefore, focused on policies that would contribute to achieving the authorities' macroeconomic objectives. In support of their policy framework, the authorities are requesting Fund financial assistance in the context of a 36-month SBA (Section III and Attachment 1).

9. **The authorities' policy framework aims at restoring macroeconomic stability and building a solid foundation for a sustained pick-up in growth and a stable financial system** (MEFP, paragraph 6).

- ***Real GDP growth.*** It is expected that St. Kitts and Nevis' economy will remain tourism dependent, while investment will enhance the quality of services and diversify the product to boost competitiveness and potential output. The framework is predicated on the expectation of a slow growth recovery, reaching 1½ percent of GDP in 2011 and picking up gradually to about 3½ percent in the medium term, broadly in line with the historical average. During 2011–12, the projections assume subdued tourism activities, given continued high unemployment rates in advanced economies (particularly in the U.S.), higher oil and food prices, and limited FDI inflows. The medium term growth outlook is predicated on a gradual recovery in the demand for tourism as well as an increase in private investment, as the public debt is brought under control.

- ***Inflation.*** Consumer price inflation is likely to reach 3.9 percent in 2011, reflecting WEO projections of international prices of oil and food. In the medium term, it is expected to gradually revert to its historical average of 2½ percent, anchored by the quasi-currency board arrangement.

- ***Balance of payments.*** The external current account deficit is projected to widen in 2011, with higher energy and food prices expected to more than offset the impact of fiscal consolidation. In the medium term, better global economic conditions and an improved investment climate are projected to result in a recovery in private inflows. By 2016, exports of goods and tourism receipts are projected to reach about 11.9 percent of GDP and 19.5 percent of GDP, respectively. As a result, the current account deficit is expected to narrow, reaching 21.4 percent of GDP in 2016. The overall balance of payments projections suggest that external financing gaps could reach an average of US$71.4 million (or about 12.2 percent of GDP) per year during 2011–13, reflecting the maturity profile of the public debt. The external financing gaps are expected to be covered by a comprehensive debt restructuring and support from International/Regional Financial Institutions, including Fund resources (discussed below).

St. Kitts and Nevis: Key Economic Indicators, 2009-16

			Projections					
	2009	2010	2011	2012	2013	2014	2015	2016
GDP real growth, at factor cost, in percent	-9.6	-1.5	1.5	1.8	2.5	3.0	3.5	3.5
CPI inflation, end of period, in percent	1.0	3.9	3.9	2.9	2.5	2.5	2.5	2.5
Primary fiscal balance, in percent of GDP	4.9	-0.5	5.0	5.4	6.4	4.5	4.4	4.3
Overall fiscal balance, in percent of GDP	-3.8	-9.4	-4.0	-3.2	-2.4	-4.5	-5.0	-5.6
Public debt, in percent of GDP	189.3	199.2	190.4	183.7	177.1	171.6	166.1	161.5
Current account balance, in percent of GDP	-34.0	-27.5	-29.5	-27.4	-25.2	-23.5	-22.1	-21.4
Gross international reserves, in US$ million	122.9	155.7	154.0	152.2	150.4	148.4	146.3	144.1

Sources: St. Kitt sand Nevis authorities; Eastern Caribbean Central Bank; and Fund staff estimates and projections.

A. Fiscal Policy

10. **A key element of the authorities' program is a strong fiscal adjustment effort to restore debt sustainability.** Consequently, the program supports the authorities' intention to achieve an annual average primary fiscal surplus of about 5.6 percent of GDP during 2011-13. Given the uncertainties on economic prospects and the availability of financing, the authorities have identified contingency measures amounting to 1.0 percentage point of GDP in case of a shortfall (MEFP, paragraph 8).

11. **The authorities agreed to a primary fiscal surplus target of 5 percent of GDP for 2011** (MEFP paragraph 8), from a deficit of 0.5 percent of GDP in 2010. On the revenue front, net yields from the VAT and the electricity tariff adjustment are expected to contribute to the improvement in revenue of 4.6 percentage points of GDP. On the expenditure front, reductions in the wage bill (0.7 percent of GDP) and capital expenditure and net lending (2.5 percent of GDP) are expected to more than offset increases in goods and services (1.0 percent of GDP) and transfers (1.2 percent of GDP), implying savings of 1.0 percent of GDP in relation to the 2010 outturn. The primary surplus target of 5 percent of GDP in 2011 includes grants (primarily from the European Union) similar to 2010. Despite these measures, there is a financing gap of 11.3 percent of GDP that is expected to be closed with

resources from St. Kitts and Nevis' development partners (including the IMF), as well as a comprehensive debt restructuring.

12. **The authorities intend to take expenditure measures in the context of the 2012 and 2013 budgets to reach primary fiscal surplus targets of 5.4 percent and 6.4 percent of GDP, respectively.** In order to realize additional savings in the medium term, the authorities are committed to freezing the wage bill and containing expenditure on goods and services for the next three years (MEFP, paragraph 8). Reduction in the wage bill is projected to contribute to savings of about 0.7 percentage points of GDP per annum in 2012 and 2013. They have also reaffirmed their commitment to implementing broad-based public expenditure reforms to rationalize the public sector wage structure and employment (MEFP, paragraph 13).

B. Debt Restructuring

13. **The mission and the authorities agreed that fiscal adjustment alone will not ensure debt sustainability** (MEFP, paragraph 10). It was recognized that attempts to achieve higher primary fiscal targets over the medium term would not be sustainable unless accompanied by a meaningful reduction in the public debt service burden, which will require burden sharing by all stakeholders. In this context, the authorities have retained debt and legal advisors, publicly announced to seek a comprehensive and substantive restructuring of the public debt, initiated discussions with creditors, and obtained financing assurances from the Paris Club. The authorities' strategy (Box 4), developed with the assistance of their debt advisors, emphasizes dialogue with all creditors and information transparency (including publishing relevant information on the debt restructuring on their website).

14. **A key element of the overall restructuring strategy is to resolve the collateralized debt of St. Kitts Sugar Manufacturing Corporation (SSMC) that was assumed by the federal government in 2005, through a debt-land swap.** The authorities have established a working group to consider associated legal, accounting, and regulatory issues. They are also taking steps to update the mapping and valuation of land and preparing a plan to establish a government-owned company to sell land.

15. **The goal of the restructuring exercise is to place public debt on a firmly downward trajectory in line with the ECCU's target of 60 percent of GDP by 2020.**[4] The restructuring is expected to alleviate the debt burden and close financing gaps beyond the program period. Steps have already been taken to resolve outstanding arrears to creditors and negotiations with other creditors have begun, with commercial creditors actively engaged in the dialogue.

[4] The debt-to-GDP target would remain the same under the rebased GDP.

C. Structural and Social Policies

16. **Other elements of the program include structural reforms aimed at strengthening public financial management, improving the effectiveness and efficiency of the public sector, and removing impediments to growth.** These measures include (i) improving public financial management; (ii) pension reform; (iii) civil service reform; and (iv) social safety net reforms.

- **Strengthening public financial management.** This is a key priority under the authorities' program as it supports and facilitates fiscal consolidation. To advance this agenda during the program period, structural benchmarks include: (i) strengthening financial management, reporting and auditing of line ministries; (ii) strengthening the procurement office; (iii) prioritizing investment projects; and (iv) preparing a medium-term macro framework to help frame annual budgets (MEFP, paragraph 12 and Table 3). Staff also welcomed the authorities' commitment to maintaining strict discipline among non-financial public enterprises (MEFP, paragraph 7).

- **Social Security Reform.** Actuarial reviews of the Social Security Scheme[5] indicate that the system could begin to run deficits in 2029 and deplete its reserves by 2041. The benefit-to-payments ratio increased in 2010, with contributions down 3 percent relative to 2009, reflecting the impact of the economic downturn. In line with recommendations of the ECCU-wide Pension Commission, the mission welcomed the authorities' commitment to strengthening the Social Security Scheme (MEFP, paragraph 14). This should include parametric reforms, with a view to strengthening and preserving the sustainability of the scheme.

- **Civil service reform.** St. Kitts and Nevis' public sector is large even by standards of small states. In order to underpin improvements in the fiscal position during the program period, the authorities will freeze the wage bill for the next three years. Given the signaling role of the public sector, this should also facilitate wage restraint in the private sector and lead to an improvement in competitiveness. The mission also welcomed the authorities' commitment to pressing ahead with plans to rationalize employment and the wage structure in the public sector, for which the authorities are seeking technical assistance from the World Bank.

- **Strengthening social safety nets.** There are indications that poverty has increased in recent years. A series of social programs has evolved over time in a piecemeal manner, which is both expensive and inefficient in targeting the needs of the most

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[5] See Tareq S., et. al. (2010), "St. Kitts and Nevis: Options for Expenditure Rationalization," FAD Technical Assistance Report.

vulnerable.[6] The mission welcomed the authorities' plans to streamline social safety nets (MEFP, paragraph 16) and to develop a social safety net reform strategy, seeking technical assistance from UNICEF and the World Bank. Staff underscored the need to sharpen the focus and coherence of poverty reduction initiatives to ensure that they are linked to the social development programs in the budget, consistent with overall macroeconomic and fiscal objectives.

D. Financial Sector Policies

17. **Maintaining the health of the financial sector will be critical.** The authorities agreed that maintaining banking sector stability during the debt-restructuring exercise will be paramount. Given the large exposure of domestic institutions to the government and the uncertainty surrounding the debt restructuring, the program envisages the establishment of a Banking Sector Reserve Fund (MEFP, paragraph 11) to provide temporary liquidity, if needed, to solvent indigenous banks that face liquidity constraints. The resources for the proposed Reserve Fund will be secured with IMF financing upon approval of the SBA, given St. Kitts and Nevis' balance of payments needs and the fact that it will implement an IMF-supported program to address these needs (first bullet, paragraph 20). The operation of this facility will be governed by a Memorandum of Understanding between the Government and the ECCB, which will administer the Reserve Fund on behalf of the Government (Annex IV). Preliminary stress tests were conducted, which will be updated by the time of the first review.

18. **Strengthening the oversight of non-bank financial institutions is a priority.** St. Kitts' Single Regulatory Unit (SRU) began operations in 2010. In the period ahead, the priorities are to strengthen regulatory oversight of the insurance business, private sector pension plans and credit unions. The SRU is currently implementing a new reporting structure based on CARTAC technical assistance, and has stepped up on-site inspections and tightened licensing provisions, especially for insurance related businesses. A new credit union and cooperative bill is expected to be approved by parliament in the second half of 2011. While the resolution process for BAICO appears to have stalled, a judicial manager has been appointed for CLICO in April 2011 and a report is expected by end-July 2011. The authorities were confident that there are sufficient assets in CLICO St. Kitts to cover its liabilities.

[6] See Tareq S., et. al., (2010).

E. Exchange Rate Assessment

19. **The different CGER methodologies indicate that the real exchange rate is somewhat overvalued** (Annex I). Staff analysis shows that the macro-economic balance (MB), external sustainability (ES), and equilibrium real effective exchange rate (REER) approaches indicate overvaluation. A simple average of the three approaches gives an overvaluation of 14.4 percent. Given the need to promote growth and strengthen the economy against vulnerabilities, labor market policies are critical. In this context, the authorities indicated that the freezing of public wage measures envisaged under the Fund-supported program will contribute to a reduction in real wage pressures, given the signaling effect of public sector wages for the private sector. This in turn should help relative price changes necessary to raise St. Kitts and Nevis' competitiveness.

III. Program Issues

20. **In support of their program, the authorities have requested a 36-month SBA from the Fund.** In view of the difficult economic situation, mounting actual and potential balance of payments needs, and precarious budget and debt position, a three-year SBA in an amount equivalent to 590 percent of quota or SDR52.5 million (about US$84.0 million, equivalent to 15 percent of GDP) would help cushion the adjustment effort and restore confidence by signaling sustainable macroeconomic policies. A Fund program would also be key to a Paris Club rescheduling/restructuring and for catalyzing additional financial resources.

- **Access and Financing:** Balance of payments projections based on fiscal adjustment suggest that financing gaps could reach US$73.0 million (or 13.1 percent of GDP) and US$90.0 million (or 15.3 percent of GDP) in 2011 and 2012, respectively. In addition, the Banking Sector Reserve Fund will require US$17.1 million. The financing gap is expected to be closed in large part through the debt restructuring. A Fund program of SDR 52.5 million would help fill the remaining part of the financing gap, along with resources from other multilateral/regional financial institutions. Given that St. Kitts and Nevis is a middle income country and not a member of the Inter-American Development Bank (IDB), additional sources of financing are limited. Both the World Bank and Caribbean Development Bank are currently exploring options to provide additional resources, which could serve as contingencies.

  Justification for Exceptional Access. Staff estimates that the dual impact of the global downturn and increase in food and fuel prices will lead to a cumulative balance of payments gap of US$220 million or 1,546 percent of quota over 2011–14. Also, there is a significant risk that uncertainty relating to the debt restructuring could lead to pressures on the capital account. In the case of large deposit outflows that would merit emergency liquidity support, exceptional balance of payments pressures in the capital account would arise. In the absence of new external financing, these outflows could produce a severe liquidity crunch, hence a disorderly fiscal adjustment. To preempt this eventuality, the Banking Sector Reserve Fund would act as a buffer for the banking system during the debt restructuring—generating a large up-front financing need, and thus providing a key justification for the authorities' request for exceptional access (Boxes 2 and 3). If the outflows were too large or persistent, however, the authorities would have to adopt corrective measures, in consultation with Fund staff.

- **Phasing and Use of Resources:** The phasing of the disbursement is substantially front-loaded, with about half of the total program funds proposed to be disbursed on approval of the SBA by the Board. The resources would address St. Kitts and Nevis' balance of payments problem and to help maintain the stability of the domestic financial system by providing the financing for the Banking Sector Reserve Fund.

- **Conditionality and Reviews:** Quarterly quantitative performance criteria focus on fiscal targets, in particular the overall fiscal balance of the central government. In addition, they include the standard continuous PC on contraction of short-term external debt and on the non-accumulation of domestic and external arrears. The authorities have implemented all prior actions including on initiating the debt restructuring process, and on a framework for monitoring expenditure arrears. Structural benchmarks include strengthening fiscal management, improving the effectiveness and efficiency of the public sector, and removing obstacles to growth. Quarterly reviews will help the authorities to establish a solid track record of fiscal performance, while seeking to contain risks to the Fund. All disbursements and outstanding balances from the use of the Banking Sector Reserve Fund will be reported to the Fund on a weekly basis.

21. **The proposed program is consistent with the Fund's arrears policy.** In staff's view, the authorities are in compliance with the Fund's policy on lending into arrears, based on their good faith efforts to engage with their private creditors. The authorities have initiated collaborative discussions with private creditors and are working on a debt restructuring strategy. The strategy focuses on information transparency, inter-creditor equity, and dialogue with all creditors and would therefore be consistent with Fund's lending into arrears policy. Staff judges that the authorities engage in good faith efforts to reach a collaborative agreement with these creditors. There has been an accumulation of arrears to non-Paris Club bilateral creditors and discussions have started with concerned creditors and the arrears are being addressed. Currently, there are no arrears to Paris Club creditors and Paris Club creditors have provided financing assurances.

22. **Under the Fund's safeguards assessment policy, the ECCB is subject to a full safeguard assessment under a four year cycle.** The most recent assessment was completed in July 2007, and concluded that the ECCB continues to have appropriate control mechanisms in place, which have strengthened since the first safeguards assessment was

completed in 2003. ECCB management places emphasis on good governance and sound controls, and has enhanced the bank's transparency and accountability since the last assessment, including through the publication of financial statements that comply with International Financial Reporting Standards. The next assessment will take place in the second half of 2011 and the ECCB has agreed to provide the necessary information.

23. **Additional financial and technical assistance would be required.** Given the limited capacity, the authorities have hired a macro advisor (financed by DFID) and formally requested financial and TA support from the WB (in the areas of budget support, civil service reform, social safety nets and natural disaster insurance), the IFC and EU (in the area of land management), and CARTAC (in the area of public financial management).

24. **Although a SBA with St. Kitts and Nevis carries significant risks, staff believes that there is a compelling case for a Fund program.**

- **Capacity to repay the Fund.** With strong program implementation including debt restructuring, St. Kitts and Nevis' capacity to repay the Fund is expected to be adequate (Table 9). Combined with the use of Fund resources from a previous Emergency Natural Disaster Assistance (ENDA), debt service to the Fund will peak in 2015 and 2016 at 4.7 percent of GDP[7] and 11.7 percent of exports of goods and services, but will significantly fall in the following years. Also, St. Kitts and Nevis has demonstrated to be able to make large debt service payments—14.7 percent of GDP on average over the past 5 years. The program is heavily frontloaded, but the debt restructuring will help put debt firmly on a downward trajectory. The staff judges that the authorities' commitment to the Fund program will deepen St. Kitts and Nevis' ability to access markets and strengthen public finances allowing the government to discharge its obligations in a timely manner. Also, the modalities of the Banking Sector Reserve Fund are set-up to ensure that a large part of the resources could be used only as liquidity support to solvent banks with a high probability of being repaid, therefore improving the capacity to repay.

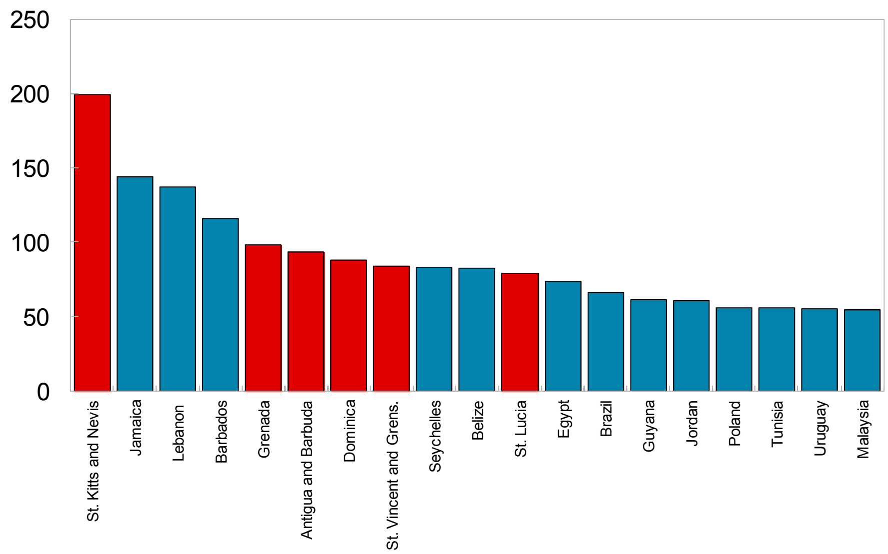
- **Debt sustainability.** Fiscal adjustment measures by themselves would not be sufficient to achieve public debt sustainability. At almost 200 percent of GDP, St. Kitts and Nevis' public debt level is unsustainably high by international standards.[8] The government has relied heavily on short-term financing, with T-bills

[7] Under the rebased GDP, the ratio will peak at 3.7 percent.

[8] St. Kitts and Nevis continued to have the highest public debt-to-GDP ratio in 2010 among the ECCU member countries even under the rebased GDP (once published: 156 percent of GDP). For the rest of the ECCU member countries, public debt-to-GDP ratios under the rebased GDP in 2010 stood at 97 percent in Grenada, 90 percent in Antigua and Barbuda, 75 percent in St. Lucia, 67 percent in Dominica, and 66 percent in St. Vincent and Grenadines.

(mainly 91-day) and overdrafts constituting about 30 percent of total domestic debt, which exposes the government to significant rollover risks. A Fund program prior to the rollover of T-bills in mid-August 2011 would help instill confidence and minimize rollover risks. Debt sustainability analysis shows that fiscal adjustment under the program will put the debt on a downward trajectory (reaching 162 percent of GDP or 126 percent of rebased GDP by 2016), but remain unsustainable and the debt dynamics are extremely susceptible to growth shocks. Therefore, to achieve debt sustainability, a comprehensive and substantive debt restructuring is paramount. Preliminary DSA calculations show that, combined with the fiscal adjustment, a comprehensive debt restructuring (including debt-land swaps) would bring the debt-to-GDP ratio down, in line with the ECCU's target level of 60 percent by 2020.

Public Sector Debt in Highly-Indebted Emerging Market Countries 1/
(End 2010, in percent of GDP)



1/ Debt ratio for ECCU countries are based on old GDP before rebasing.

- **Downside risks.** The largest risks are related to program implementation and additional adverse shocks, including natural disasters. Given the comprehensiveness of the program, capacity constraints could lead to implementation delays. To address this issue, the authorities have hired a macroeconomic advisor, financed by DFID, and are requesting TA to assist in land management from the IFC. Regarding exogenous shocks, the fiscal saving under the comprehensive debt restructuring will provide a buffer for some fiscal deviation without undermining the debt trajectory.[9] In addition, the authorities are seeking World Bank support to enhance insurance against

[9] In the last hurricane that hit the country in 2008, the primary surplus decline by 0.7 percentage points compared to the recent average. There is the risk that the fiscal deviation will exceed the buffer.

natural disasters.[10] While the authorities have been able to run large primary surpluses, there are risks of slippages. For these, the program contemplates contingency measures of about 1 percent of GDP per annum. Given the uncertainties during the debt restructuring, the Banking Sector Reserve Fund would address liquidity pressures in the banking sector and corresponding balance of payments financing needs. Since St. Kitts and Nevis is part of the ECCU, adverse developments in any of the other member states could lead to spillovers.

- **Upside risks**. First, consumers and businesses could view the fiscal consolidation measures as signaling a permanent reduction in their future tax burden and an increase in their permanent income, which could trigger higher private spending and growth. Second, fiscal consolidation and debt sustainability, if achieved, could reduce interest rates and stimulate economic growth above those projected under the program. In both cases, a virtuous cycle of growth and improved fiscal outcomes would accelerate the decline in the public debt-to-GDP ratio and reduce the economy's vulnerability to exogenous shocks.

IV. Staff Appraisal

25. **Following a two-year long recession, a gradual recovery of St. Kitts and Nevis' highly indebted economy is underway.** The economy is faced both with financing and liquidity difficulties. Given the structure of the public debt, heightened uncertainty in St. Kitts and Nevis, if not addressed, could spill over to economic activity in the rest of the ECCU through adverse feedback loops between sovereign risk and the banking system. The authorities' multipronged reform agenda, for which they are seeking support under the SBA, appropriately lays out a strategy to dramatically reduce the country's debt burden. The strategy is focused on (i) achieving ambitious primary fiscal surpluses; (ii) lowering the debt service burden; and (iii) further strengthening the financial sector. In addition, the structural reform agenda include initiatives aimed at strengthening the medium-term orientation of the public expenditure framework, which would underpin the fiscal efforts as well as address the overvaluation of the exchange rate and boost confidence for private sector investment. Based on the soundness of the policy framework, staff is confident of the prospects for a return to stable growth and a further strengthened financial system.

26. **The authorities have shown remarkable resolve in pursuing fiscal consolidation.** In the staff's view, both revenue and expenditure measures implemented under the authorities' home-grown program so far are in line with the 2010 Article IV consultation recommendations. On the revenue front, measures seek to broaden the tax base—to take advantage of the cyclical recovery—and decrease distortions by reducing exemptions. On the expenditure front, the extension of the wage-bill freeze for the next three years is important

[10] St. Kitts and Nevis is already a member of the Caribbean Catastrophic Risk Insurance Fund (CCRIF).

to secure fiscal savings. It would, however, be crucial to design and implement the civil service reform strategy as soon a possible in order to achieve the desired reduction in the wage-to-GDP ratio. Furthermore, the authorities' plans to enhance social safety nets to protect the most vulnerable will strengthen the program's credibility and sustainability.

27. **Notwithstanding the fiscal adjustment, a comprehensive and timely public debt restructuring is critical for the program to be fully financed and to achieve debt sustainability.** The authorities have taken a series of important steps that mark the first phase of implementing a comprehensive public debt restructuring strategy and approached creditors. The updated macroeconomic assessment reflected in this staff report will inform the next round of consultations—in particular, the specific restructuring options. Debt restructuring, including the debt-land swap, will complement the ongoing fiscal effort, ensuring burden sharing by all. Nevertheless, given the structure of the debt, ensuring the strength of the domestic financial system is a critical element in the design of the debt operation. Staff therefore supports the authorities' efforts to engage in open and transparent negotiations with creditors on a restructuring aimed at restoring public debt sustainability, consistent with St. Kitts and Nevis' long-term repayment capacity, while ensuring the viability of the domestic financial system. Staff is confident that the authorities will achieve a substantial debt restructuring sufficient to fill the remaining financing gaps, which will place the debt on a firmly downward trajectory toward the ECCU's debt-to-GDP target of 60 percent by 2020.

28. **Supervision of nonbank financial institutions needs to be stepped up.** The collapse of two important regional insurance companies (BAICO and CLICO) illustrates the weaknesses in the supervisory framework. While recent amendments to the Insurance Act and other legislation are welcome, technical assistance would be needed to strengthen the newly established Single Regulatory Unit through adequate training of regulators and supervisors. In the staff's view, better and timelier information on nonbank financial institutions would improve transparency and provide more effective market discipline to the sector.

29. **Staff considers the structural conditionalities under the program appropriate.** The comprehensive reforms to rationalize and enhance the efficiency and accountability of the public sector and improved controls over public sector employment and compensation are key to sustaining the fiscal adjustment beyond the program period. It is also imperative that the authorities maintain strict discipline among non-financial entities.

30. **The exceptional annual access under the proposed arrangement addresses St. Kitts and Nevis' balance of payments vulnerabilities, while keeping Fund exposure manageable.** First, there is a risk that due to uncertainty relating to the debt restructuring, there could be pressures on the capital account. Second, in the absence of Fund engagement, financing difficulties could lead to a depletion of external reserves, especially in the context of higher oil and food prices. The proposed level of access would, therefore, help leave

external reserves stable. Third, through prior actions, the authorities have shown their ability to deliver on their commitments.

31. **In view of St. Kitts and Nevis' balance of payments financing needs and the strong policies proposed by the authorities, the staff supports the authorities' request for an arrangement under the SBA in the amount of SDR 52.5 million.**

32. The staff recommends that the next Article IV consultation with St. Kitts and Nevis be held on the cycle for countries with a Fund arrangement, in accordance with the Decision on Article IV Consultation Cycles.

Box 1. Key Ratios Under the Rebased GDP

In line with other ECCU members, St. Kitts and Nevis' national accounts series is being rebased to base year 2006 from 1990. The rebased GDP will improve the current and constant price GDP series by using a wider range of data sources (including economic surveys and administrative data), changes in methodology, and improved estimation procedures. The rebased GDP series also reflect the inclusion of financial intermediation services indirectly measured, activities of offshore universities, and the output of owner-occupied housing. St. Kitts and Nevis rebased GDP series will lead to an increase in nominal GDP by 21 percent on average for 2000-09.[1]

Under the rebased GDP, the primary balance will amount to 3.9 percent of GDP (5.0 percent under the old GDP) in 2011 from -0.4 percent in the previous year (see table). The primary balance will average 4.6 percent of GDP in 2012–14. The fiscal adjustment will result in a debt-to-GDP ratio of about 113 percent by 2020, which is far short of the ECCU's debt target of 60 percent of GDP.

St. Kitts and Nevis: Key Indicators

	avg.		Projection						
	2005-09	2010	2011	2012	2013	2014	2015	2016	2020
			(In percent of rebased GDP)						
Total revenue and grants	32.3	30.9	34.5	33.3	33.6	31.5	31.5	31.4	…
Total expenditure	36.0	38.3	37.6	35.8	35.5	35.1	35.4	35.7	…
Overall balance	-3.7	-7.4	-3.1	-2.5	-1.9	-3.5	-3.9	-4.3	…
Primary balance	3.4	-0.4	3.9	4.2	5.0	3.5	3.4	3.4	…
Public sector debt	…	155.8	148.9	143.7	138.5	134.2	129.9	126.3	112.7
External current account	-21.1	-21.5	-23.1	-21.4	-19.7	-18.4	-17.3	-16.8	…
			(In percent of old GDP)						
Total revenue and grants	39.6	39.5	44.1	42.5	43.0	40.3	40.2	40.2	…
Total expenditure	44.2	49.0	48.1	45.8	45.4	44.8	45.2	45.7	…
Overall balance	-4.5	-9.4	-4.0	-3.2	-2.4	-4.5	-5.0	-5.6	…
Primary balance	4.1	-0.5	5.0	5.4	6.4	4.5	4.4	4.3	…
Public sector debt	…	199.2	190.4	183.7	177.1	171.6	166.1	161.5	144.1
External current account	-26.0	-27.5	-29.5	-27.4	-25.2	-23.5	-22.1	-21.4	…

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

[1] The increase for the ECCU overall averaged 17 percent.

Box 2. St. Kitts and Nevis: Magnitude of the Balance of Payment Needs

Proposed total access under the SBA equals SDR 52.5 million (590 percent of quota, or approximately US$84 million). The annual access under the program is expected to exceed the normal access limit of 200 percent of quota. This proposed access level would meet the large actual and potential balance of payments needs and to assist the authorities in the establishment of a banking sector reserve fund.

- **Balance of Payments Needs.** The global slowdown has severely affected the economy through its impact on tourist arrivals, FDI inflows, and remittances. The current surge in food and fuel prices has added to the balance of payments pressures. Staff estimates that the dual impact of the global downturn and increase in food and fuel prices will lead to a cumulative balance of payments gap of US$220 million or 1,546 percent of quota over 2011–14. While the debt restructuring is expected to close a substantive part of the gap, the remaining gap would be financed through Fund resources.

- **Banking Sector Reserve Fund.** The program envisions establishing an upfront Banking Sector Reserve Fund (US$17.1 million) to act as a buffer for the banking system during the debt restructuring process. The size of the reserve fund is equivalent to 15 percent of private deposits minus the net liquid assets of the indigenous banks in St. Kitts and Nevis[1] and the 2009 SDR allocation.

The program is expected to be heavily frontloaded. The balance of payments needs in the first year of the program will be 378 percent of quota—and to assist the authorities in the establishment of a banking sector reserve fund—exceeding the normal annual access limit of 200 percent of quota. In the remaining program years, the additional balance of payments needs amount to 212 percent of quota.

[1/] There are two indigenous banks in St. Kitts and Nevis.

Box 3. St. Kitts and Nevis: Exceptional Access Criteria

Staff's assessment is that St. Kitts and Nevis meets all four criteria for exceptional access. While total access under the proposed SBA (590 percent of quota) is within the cumulative access limit, the annual access will exceed the normal access limit of 200 percent of quota in the first year. Evaluation of the case for exceptional access is given as follows:

- **Criterion 1—The member is experiencing or has the potential to experience exceptional balance of payments pressures on the current account or the capital account, resulting in a need for Fund financing that cannot be met within the normal limits** Staff estimates that the dual impact of the global downturn and increase in food and fuel prices will lead to a cumulative balance of payments gap of US$220.1 million or 1,546 percent of quota over 201114. A significant portion of this gap will be filled through a comprehensive debt restructuring. The remaining gap will be filled through Fund financing (US$67 million or 470 percent of quota). In addition, the program envisions establishing upfront a Banking Sector Reserve Fund (US$17.1 million or 120 percent of quota) to act as a buffer for the banking system. Once the debt restructuring is complete and St. Kitts and Nevis regains access to private capital markets, the financing gap is expected to be filled in part through the Regional Government Securities Market (RGSM).

- **Criterion 2—A rigorous and systematic analysis indicates that there is a high probability that the member's public debt is sustainable in the medium term**. Debt sustainability for these purposes will be evaluated on a forward-looking basis and may take into account, inter alia, the intended restructuring of debt to restore sustainability. Staff's preliminary calculations indicate that there is a high probability that the debt is sustainable in the medium term. The fiscal saving under the comprehensive debt restructuring and the fiscal contingencies will provide a buffer for some fiscal deviation, including potential contingent liabilities without undermining the debt trajectory. The initial public and publicly-guaranteed debt amounted to 200 percent of GDP at end December 2010. This debt would be put firmly on a downward trajectory in line with the multipronged approach of the authorities consisting of (i) strong fiscal adjustment and (ii) comprehensive debt restructuring, including a debt-land swap. Preliminary debt sustainability calculations suggest that the implementation of these measures will help reduce the public debt to sustainable levels in the medium term

- **Criterion 3—The member has prospects of gaining or regaining access to private capital markets within the timeframe when Fund resources are outstanding**. St Kitts and Nevis has accessed private capital markets, including the Regional Government Securities Market (RGSM), in the past. The program will boost confidence in St Kitts and Nevis' ongoing debt sustainability and, once the debt restructuring is complete, facilitate a resumption of access to private bond markets, including through the RGSM, which would contribute to the broader goal of reducing government's dependence on the domestic financial sector.

- **Criterion 4—The policy program of the member provides a reasonably strong prospect of success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment.** The program entails risks given the magnitude of the targeted fiscal consolidation strategy and weaknesses in implementation capacity. However, these are mitigated by strong policy ownership, frontloading of key fiscal measures, on-going engagement with debt advisors, and the fact that St. Kitts and Nevis managed to run persistent fiscal primary surpluses in the past. On the structural front, institutional capacity to deliver the core elements of the program will be strengthened by on-going technical support from the Fund, CARTAC and other IFIs. Given the strong political support, staff believes that the program has a sufficient chance for success.

Box 4. Status of the Debt Restructuring

The authorities are working with their debt advisers to develop and implement a comprehensive debt restructuring with the overall objective of filling the identified financing gaps and placing the public debt on a firmly downward trajectory towards achieving the ECCU's target of 60 percent of GDP by 2020. Staff understands that all public debt is eligible for restructuring with the exception of multilateral debt and Treasury bills.

The debt restructuring is expected to take several months and involve a series of phases across both commercial and official sector creditors, including:

- Initial engagement of commercial creditors.
- Verification of creditor claims.
- Commencement of negotiations, including tabling of specific options.
- Agreement of terms of restructuring offer.
- Formal offering and completion of the debt exchange.

In parallel, the authorities are taking steps to resolve arrears with official sector creditors and engaging, along similar lines, with bilateral creditors.

The first phase of the process (initial engagement of commercial creditors), is in train. Initial indications suggest that key domestic creditors support the overall aims of the debt restructuring and will engage constructively. Dialogue with other creditors is also proceeding in line with expectations. Given the weak fiscal position, servicing of external commercial debt has been suspended pending the resolution of the debt restructuring. The consequent arrears will be treated in line with the Fund's lending into arrears policy.

Debt Restructuring: Steps Taken

-- Hiring of Debt and Legal Advisors

June 2011

-- Press release announcing the intention to seek debt restructuring

-- Creation of the website to provide information to creditors

-- Posting of the first presentation material updating the economic and financial situation

-- Initiation of bilateral discussions with key creditors

July 2011

-- Establishing a working group for debt-land swap issues

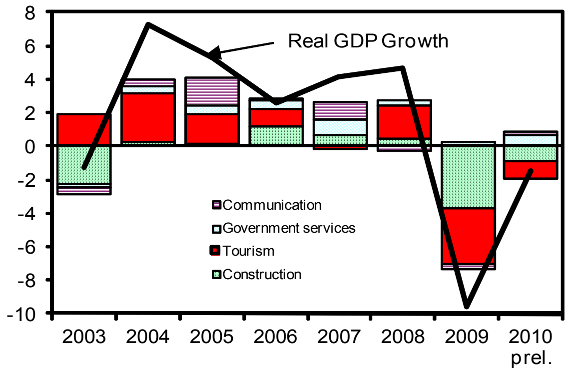
-- Received financing assurances including from Paris Club

A key element of the overall restructuring exercise is to resolve collateralized debt, in particular the debt of the state-owned St. Kitts Sugar Manufacturing Corporation (SSMC) that was assumed by the federal government on closure of the sugar industry in 2005. The authorities intend to include a debt-land swap as part of the debt restructuring.

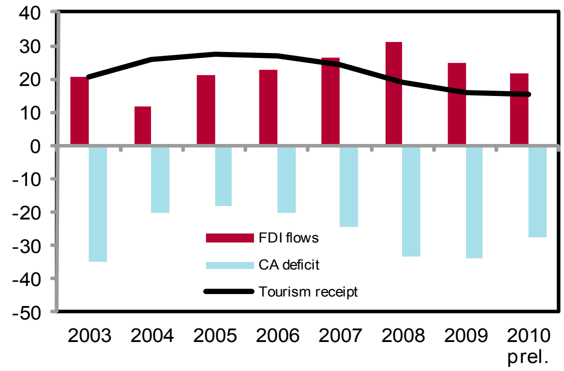
The Banking Sector Reserve Fund, operational once the SBA has been approved, will ensure that short-term liquidity constraints are mitigated.

Figure 1. St. Kitts and Nevis: Selected Economic Indicators

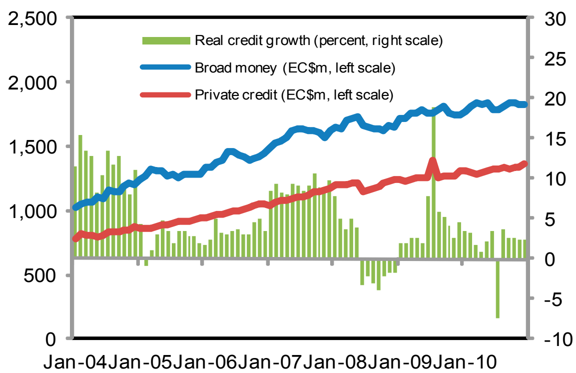
Economic activity contracted during both 2009 and 2010...



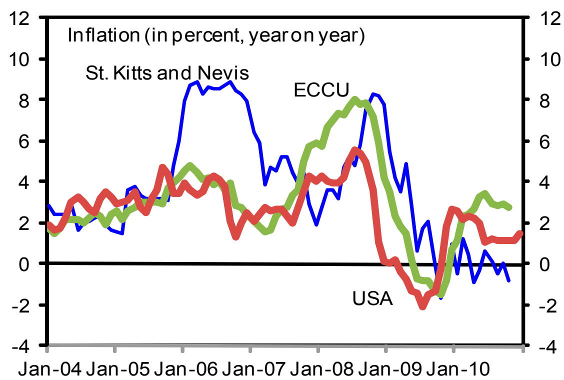
...reflecting declines in tourism receipts and FDI inflows (in percent of GDP).



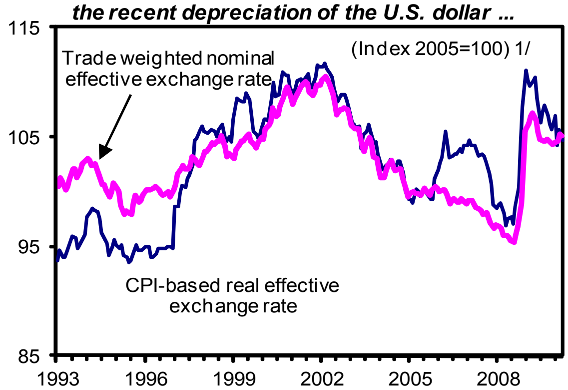
Real credit growth has also declined.



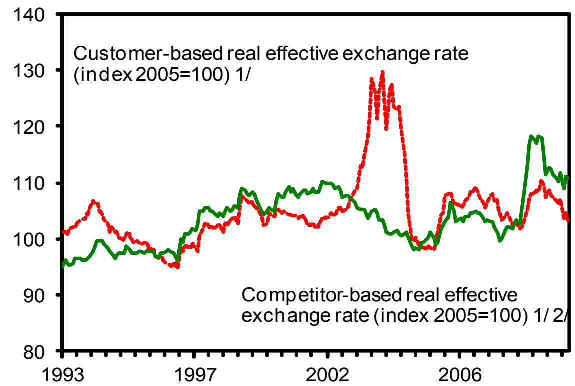
Inflationary pressures are mounting due to fuel and food price increases.



Following the sharp appreciation in late 2008, the CPI-based REER depreciated, reflecting the recent depreciation of the U.S. dollar ...

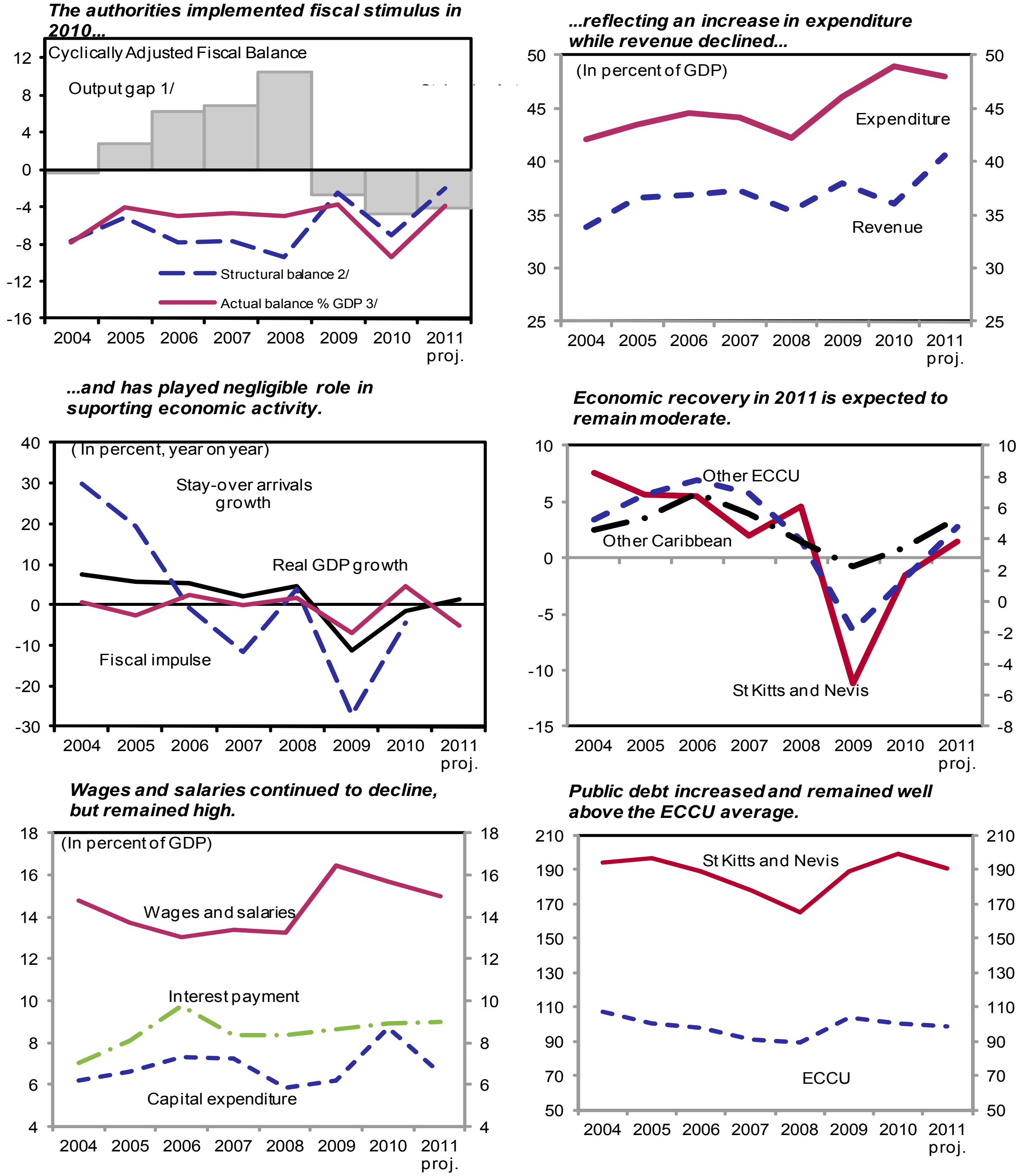


...as has the customer-based measure.



Sources: ECCB; Caribbean Tourism Organizations; St. Kitts and Nevis authorities; and Fund staff estimates and calculations.
1/ An increase (decrease) indicates and appreciation (depreciation).
2/ The spike in the competitor-based real exchange rate in 2002-03 was largely caused by the real effective depreciation and subsequent appreciation of the Dominican Republic's peso.

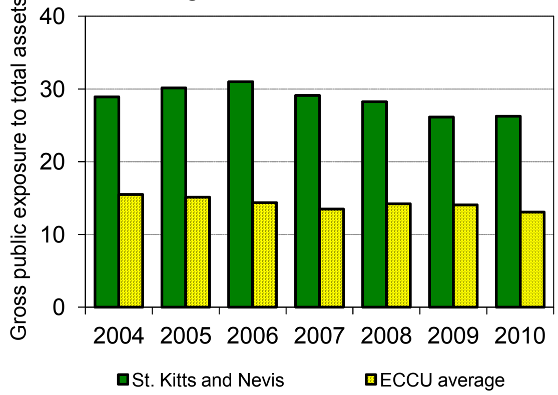
Figure 2. St. Kitts and Nevis: Policy Response



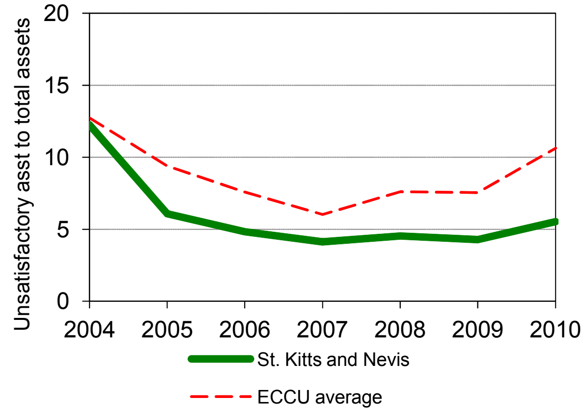
Sources: St. Kitts and Nevis authorities; ECCB; and Fund staff estimates and projections.
1/ Actual output is mesures as gross domestic product (GDP) at factor cost. The output gap is actual output less potential output, as a percent of potential output.
2/ The structural balance, expressed as a percent of potential output, is the budgetary position (overall balance) that would be observed if the level of actual output coincided with potential output.
3/ Actual balance is the overall balance (revenue and grants less expenditure), and is expressed as a percentage of actual output.

Figure 3. St. Kitts and Nevis: Banking System Developments, 2004–2010
(In percent)

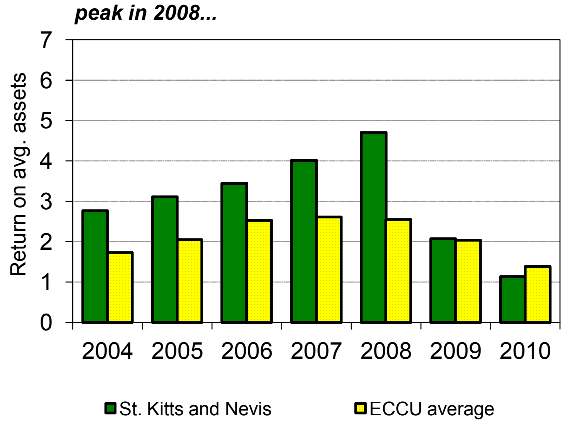
Gross public sector exposure is high in the banking sector.



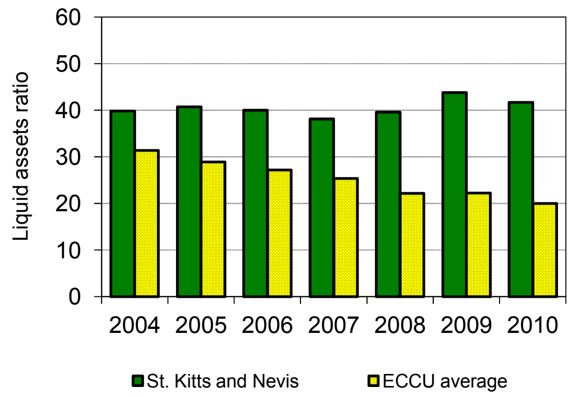
The unsatisfactory asset ratios increased moderately in 2010, but remained below the ECCU average 1/



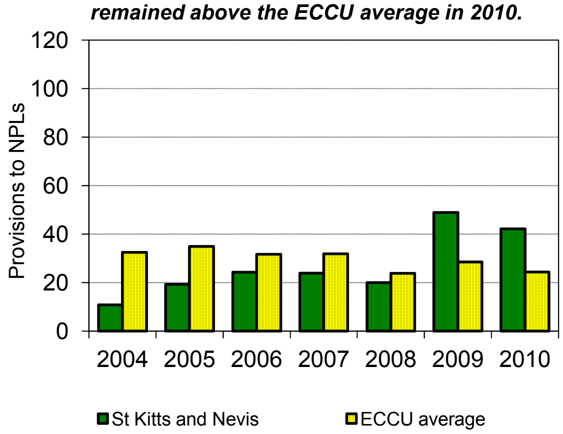
Profitability deteriorated further in 2010 from the peak in 2008...



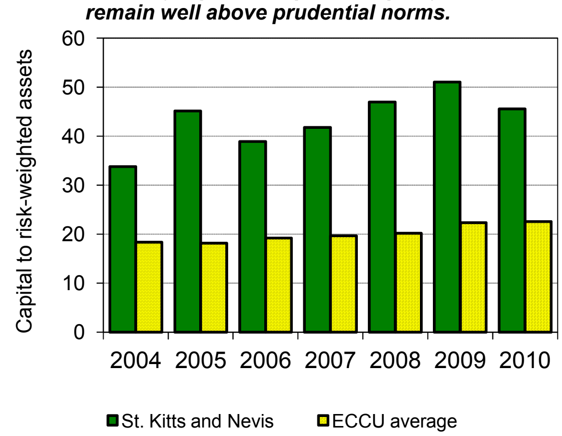
...while liquidity remained broadly stable.



Provisionings increased in 2009 and remained above the ECCU average in 2010.



Officially reported capital adequacy ratios remain well above prudential norms.



Source: ECCB
1/ Unsatisfactory assets include nonperforming loans, credits, and overdrafts.

Table 1. St. Kitts and Nevis: Basic Data

I. Social and Demographic Indicators

Area (sq. km)	269.4	Adult literacy rate (percent, 2009)	97.8
Population		Health and nutrition	
Total (thousands, 2001)	46.1	Calorie intake (per capita a day, 1996)	2,639
Rate of growth (percent per year, 2001)	0.02	Population per physician (thousand, 2000)	0.9
Density (per sq. km., 2001)	171.2	Access to safe water (percent, 2008)	99
Net migration rate (per thousand, 2002)	-9.8	AIDS incidence rate (per 100,000, 1998)	14
Population characteristics (2008)		Gross domestic product (2010)	
Life expectancy at birth (years)	73	(millions of U.S. dollars)	528
Infant mortality (per thousand live births)	14	(millions of E.C. dollars)	1,427
Under 5 mortality rate (per thousand)	15	(US$ per capita)	9,401

II. Economic and Financial Indicators, 2005–12

	2005	2006	2007	2008	2009	Prel. 2010	Proj. 2011	Proj. 2012
(Annual percentage change; unless otherwise specified)								
National income and prices								
Real GDP (factor cost)	5.2	2.6	4.2	4.6	-9.6	-1.5	1.5	1.8
Consumer prices, end-of-period	6.0	7.9	2.1	7.6	1.0	3.9	3.9	2.9
Real effective exchange rate (end-of-period)	2.7	2.2	-5.6	12.5	-3.9	0.8	...	...
Banking system								
Net foreign assets 1/	7.8	6.4	6.9	11.6	-8.4	1.1	4.1	2.2
Net domestic assets 1/	-1.2	7.3	5.0	-10.0	14.3	3.9	1.5	3.2
Of which								
Credit to private sector 1/ 2/	5.8	8.4	8.6	4.3	4.1	3.5	5.1	3.6
Broad money 2/	6.6	13.6	11.9	1.6	5.9	4.9	5.5	5.4
Of which								
Money	2.3	14.5	12.2	11.4	-3.1	14.9	5.5	5.4
Quasi-money	7.3	13.5	11.9	0.0	7.5	3.3	5.5	5.4
(In percent of GDP)								
Public sector 3/								
Primary balance	4.0	4.7	3.6	3.3	4.9	-0.5	5.0	5.4
Overall balance	-4.1	-5.0	-4.8	-5.0	-3.8	-9.4	-4.0	-3.2
Current revenue	36.7	36.8	37.3	35.4	38.0	36.0	40.6	40.1
Grants	2.7	2.7	2.1	1.8	4.7	3.6	3.5	2.5
Current expenditure	36.8	36.6	35.9	35.4	39.8	39.9	41.5	39.5
Capital expenditure and net lending	6.7	8.0	8.2	6.8	6.7	9.1	6.6	6.3
Foreign financing	-4.1	-0.4	-1.7	4.6	0.2	0.5	-3.8	-7.3
Domestic financing	17.7	6.0	2.0	-5.8	4.6	3.1	-3.8	0.5
Sale of assets	0.3	0.5	2.6	4.0	2.2	0.9	0.3	0.3
Change in External arrears	…	…	…	0.9	1.5	2.7	0.0	-4.7
Statistical discrepancy	-9.9	-1.1	1.8	1.2	-4.6	2.2	-	-
Financing gap 4/	…	…	…	…	…	…	11.3	14.4
Total public debt (end-of-period)	195.5	187.7	178.2	165.0	189.3	199.2	190.4	183.7
Of which								
Central government 5/	123.5	140.6	134.5	125.4	145.4	154.7	150.3	145.6
Public enterprises 5/	72.0	47.2	43.7	39.6	43.9	44.5	40.1	38.1
Public debt service (percent of total revenue and grants	32.5	34.3	30.1	28.4	25.2	28.7	30.1	49.0
External sector								
External current account balance	-18.3	-20.4	-24.3	-33.2	-34.0	-27.5	-29.5	-27.4
Trade balance	-27.7	-33.1	-35.4	-38.0	-37.5	-31.0	-35.0	-34.2
Services, net	15.6	15.7	13.9	7.2	6.1	5.7	6.5	7.3
Of which								
Tourism receipts	27.6	27.0	24.3	19.3	15.9	15.6	16.3	17.1
Transfers, net	5.4	6.6	5.7	5.8	5.5	5.7	6.1	6.0
Net capital inflow 6/	16.7	23.9	25.7	34.8	34.9	31.0	16.1	16.6
FDI (net)	21.2	22.7	26.2	31.2	24.8	21.6	21.7	21.8
External financing gap 4/	…	…	…	…	…	…	13.1	15.3
External public debt (end-of-period)	76.4	67.6	58.7	56.6	60.2	60.4	52.4	38.9
(In percent of exports of goods and nonfactor services)								
External public debt service	22.0	22.7	21.0	18.8	21.8	21.4	28.6	29.5
External public debt (end-of-period)	147.8	139.7	130.6	140.3	170.7	169.3	142.6	103.4
Memorandum items								
Gross international reserves, end-of-period								
(in millions of U.S. dollars)	71.5	88.6	95.6	110.2	122.9	155.7	154.0	152.2
(in percent of broad money)	15.1	16.5	15.9	18.0	19.0	22.9	21.5	20.2
Holding of SDRs, millions of U.S. dollars	…	…	…	…	13.3	12.8	12.8	12.8
Nominal GDP at market prices (in millions of EC dollar:	1,184.5	1,315.3	1,385.7	1,539.4	1,420.8	1,426.7	1,505.6	1,586.3

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

1/ In relation to broad money at the beginning of the period.
2/ Data from 2009 includes non-bank financial institutions and subsidiaries and affiliates as parts of private sector to reflect the changes in definitior in Jan 2009.
3/ Central government unless otherwise noted.
4/ The financing gap to be closed through debt restructuring and IMF financing.
5/ St. Kitts Sugar Manufacturing Corporation (SSMC) debt included in central government debt since 2006.
6/ Includes errors and omissions.

Table 2. St. Kitts and Nevis: Central Government Fiscal Operations, 2007–16 1/

(In millions of Eastern Caribbean dollars)

				Prel.	Proj.					
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Total revenue	**517.3**	**544.4**	**539.4**	**513.5**	**611.6**	**636.0**	**667.8**	**704.3**	**746.3**	**790.9**
Current revenue	517.3	544.4	539.4	513.5	611.6	636.0	667.8	704.3	746.3	790.9
Tax revenue	400.4	422.0	396.1	342.4	412.1	443.6	466.7	493.1	523.5	555.8
Taxes on income	116.0	135.7	148.7	92.6	87.6	92.3	97.0	102.4	108.8	115.5
Taxes on property	7.4	6.6	8.8	9.4	9.9	11.2	12.5	13.2	14.0	14.8
Taxes on domestic goods and consumption 2/	84.1	83.9	69.6	84.2	197.2	207.5	218.0	230.3	244.5	259.6
Taxes on international trade and transactions	192.9	195.9	169.0	156.3	117.4	132.6	139.3	147.2	156.2	165.9
Nontax revenue	116.8	122.5	143.3	171.0	199.5	192.4	201.1	211.2	222.8	235.1
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	**611.6**	**650.4**	**661.1**	**698.5**	**723.6**	**726.2**	**756.5**	**789.6**	**845.3**	**907.1**
Current expenditure	497.8	545.3	565.6	568.7	624.2	626.0	634.7	660.9	708.8	762.2
Wages and salaries	185.8	204.5	233.4	224.0	226.0	226.0	226.0	232.4	246.7	261.9
Goods and services	141.5	151.8	150.1	161.5	185.9	182.9	187.4	192.7	204.6	217.2
Interest	116.3	128.7	123.2	127.0	135.6	137.0	147.8	158.3	175.1	195.6
Domestic	77.3	86.8	81.6	86.7	100.9	110.3	128.6	142.8	158.9	178.2
Foreign	39.0	41.9	41.6	40.3	34.7	26.7	19.2	15.5	16.2	17.4
Transfers	54.1	60.3	58.9	56.2	76.8	80.1	73.4	77.6	82.3	87.4
Net lending	13.1	15.4	7.6	5.8	1.0	1.0	1.0	1.0	1.0	1.0
Capital expenditure	100.7	89.7	87.9	124.0	98.4	99.1	120.8	127.6	135.5	143.9
Current balance	**19.5**	**-0.9**	**-26.2**	**-55.3**	**-12.6**	**9.9**	**33.1**	**43.4**	**37.6**	**28.6**
Overall balance (before grants)	-94.3	-106.0	-121.7	-185.0	-112.0	-90.2	-88.7	-85.3	-99.0	-116.2
Grants	28.4	28.3	67.5	50.7	52.1	38.9	48.1	6.0	6.0	6.0
Overall balance (after grants)	**-65.9**	**-77.7**	**-54.2**	**-134.3**	**-59.9**	**-51.3**	**-40.6**	**-79.3**	**-93.0**	**-110.2**
Primary balance	50.5	51.0	69.0	-7.3	75.7	85.7	107.2	79.0	82.1	85.4
Financing	**41.2**	**58.7**	**120.0**	**102.4**	**-110.5**	**-177.6**	**-90.6**	**-12.4**	**-9.6**	**-68.1**
Net foreign financing	-23.0	70.3	2.9	6.8	-57.4	-115.7	-103.6	-30.5	-28.8	-31.6
Disbursements	24.9	104.3	32.2	41.9	6.9	4.0	2.5	1.4	0.3	0.0
Amortization	47.9	33.9	29.2	35.2	64.3	119.7	106.1	32.0	29.2	31.6
Net domestic financing	27.8	-88.5	64.7	44.2	-56.9	8.4	8.8	9.3	9.9	-46.4
Banking system	1.6	-133.9	24.6	3.7	0.0	0.0	0.0	0.0	0.0	0.0
Nonbanks and other	26.2	45.4	40.1	40.6	0.0	8.4	8.8	9.3	9.9	10.5
Principal repayments of SSMC debt	0.0	0.0	0.0	0.0	-56.9	0.0	0.0	0.0	0.0	-56.9
Sale/purchase of assets	36.4	62.3	31.4	12.8	3.9	4.0	4.2	8.8	9.3	9.9
External arrears		14.6	21.0	38.6	0.0	-74.2	0.0	0.0	0.0	0.0
Statistical discrepancy	**24.7**	**19.0**	**-65.8**	**31.9**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Financing gap	**0.0**	**0.0**	**0.0**	**0.0**	**170.4**	**228.8**	**131.2**	**91.7**	**102.6**	**178.4**
Memorandum items:										
GDP (market prices)	1,386	1,539	1,421	1,427	1,506	1,586	1,666	1,761	1,869	1,984
Stock of external arrears		15	36	74	74	0	0	0	0	0
Public sector debt (end of period)	2,469	2,540	2,689	2,842	2,867	2,915	2,951	3,021	3,105	3,205
Of which										
Central government	1,864	1,931	2,066	2,207	2,263	2,310	2,347	2,417	2,501	2,601
Domestic	1,292	1,293	1,422	1,543	1,625	1,825	1,940	2,020	2,110	2,212
External	572	638	643	664	638	486	407	397	391	389

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

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

2/ The sharp drop in international taxes and concurrent rise in taxes on domestic goods and services reflect the introduction of VAT in November 2010.

Table 3. St. Kitts and Nevis: Central Government Fiscal Operations, 2007–16 1/

(In percent of GDP)

				Prel.	Proj.					
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Total revenue	**37.3**	**35.4**	**38.0**	**36.0**	**40.6**	**40.1**	**40.1**	**40.0**	**39.9**	**39.9**
Current revenue	37.3	35.4	38.0	36.0	40.6	40.1	40.1	40.0	39.9	39.9
Tax revenue	28.9	27.4	27.9	24.0	27.4	28.0	28.0	28.0	28.0	28.0
Taxes on income	8.4	8.8	10.5	6.5	5.8	5.8	5.8	5.8	5.8	5.8
Taxes on property	0.5	0.4	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Taxes on domestic goods and consumption 2/	6.1	5.4	4.9	5.9	13.1	13.1	13.1	13.1	13.1	13.1
Taxes on international trade and transactions	13.9	12.7	11.9	11.0	7.8	8.4	8.4	8.4	8.4	8.4
Nontax revenue	8.4	8.0	10.1	12.0	13.3	12.1	12.1	12.0	11.9	11.8
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	**44.1**	**42.2**	**46.5**	**49.0**	**48.1**	**45.8**	**45.4**	**44.8**	**45.2**	**45.7**
Current expenditure	35.9	35.4	39.8	39.9	41.5	39.5	38.1	37.5	37.9	38.4
Wages and salaries	13.4	13.3	16.4	15.7	15.0	14.2	13.6	13.2	13.2	13.2
Goods and services	10.2	9.9	10.6	11.3	12.3	11.5	11.2	10.9	10.9	10.9
Interest	8.4	8.4	8.7	8.9	9.0	8.6	8.9	9.0	9.4	9.9
Domestic	5.6	5.6	5.7	6.1	6.7	7.0	7.7	8.1	8.5	9.0
Foreign	2.8	2.7	2.9	2.8	2.3	1.7	1.2	0.9	0.9	0.9
Transfers	3.9	3.9	4.1	3.9	5.1	5.1	4.4	4.4	4.4	4.4
Net lending	0.9	1.0	0.5	0.4	0.1	0.1	0.1	0.1	0.1	0.1
Capital expenditure	7.3	5.8	6.2	8.7	6.5	6.3	7.3	7.3	7.3	7.3
Current balance	**1.4**	**-0.1**	**-1.8**	**-3.9**	**-0.8**	**0.6**	**2.0**	**2.5**	**2.0**	**1.4**
Overall balance (before grants)	-6.8	-6.9	-8.6	-13.0	-7.4	-5.7	-5.3	-4.8	-5.3	-5.9
Grants	2.1	1.8	4.7	3.6	3.5	2.5	2.9	0.3	0.3	0.3
Overall balance (after grants)	**-4.8**	**-5.0**	**-3.8**	**-9.4**	**-4.0**	**-3.2**	**-2.4**	**-4.5**	**-5.0**	**-5.6**
Primary balance	3.6	3.3	4.9	-0.5	5.0	5.4	6.4	4.5	4.4	4.3
Financing	**3.0**	**3.8**	**8.4**	**7.2**	**-7.3**	**-11.2**	**-5.4**	**-0.7**	**-0.5**	**-3.4**
Net foreign financing	-1.7	4.6	0.2	0.5	-3.8	-7.3	-6.2	-1.7	-1.5	-1.6
Drawings	1.8	6.8	2.3	2.9	0.5	0.3	0.1	0.1	0.0	0.0
Amortization	3.5	2.2	2.1	2.5	4.3	7.5	6.4	1.8	1.6	1.6
Net domestic financing	2.0	-5.8	4.6	3.1	-3.8	0.5	0.5	0.5	0.5	-2.3
Banking system	0.1	-8.7	1.7	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Nonbanks and other	1.9	2.9	2.8	2.8	0.0	0.5	0.5	0.5	0.5	0.5
Principal repayments of SSMC debt	0.0	0.0	0.0	0.0	-3.8	0.0	0.0	0.0	0.0	-2.9
Sale/purchase of assets	2.6	4.0	2.2	0.9	0.3	0.3	0.3	0.5	0.5	0.5
External arrears	…	0.9	1.5	2.7	0.0	-4.7	0.0	0.0	0.0	0.0
Statistical discrepancy	**1.8**	**1.2**	**-4.6**	**2.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Financing gap	…	…	…	…	**11.3**	**14.4**	**7.9**	**5.2**	**5.5**	**9.0**
Memorandum items:										
Stock of unpaid fuel expenses	…	0.9	2.5	5.2	4.9	0.0	0.0	0.0	0.0	0.0
Public sector debt (end of period)	178.2	165.0	189.3	199.2	190.4	183.7	177.1	171.6	166.1	161.5
Of which										
Central government	134.5	125.4	145.4	154.7	150.3	145.6	140.8	137.3	133.8	131.1
Domestic	93.2	84.0	100.1	108.2	108.0	115.0	116.4	114.7	112.9	111.5
External	41.3	41.4	45.3	46.5	42.4	30.6	24.4	22.6	20.9	19.6

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

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

2/ The sharp drop in international taxes and concurrent rise in taxes on domestic goods and services reflect the introduction of VAT in November 2010.

Table 4. St. Kitts and Nevis: Structure of the Public Debt, 2005–10 1/

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

	2005	2006	2007	2008	2009	2010
Total stock of debt	**857.8**	**914.6**	**914.4**	**940.9**	**996.0**	**1052.8**
(In percent of GDP)	195.5	187.7	178.2	165.0	189.3	199.2
Total external debt (by debtor)	**335.1**	**329.3**	**301.3**	**322.9**	**316.9**	**319.2**
St. Kitts Government	177.2	181.8	171.0	199.8	202.0	215.8
Nevis Island Administration	47.0	44.1	40.8	36.4	36.3	30.0
Public enterprises 2/	110.9	103.4	89.5	86.7	78.7	73.4
Total external debt (by creditor)	**335.1**	**329.3**	**301.3**	**322.9**	**316.9**	**319.2**
Bilateral	39.9	44.6	42.5	38.0	33.8	30.1
Taiwan, Province of China	15.3	24.0	24.9	23.0	21.1	18.9
Kuwait	9.9	8.4	7.7	6.2	4.9	4.5
Other	14.7	12.3	9.9	8.8	7.8	6.6
Multilateral	98.9	105.6	106.6	115.0	119.8	124.3
CDB	79.8	84.3	86.1	95.2	97.4	105.3
World Bank	13.0	14.6	14.8	14.6	13.5	11.1
Other	6.1	6.7	5.8	5.2	9.0	7.9
Commercial and other	196.4	179.0	223.4	234.8	221.6	164.8
Total domestic debt (by debtor)	**522.7**	**585.3**	**613.0**	**618.0**	**679.1**	**733.6**
St. Kitts Government	281.1	418.8	419.2	406.8	439.7	467.4
Nevis Island Administration	36.6	40.2	59.2	72.3	87.0	104.2
Public enterprises 2/	204.9	126.3	134.6	138.9	152.3	162.0
Total domestic debt (by instruments)	**522.7**	**585.3**	**613.0**	**618.0**	**679.1**	**733.6**
Loans and advances	333.7	404.7	448.4	410.6	458.8	505.6
Treasury bills	152.4	144.0	126.9	137.4	151.4	161.1
Debentures	8.8	10.3	10.3	42.4	42.3	39.9
Regional government securities market	15.7	15.7	15.7	15.4	15.4	15.4
Other	12.1	10.6	11.8	12.1	11.2	11.6
Total domestic debt (by creditor)	**522.7**	**585.3**	**613.0**	**618.0**	**679.1**	**733.6**
ECCB	6.2	6.4	6.9	4.7	11.0	10.4
Commercial banks	362.5	424.0	439.4	427.0	454.6	487.6
of which: overdrafts	473.0	855.3	847.5	875.1	0.0	0.0
Social security	79.6	83.5	84.5	94.5	110.1	114.1
Other	74.4	71.5	82.3	91.9	103.4	121.4
Memorandum items (in percent of GDP):						
Debt of former St. Kitts Sugar Manufacturing Corporation	24.2	26.6	25.2	22.6	24.5	24.4
Public sector debt excluding debt to social security system	171.3	161.2	152.9	142.4	164.7	174.8
Net assets of Social Security Board	64.0	63.3	65.7	64.4	75.2	80.2

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

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

2/ Including SSMC in 2005.

Table 5. St Kitts and Nevis: Balance of Payments, 2007–16

				Prel.	Proj.					
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
	(In millions of Eastern Caribbean dollars)									
Current account	**-336.8**	**-510.8**	**-482.7**	**-391.9**	**-444.8**	**-434.1**	**-419.9**	**-413.3**	**-413.8**	**-425.2**
Trade balance	-490.9	-585.6	-532.2	-442.0	-526.3	-542.1	-552.0	-568.4	-589.1	-623.6
Exports, f.o.b.	155.8	186.2	145.2	157.0	170.2	180.6	192.8	206.3	220.6	236.1
Imports f.o.b.	-646.7	-771.8	-677.4	-598.9	-696.5	-722.7	-744.8	-774.7	-809.7	-859.7
Of which										
Mineral fuel	-39.5	-62.2	-27.2	-34.7	-47.1	-47.5	-46.4	-45.9	-46.1	-46.1
Services and transfers (net)	154.1	74.7	49.5	50.1	81.6	108.0	132.1	155.1	175.3	198.4
Services (net)	192.6	110.7	86.8	81.5	97.4	115.6	130.7	148.9	169.5	193.4
Services (receipts)	467.1	435.0	356.1	352.0	382.8	416.3	446.6	482.6	523.8	569.5
Of which										
Tourism receipts	336.9	297.2	225.4	222.2	245.2	270.5	292.7	319.9	351.2	386.4
Services (payments)	-274.4	-324.3	-269.3	-270.4	-285.4	-300.7	-315.9	-333.7	-354.3	-376.1
Factor income (net)	-117.3	-125.4	-115.4	-113.2	-107.0	-102.5	-97.6	-97.0	-101.6	-106.7
Of which										
Public sector interest	-52.5	-55.6	-53.3	-50.8	-41.2	-33.1	-24.8	-20.1	-19.9	-19.9
Transfers (net)	78.8	89.4	78.2	81.7	91.2	94.9	99.0	103.2	107.4	111.7
Official (net)	12.4	12.4	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1
Private (net)	66.4	77.0	80.3	83.8	93.3	97.0	101.1	105.3	109.5	113.8
Capital and financial account	**271.6**	**479.2**	**552.5**	**441.6**	**242.7**	**262.7**	**281.8**	**369.9**	**374.7**	**365.3**
Official	-13.2	33.5	-11.9	42.5	9.8	-57.8	-49.6	-21.2	-14.8	-8.0
Capital transfers (net)	27.8	49.1	11.9	50.7	52.1	38.9	48.1	6.0	6.0	6.0
Long-term borrowing (net)	-41.0	-15.5	-23.8	-8.2	-42.3	-96.7	-97.7	-27.2	-20.8	-14.0
Disbursements	37.4	45.7	32.3	49.7	74.6	46.4	27.1	22.6	23.2	35.6
Amortization	78.4	61.3	56.0	57.9	116.9	143.1	124.8	49.8	44.0	49.7
Private capital	284.8	445.6	564.4	399.1	232.9	320.5	331.4	391.1	389.6	373.3
Capital transfers (net)	10.5	11.1	11.9	12.3	12.2	12.1	12.0	11.9	11.7	11.5
Foreign direct investment (net)	363.1	480.3	353.0	307.8	326.0	346.0	362.6	386.4	410.8	441.2
Portfolio investment (net)	-35.0	28.3	-28.4	-28.4	-28.4	-28.4	-28.4	-28.4	-28.4	-28.4
Commercial banks	-80.5	-149.6	148.7	69.7	-79.2	-46.5	-39.5	-39.3	-47.3	-81.3
Other private (net)	26.7	75.5	79.3	37.7	2.3	37.3	24.7	60.6	42.8	30.3
Errors and omissions	84.4	56.5	-56.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	**19.1**	**24.8**	**13.3**	**49.7**	**-202.1**	**-171.3**	**-138.1**	**-43.4**	**-39.1**	**-59.9**
Overall financing	**-19.1**	**-24.8**	**-13.3**	**-49.7**	**202.1**	**171.3**	**138.1**	**43.4**	**39.1**	**59.9**
Net international reserves	**-19.1**	**-39.4**	**-34.3**	**-88.4**	**4.5**	**2.5**	**0.5**	**3.0**	**5.6**	**6.0**
Gross reserve (increase = -)	-19.1	-39.4	-43.2	-88.4	4.5	4.8	5.0	5.3	5.6	6.0
IMF reserve liabilities (purchase = +	0.0	0.0	9.0	0.0	0.0	-2.3	-4.5	-2.3	0.0	0.0
Change in arrears		14.6	21.0	38.6	0.0	-74.2	0.0	0.0	0.0	0.0
Financing gap	…	…	…	…	197.5	243.1	137.6	40.4	33.5	54.0
IMF financing 1/					99.1	54.6	19.1	1.6	-59.8	-74.2
Residual financing gap					98.4	188.5	118.5	38.8	93.2	128.2
Banking Sector Reserve Fund					46.1	0.0	0.0	-5.8	-23.1	-17.3
	(In percent of GDP)									
Current account	-24.3	-33.2	-34.0	-27.5	-29.5	-27.4	-25.2	-23.5	-22.1	-21.4
Exports of goods and nonfactor service	44.9	40.4	35.3	35.7	36.7	37.6	38.4	39.1	39.8	40.6
Merchandise exports	11.2	12.1	10.2	11.0	11.3	11.4	11.6	11.7	11.8	11.9
Of which										
Sugar	-	-	-	-	-	-	-	-	-	-
Nonfactor services	33.7	28.3	25.1	24.7	25.4	26.2	26.8	27.4	28.0	28.7
Of which										
Tourism receipts	24.3	19.3	15.9	15.6	16.3	17.1	17.6	18.2	18.8	19.5
Imports of goods and nonfactor service	-66.5	-71.2	-66.6	-60.9	-65.2	-64.5	-63.6	-63.0	-62.3	-62.3
Merchandise imports	-46.7	-50.1	-47.7	-42.0	-46.3	-45.6	-44.7	-44.0	-43.3	-43.3
Nonfactor services	-19.8	-21.1	-19.0	-19.0	-19.0	-19.0	-19.0	-19.0	-19.0	-19.0
Foreign direct investment (net)	26.2	31.2	24.8	21.6	21.7	21.8	21.8	21.9	22.0	22.2
Stock of external arrears		0.9	2.5	4.2	3.7	0.0	0.0	0.0	0.0	0.0
External financing gap	…	…	…	…	13.1	15.3	8.3	2.3	1.8	2.7
External public debt	58.7	56.6	60.2	60.4	52.4	38.9	31.2	28.0	25.2	23.1
	(Annual percentage change)									
Merchandise exports	-1.0	19.5	-22.0	8.1	8.4	6.1	6.7	7.0	6.9	7.0
Tourism receipts	-5.2	-11.8	-24.1	-1.4	10.3	10.3	8.2	9.3	9.8	10.0
Merchandise imports	9.1	19.3	-12.2	-11.6	16.3	3.8	3.1	4.0	4.5	6.2
Terms of trade	-1.6	-3.1	4.6	-4.5	-5.5	0.9	1.6	1.5	0.9	0.9
	(In percent of exports of goods and nonfactor services)									
External public debt	130.6	140.3	170.7	169.3	142.6	103.4	81.3	71.5	63.4	56.8
External debt service	21.0	18.8	21.8	21.4	28.6	29.5	23.4	10.1	8.6	8.6
Of which										
Interest	7.9	8.6	10.1	9.5	7.1	5.3	3.7	2.8	2.6	2.4

Sources: ECCB; and Fund staff estimates and projections.
1/ Negative indicates repayment to the IMF.

Table 6. St. Kitts and Nevis: Monetary Survey, 2006–12

	2006	2007	2008	2009	Prel. 2010	Proj. 2011	Proj. 2012
	(In millions of EC$)						
Net foreign assets	**562.1**	**661.7**	**850.7**	**711.5**	**730.1**	**804.8**	**846.5**
ECCB imputed reserves	239.1	258.3	297.6	331.9	420.3	415.8	411.0
Crown agents	10.6	10.6	10.6	10.6	10.6	10.6	10.6
Commercial banks	312.3	392.8	542.4	369.0	299.2	378.4	424.9
Net domestic assets	**889.7**	**963.0**	**799.8**	**1036.4**	**1103.7**	**1130.4**	**1192.5**
Net credit to the public sector	392.1	393.4	366.3	390.9	407.5	341.0	333.1
Net credit to central government	422.5	464.8	337.2	427.4	433.4	376.5	376.5
Net credit to St. Kitts	397.5	412.5	263.0	298.9	259.2	202.3	202.3
Net credit to Nevis	25.0	52.2	74.2	128.5	174.3	174.3	174.3
Net credit to non-financial public sector	-30.3	-71.4	29.1	-36.5	-26.0	-35.6	-43.5
Credit to the private sector 1/	1048.9	1173.4	1242.7	1311.1	1371.7	1464.9	1534.8
Net other assets 2/	-551.3	-603.8	-809.2	-665.6	-675.5	-675.5	-675.5
Broad money (M2)	**1451.8**	**1624.7**	**1650.5**	**1747.9**	**1833.8**	**1935.2**	**2039.0**
Money	201.5	226.0	251.7	243.9	280.2	295.6	311.5
Currency in circulation	55.1	56.2	70.1	78.3	101.1	106.6	112.4
Demand deposits 1/	146.3	169.8	181.6	165.5	179.1	189.0	199.1
Quasi-money 1/	1250.3	1398.6	1398.8	1504.0	1553.7	1639.6	1727.5
Savings deposits	521.8	565.6	602.6	638.5	638.4	673.7	709.8
Time deposits	309.5	377.6	398.1	491.0	552.4	582.9	614.2
Foreign currency deposits	419.0	455.4	398.1	374.5	362.8	382.9	403.4
	(Percentage change relative to broad money at beginning of period)						
Net foreign assets	6.4	6.9	11.6	-8.4	1.1	4.1	2.2
Net domestic assets	7.3	5.0	-10.0	14.3	3.9	1.5	3.2
Net credit to the public sector	5.8	0.1	-1.7	1.5	0.9	-3.6	-0.4
Net credit to central government	5.5	2.9	-7.9	5.5	0.3	-3.1	0.0
Net credit to non-financial public sector	0.3	-2.8	6.2	-4.0	0.6	-0.5	-0.4
Credit to the private sector 1/	8.4	8.6	4.3	4.1	3.5	5.1	3.6
Net other assets 2/	-7.0	-3.6	-12.6	8.7	-0.6	0.0	0.0
	(Annual percentage change)						
Broad money (M2)	13.6	11.9	1.6	5.9	4.9	5.5	5.4
Money	14.5	12.2	11.4	-3.1	14.9	5.5	5.4
Currency in circulation	10.5	2.0	24.8	11.7	29.0	5.5	5.4
Demand deposits 1/	16.1	16.1	6.9	-8.8	8.2	5.5	5.4
Quasi-money 1/	13.5	11.9	0.0	7.5	3.3	5.5	5.4
Savings deposits	10.8	8.4	6.5	6.0	0.0	0.0	0.0
Time deposits	7.6	22.0	5.4	23.3	12.5	0.0	0.0
Foreign currency deposits	22.2	8.7	-12.6	-5.9	-3.1	0.0	0.0
Credit to the private sector (in nominal terms)	11.5	11.9	5.9	5.5	4.6	6.8	4.8
Credit to the private sector (in real terms)	3.3	9.6	1.4	4.5	0.7	2.8	1.8
Memorandum items:							
Income velocity of money	6.5	6.1	6.1	5.8	5.1	5.1	5.1
Income velocity of broad money	0.9	0.9	0.9	0.8	0.8	0.8	0.8
Private sector credit/GDP (in percent)	79.7	84.7	80.7	92.3	96.1	97.3	96.8
Foreign currency deposits/GDP (in percent)	31.9	32.9	25.9	26.4	25.4	25.4	25.4

Sources: ECCB; and Fund staff estimates and projections.

1/ Data up to 2008 is revised to reflect the changes in the definition of private sector in January 2009.
2/ Includes capital accounts.

Table 7. St. Kitts and Nevis: Indicators of External and Financial Vulnerability, 2005–10

(12-month percentage change, unless otherwise stated)

	2005	2006	2007	2008	2009	Prel. 2010
External indicators						
Merchandise exports	8.0	-8.2	-1.0	19.5	-22.0	8.1
Merchandise imports	15.2	18.6	9.1	19.3	-12.2	-11.6
Terms of trade deterioration (-)	-3.5	-4.4	-1.6	-3.1	4.6	-4.5
Tourism earnings	18.0	8.7	-5.2	-11.8	-24.1	-1.4
Current account balance (percent of GDP)	-18.3	-20.4	-24.3	-33.2	-34.0	-27.5
Capital and financial account balance (percent of GDP) 1/	12.0	17.8	19.6	31.1	38.9	31.0
Of which						
Foreign direct investment	21.2	22.7	26.2	31.2	24.8	21.6
Gross international reserves of the ECCB						
In millions of U.S. dollars	600.8	696.0	764.5	759.0	800.8	927.3
In percent of broad money	17.9	18.6	18.6	17.0	17.5	19.9
Commercial banks' net foreign assets (millions of U. S. dollars)	102.6	115.7	145.5	200.9	136.7	110.8
External public debt (percent of GDP)	76.4	67.6	58.7	56.6	60.2	60.4
External debt service (in percent of exports of goods and services	22.0	22.7	21.0	18.8	21.8	21.4
Of which						
Interest	9.5	8.8	7.9	8.6	10.1	9.5
Nominal exchange rate (E.C. dollars per U.S. dollar, end period)	2.7	2.7	2.7	2.7	2.7	2.7
Real effective exchange rate depreciation (-), end period 2/	2.8	2.2	-5.5	12.8	-3.8	-5.6
Financial indicators						
Broad money	6.6	13.6	11.9	1.6	5.9	4.9
Credit to the private sector	7.9	11.5	11.9	5.9	5.5	4.6
Share of nonperforming assets to total assets of banks (percent)	8.1	6.7	5.7	5.5	4.1	5.3
Provisions for loan losses/nonperforming assets (percent)	19.3	24.3	23.9	20.0	48.9	42.2
Provisions for loan losses/total loans (percent)	1.2	1.2	1.0	0.9	2.1	2.3
Gross government exposure/total assets (percent)	30.1	31.0	29.1	28.2	26.1	26.3
Total loans/total deposits (percent)	80.4	85.1	86.9	88.7	77.4	78.1
Net liquid assets/total deposits (percent)	38.4	38.3	38.0	42.3	42.9	41.0
Foreign currency deposits/total deposits (percent)	21.1	25.0	23.4	22.9	30.2	27.5
Liquid assets/total deposits (percent)	39.7	40.0	38.1	39.6	43.8	41.7
Liquid assets/current liabilities (percent)	53.1	45.4	47.6	48.5	51.1	51.3
Total capital/total assets (percent) 3/	7.6	8.0	9.5	12.3	12.3	11.6
Total Capital/Risk Weighted Assets (percent) 3/	45.1	38.9	41.8	47.0	51.0	45.6
Tier 1 Capital/Risk Weighted Assets (percent) 3/	41.1	36.0	37.7	40.1	42.0	36.8
Ratio of bank's before-tax profits to average assets (percent)	3.1	3.4	4.0	4.7	2.1	1.1

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

1/ Includes errors and omissions.

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

3/ For locally incorporated banks only.

Table 8. St. Kitts and Nevis: External Financing Requirement and Sources, 2009-2016
(In millions of U.S. dollars)

		Prel.	Projection					
	2009	2010	2011	2012	2013	2014	2015	2016
Gross financing requirement	**127.8**	**159.5**	**234.9**	**216.3**	**207.0**	**162.5**	**169.2**	**192.6**
Current account deficit	178.8	145.1	164.7	160.8	155.5	153.1	153.3	157.5
Amortization	-63.7	-18.4	71.8	56.4	51.7	10.6	18.0	37.3
Official (public sector and central g	20.8	21.4	43.3	53.0	46.2	18.4	16.3	18.4
of which: to official creditors								
Private sector (net)	-84.4	-39.8	28.5	3.4	5.5	-7.9	1.7	18.9
Commercial banks	-55.1	-25.8	29.3	17.2	14.6	14.6	17.5	30.1
Other private	-29.4	-14.0	-0.8	-13.8	-9.2	-22.4	-15.8	-11.2
Reserve accumulation (+: increase)	12.7	32.7	-1.7	-0.9	-0.2	-1.1	-2.1	-2.2
Sources of financing	**141.0**	**145.2**	**161.7**	**153.7**	**156.1**	**147.6**	**156.8**	**172.6**
Capital grants and transfers	8.8	23.3	23.8	18.9	22.3	6.6	6.6	6.5
Foreign Direct Investment (net)	130.8	114.0	120.7	128.2	134.3	143.1	152.2	163.4
Net inflow of equity and other capital	-10.5	-10.5	-10.5	-10.5	-10.5	-10.5	-10.5	-10.5
New borrowing	11.9	18.4	27.6	17.2	10.0	8.4	8.6	13.2
of which: public sector	11.9	18.4	27.6	17.2	10.0	8.4	8.6	13.2
Financing gap	**-13.2**	**14.3**	**73.2**	**62.5**	**50.9**	**15.0**	**12.4**	**20.0**
Errors and omissions	-20.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Accumulation of arrears	7.8	14.3	0.0	-27.5	0.0	0.0	0.0	0.0
Exceptional external financing	**0.0**	**0.0**	**36.3**	**19.2**	**5.9**	**-0.7**	**-23.2**	**-28.1**
IMF net disbursement	0.0	0.0	36.3	19.2	5.9	-0.7	-23.2	-28.1
Potential Fund disbursement 1/	0.0	0.0	36.7	20.2	7.1	2.9	0.0	0.0
Repurchases	0.0	0.0	0.0	0.0	0.0	-2.3	-22.1	-27.5
Interest due	0.0	0.0	-0.4	-1.0	-1.2	-1.3	-1.1	-0.6
Other new financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual financing gap	0.0	0.0	36.9	70.8	45.1	15.7	35.6	48.1

Sources: St. Kitts and Nevis authorities; Eastern Caribbean Central Bank; and Fund staff estimates and projections.

Table 9: St.Kitts and Nevis: Indicators of Capacity to Repay the Fund, 2011-2021 1/

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Fund obligations based on existing credit											
(in millions of SDRs)	0.03	0.64	1.18	0.61	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Principal	0.00	0.56	1.11	0.56	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Charges and interest	0.03	0.08	0.07	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Fund obligations based on existing and prospective credit (in millions of SDRs)	0.30	1.43	2.33	4.68	20.38	21.65	6.90	2.37	0.39	0.05	0.05
Principal	0.00	0.56	1.11	3.33	19.18	21.19	6.73	2.29	0.34	0.00	0.00
Charges and interest	0.30	0.87	1.22	1.35	1.20	0.46	0.17	0.08	0.05	0.05	0.05
Fund credit outstanding based on existing and prospective credit (in millions of SDRs)	35.9	47.9	51.2	49.7	30.6	9.4	2.6	0.3	0.0	0.0	0.0
Total Obligations based on existing and prospective credit											
in millions of U.S. dollars2/	0.5	2.3	3.7	7.5	32.6	34.6	11.0	3.8	0.6	0.1	0.1
in percent of exports of goods and services	0.2	1.0	1.6	2.9	11.8	11.6	3.5	1.1	0.2	0.0	0.0
in percent of external debt service3/	0.8	3.4	6.3	22.4	57.9	57.3	30.0	12.4	2.2	0.3	0.3
in percent of GDP	0.1	0.4	0.6	1.1	4.7	4.7	1.4	0.5	0.1	0.0	0.0
in percent of rebased GDP	0.1	0.3	0.5	0.9	3.7	3.7	1.1	0.4	0.1	0.0	0.0
in percent of quota	3.4	16.1	26.2	52.6	229.0	243.3	77.5	26.6	4.4	0.6	0.6
in percent of net imputed reserves	0.3	1.5	2.5	5.0	22.3	24.0	7.7	2.6	0.4	0.1	0.1
in percent of revenue and grants	0.2	0.9	1.4	2.8	11.7	11.7	3.5	1.1	0.2	0.0	0.0
Outstanding Fund Credit											
in millions of U.S. dollars2/	57.4	76.7	82.0	79.6	48.9	15.0	4.2	0.5	0.0	0.0	0.0
in percent of exports of goods and services	28.0	34.7	34.6	31.2	17.7	5.0	1.3	0.2	0.0	0.0	0.0
in percent of external debt service3/	98.0	117.5	148.1	307.7	206.4	58.2	16.4	2.0	0.0	0.0	0.0
in number of months of imports of goods and services	1.9	2.4	2.5	2.3	1.4	0.4	0.1	0.0	0.0	0.0	0.0
in percent of GDP	10.3	13.1	13.3	12.2	7.1	2.0	0.5	0.1	0.0	0.0	0.0
in percent of quota	402.8	538.5	575.7	558.9	343.4	105.3	29.7	3.8	0.0	0.0	0.0
in percent of net imputed reserves	37.3	50.4	54.5	53.6	33.4	10.4	2.9	0.4	0.0	0.0	0.0
Net use of Fund Credit (in millions of SDRs)	33.6	12.1	3.3	-1.5	-19.2	-21.2	-6.7	-2.3	-0.3	0.0	0.0
Disbursements	33.6	12.6	4.4	1.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayment and Repurchases	0.0	0.6	1.1	3.3	19.2	21.2	6.7	2.3	0.3	0.0	0.0
Memorandum items:											
Nominal GDP (in millions of US dollars)	557.6	587.5	617.2	652.1	692.3	735.0	780.3	828.4	879.4	933.7	991.3
Exports of goods and services (in millions of US dollars)	204.8	221.1	236.8	255.1	275.7	298.4	314.1	330.8	348.4	367.0	386.7
External debt service (in millions of US dollars)	58.6	65.3	55.4	25.9	23.7	25.8	25.8	26.9	28.2	27.5	25.8
Imports of goods and services (in millions of US dollars)	363.7	379.0	392.8	410.5	431.1	457.7	471.4	485.8	507.5	530.4	554.4
Net imputed reserves (in millions of US dollars)	154.0	152.2	150.4	148.4	146.3	144.1	144.1	144.1	144.1	144.1	144.1

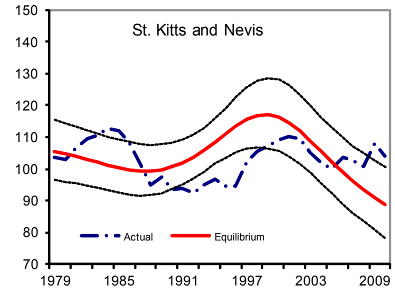
1/ Assumes a 3-year SBA with access in the amount of SDR 52.5 million (590 percent of quota)
2/ US$1 = 0.624825 SDR (as of June 30, 2011)
3/ Including prospective repurchases/repayments

Annex I. St. Kitts and Nevis: Exchange Rate Assessment

The different CGER methodologies indicate that the exchange rate is somewhat overvalued. The three methodologies indicate an overvaluation in the range of 13 to 17 percent.

- The *Equilibrium Real Effective Exchange Rate (ERER)* method—which looks at fundamentals believed to affect the equilibrium REER[1]—suggests an overvaluation of 17.2 percent over its long run equilibrium. The actual real exchange rate has been appreciating due to the strength of the U.S. dollar since 2008, peaking in 2009. But this trend abated in 2010 with the slide of the U.S. dollar against other major currencies.

Actual and Equilibrium REER, 1979–2010 1/
(Index 2005=100)



Sources: IMF, Information Notice System; and Pineda, Cashin and Sun (2009), "Assessing Exchange Rate Competitiveness in the ECCU", IMF Working Paper 09/78 (Washington: International Monetary Fund).
1/ The dotted lines around the equilibrium exchange rate represents 90 percent confidence intervals of the prediction.

- The *Macro-economic balance (MB)* approach points to an overvaluation of about 13.2 percent. The standard CGER methodology with a world sample (consisting of 111 countries including the ECCU member countries) suggests that the CA norm is -18.3 percent of GDP against the underlying CA of -21.4 percent of GDP.[2] A depreciation of about 13 percent is needed to close the gap between the norm and the current account in the medium term.

CGER Macro Balance (WORLD SAMPLE)
(In percent)

CAB/GDP Norm	**CAB/GDP Underlying (2016)**	**CAB/GDP Elasticity**	**REER (Over-valuation)**
-18.3	-21.4	-0.24	13.2

REER Deviation from Equilibrium
(in percent)

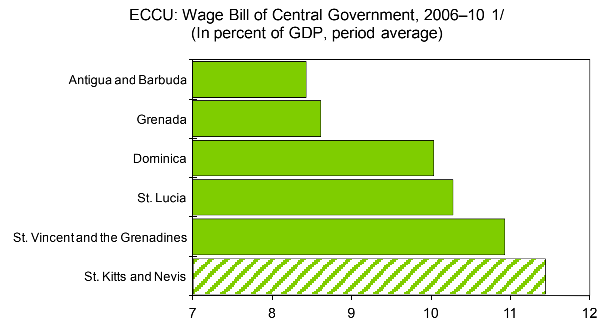
MB Approach	13.2
ERER Approach	17.2
ES Approach	12.8
Average	14.4

[1] This estimation of the exchange rate takes into account productivity differential in the tourism sector (using per capita tourist arrivals instead of per capita GDP), terms of trade for tourism, government consumption and net foreign assets. For a detailed explanation of the methodology see Pineda, Cashin and Sun (2009), "Assessing Exchange Rate Competitiveness in the ECCU," IMF Working Paper 09/78 (Washington, International Monetary Fund).

[2] This compares to the average overvaluation in the range of 2.8 percent when comparing the CARICOM countries using the methodology by Pineda, Cashin and Sun (2009) for tourism-dependent economies reported in last year's assessment. Pineda, Cashin and Sun (2009)'s methodology includes FDI as a determinant of the equilibrium current account balance as countries can run higher CA deficits financed by FDI inflows. In the medium term, however, FDI inflows are expected to remain subdued and unlikely to return to pre-crisis levels.

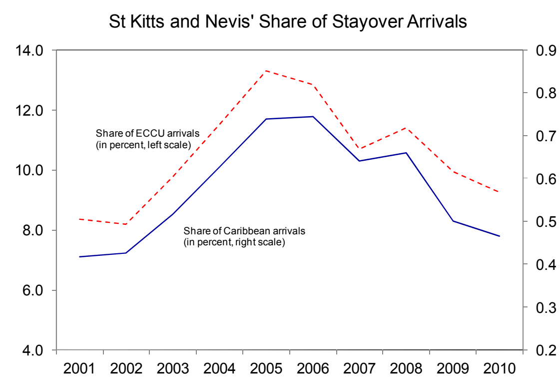
- The *External Sustainability* (ES) approach indicates an overvaluation. In ES[3], the current account norm is estimated to be -18.4 percent of GDP, requiring a REER adjustment of about 12.8 percent depreciation to stabilize net foreign assets.

With the exchange rate assessment showing a slight overvaluation, external competitiveness remains a challenge. With the exchange rate adjustment constrained by the quasi currency board, enhancing labor market flexibility is essential. Controlling increases in public sector compensation would therefore be an important step in ensuring competitiveness. Over the medium term, the strong fiscal measures recommended in the active scenario would help to reduce wage pressures and likely lower the equilibrium REER.



1/ Based on rebased GDP. St. Kitts and Nevis' high wage bill reflects in part the costs of two autonomous administrations.
Sources: ECCU country authorities; and Fund staff estimates.

The gains St. Kitts and Nevis made in increasing its share of the ECCU and Caribbean tourist market have reverted after 2005. To improve competitiveness, St. Kitts and Nevis would need to upgrade the productive capacity of the tourism sector including hotel capacity and infrastructure. Given its reliance on FDI as a financing source, it is imperative to continue to attract FDI inflows and stimulate private sector led growth over the medium term by improving the existing business climate, including by lowering the costs of registering property and getting credit and enforcing contracts, where the islands rank lower.[4]



Source: ECCB, CTO

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[3] Unlike the CGER methodology, we do not exclude capita account transfers as capital account transfers including grants are an important financing source for the ECCU countries.

[4] Based on the Doing Business 2011 database.

Annex II. St. Kitts and Nevis: Summary of Appendices

Fund Relations

St. Kitts and Nevis has outstanding obligations to the Fund. St. Kitts and Nevis is a member of the Eastern Caribbean Central Bank (ECCB), which manages monetary policy and the exchange system for its eight members. The common currency, the Eastern Caribbean dollar, has been pegged to the U.S. dollar at the rate of EC$2.70 since July 1976. St. Kitts and Nevis accepted the obligations of Article VIII, Sections 2, 3, and 4 in December 1984. The exchange system is free of restrictions on the making of payments and transfers for current international transactions. The last Article IV consultation was concluded by the Executive Board on July 7, 2010 (SM/10/153). CARTAC has provided extensive technical assistance in recent years. In addition, FAD fielded an expenditure review mission in September 2010.

Relations with the World Bank Group

In June 2010, the Organization of Eastern Caribbean States (OECS) Regional Partnership Strategy (RPS) for FY 2009–14 was presented to the Board of the World Bank. The strategy supports the sub-region's development agenda through two main pillars: (i) building resilience; and (ii) enhancing competitiveness and stimulating growth over the medium term. There is currently one active World Bank project in St. Kitts and Nevis aimed at improving the access, quality, and use of telecommunications and ICT services to achieve socio-economic development in the OECS. Looking ahead, the World Bank Group is expected to assist the government in the areas of civil service reform, strengthening social safety nets, land management, and natural disaster management.

Relations with the Caribbean Development Bank

The CDB supports the economic and social development of St. Kitts and Nevis through policy dialogue and the financing of priority capital projects and technical assistance. As of end-May 2011, CDB has approved loans totaling US$166.9 million in the areas of basic education, road infrastructure, electricity generation, student loans, child development, natural disaster management and policy-based guarantees.

Statistical Issues

St. Kitts and Nevis participates in the Fund's General Data Dissemination System (GDDS). Data provided is broadly adequate for surveillance, although significant shortcomings in data provision and data quality remain, particularly in the real sector (including the consumer price index), fiscal and balance of payments data. An April 2007 data ROSC mission to assess monetary and financial statistics noted some recent improvements and identified some shortcomings in the ECCB's monetary statistics, which a technical assistance mission in December 2009 aimed to address.

Annex III. Letter of Intent

July 13, 2011

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

Dear Ms. Lagarde:

As set out in the 2011 Budget, the Government of St. Kitts and Nevis is taking decisive actions to create the conditions for strong economic growth to improve the living conditions of all citizens by tackling the country's high public debt levels. The global downturn that started in late 2008, coupled with the damage caused by Hurricane Omar and the temporary closure of a key hotel on Nevis, drastically reduced tourism receipts and FDI inflows. As a result, St. Kitts and Nevis' economy contracted in 2009 and 2010. The decline in employment and economic activity led to a sharp deterioration in the fiscal position and a significant increase in public debt. In 2011, the current account deficit will widen due to the dual impact of economic recovery and increase in food and fuel prices. Moreover, financing needs are increasing as a result of large imminent rollover needs.

The main objective of the government's program is to foster macroeconomic stability and create a virtuous cycle of sustainable public debt and strong economic growth, which in turn would further strengthen the Eastern Caribbean Currency Union. The program, which is described in the attached Memorandum of Economic and Financial Policies (MEFP), includes expenditure cuts and revenue-enhancing measures (including those already taken) amounting to 5.5 percent of GDP in 2011 relative to 2010. It also incorporates important structural reforms that will further enhance the fiscal position over the duration of the program, while reducing vulnerabilities in the financial sector.

In addition, a comprehensive debt restructuring is envisaged. The government believes that sustained implementation of the program, complemented by debt restructuring, will put the public debt on a clear downward path. In this context, we have initiated discussions with our creditors with the goal of reaching agreement on a restructuring of our debt that enables us to sharply reduce the debt servicing burden.

The government of St. Kitts and Nevis is committed to the objectives and measures underlying the program and intends to pursue them with IMF assistance. Support from the IMF and other multilateral financial institutions will help to further boost confidence, including the provision of a liquidity buffer to further strengthen our financial system. Given the broad-based nature of the reform agenda, the government believes that sustained multilateral engagement over the medium term is essential, including through the provision of technical assistance in priority areas. Based on our balance of payments needs—including those arising from the repayment of external obligations of the government—and our policies described in the attached MEFP, we request approval of a 36-month Stand-By Arrangement (SBA) in an amount equivalent to SDR 52.5 million (about US$84 million or 590 percent of quota) for the period July 27, 2011 through July 26, 2014.

We believe that the economic and financial policies set forth in the MEFP are adequate to achieve the objectives of its program. However, we stand ready to take further measures to meet our objectives, and would consult with the IMF on the adoption of such measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultations. We will provide the Fund with the information it requires for monitoring progress during program implementation. The program will be monitored through quarterly reviews, with the first review to be completed after November 15, 2011 and the second review to be completed after February 15, 2012.

We authorize the IMF to publish this Letter of Intent and its attachments (including the Technical Memorandum of Understanding), and the related staff report.

Sincerely yours,

/s/
Dr. the Hon. Denzil Douglas
Prime Minister and Minister of Finance
St. Kitts and Nevis

Attachment 1

St. Kitts and Nevis: Memorandum on Economic and Financial Policies, 2011–14

July 13, 2011

I. Background and Program Objectives

1. The global economic and financial crisis that started in late 2008 has severely impacted St. Kitts and Nevis' economy. The economy contracted in 2009 and 2010, reflecting sharp declines in stay-over tourist arrivals and construction-related FDI inflows. The global downturn also precipitated the collapse of two large regional insurance companies with significant presence in St. Kitts and Nevis. Inflationary pressures have begun to rise in 2011, reflecting the pass through of higher international prices of energy and food. Together, these developments pose a serious threat to St. Kitts and Nevis' macroeconomic stability.

2. The crisis has taken a major toll on our public finances, notably in the form of an approximately 13½ percent drop in tax revenue in 2010, compared with 2009. To help stem the deterioration in the fiscal position, we have taken strong measures, including the introduction of a value-added tax (VAT) in November 2010, while cutting capital expenditure relative to the budget. Notwithstanding these measures, the overall fiscal deficit deteriorated by about 5½ percentage points of GDP.[1] As a result, the total stock of public debt reached about 200 percent of GDP at end-December 2010.

3. On the external front, tourism receipts, which account for approximately one half of exports of goods and services, declined by about 24 percent in 2009 and remained broadly flat in 2010. However, the external current account deficit—though still very high—narrowed to 27½ percent of GDP in 2010, reflecting a slowdown in economic activity and FDI-related imports.

4. The main objectives of the government's program are to substantially strengthen public finances, significantly reduce public debt levels (including through a comprehensive debt restructuring), and help establish the conditions for sustained economic growth. The strong fiscal adjustment, coupled with a comprehensive debt restructuring, will significantly reduce the debt service burden and help set the public debt-to-GDP ratio firmly on a downward path toward the ECCU debt target of 60 percent of GDP by 2020. We expect that steadfast implementation of this program will help mobilize external financing, including

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[1] The national accounts of the Eastern Caribbean Currency Union member states have been rebased with a base year of 2006. For St. Kitts and Nevis, this will result in a 28 percent increase in the 2009 nominal GDP, mainly reflecting a broader coverage of financial, communication, and offshore education services. The rebasing exercise was accompanied by CARTAC technical assistance. The ratios in this memorandum are expressed in GDP prior to the rebasing.

from the IMF, to support its objectives. With the improved fiscal and economic performance, we also expect to meet the conditions to facilitate the release of EU sugar grants.

5. To achieve a large and sustainable reduction in the public debt, the program targets average primary fiscal surpluses of about 5.6 percent of GDP during 2011–13 (compared with -0.5 percent of GDP in 2010). The projected improvements in the fiscal position will be driven by higher tax revenue resulting from the implementation of the VAT and other reforms, such as the increase in the electricity tariff by about 80 percent and strict control of expenditure. The program also envisages structural reforms which are critical to its success, especially in the public sector.

II. Macroeconomic Policies for 2011–12

6. Our program envisages a gradual economic recovery, with real GDP growth projected to reach about 1½ percent and 1.8 percent, in 2011 and 2012, respectively. Reflecting the pass through of higher international prices of food and energy, inflation is expected to reach 3.9 percent in 2011, before declining to 2.9 percent in 2012. In the medium term, inflation is expected to revert to its historical average of 2.5 percent, anchored by the currency board arrangement. The external current account deficit is projected to temporarily widen in 2011, due to higher energy and food prices. In line with the economic recovery, a moderate improvement in FDI flows and other private financial inflows is expected to partially finance the current account deficit in 2011–12. External financing needs are expected to amount to about 28 percent of GDP during 2011–12, which are anticipated to be addressed by the reduction in the external repayment obligations as a consequence of the debt restructuring.

7. In 2011, we intend to deepen our fiscal adjustment process and initiate a comprehensive debt restructuring, thereby setting the stage for restoring debt and external sustainability. Efforts are ongoing to strengthen budgetary performance, which will intensify in the period ahead. These efforts will be accompanied by supporting structural reforms in the public sector. In addition, we will create no new nonfinancial public enterprises, nor change the role of the existing enterprises in a way that would assume central government spending mandates.

A. Fiscal Adjustment

8. We believe that the fiscal measures implemented so far provide the critical adjustments needed to begin to restore debt sustainability. Building on the measures taken in 2010, we have increased electricity tariffs and the housing and social development levy in 2011. On the expenditure side, we have adopted a policy to freeze the wage bill until 2013 and prioritized capital expenditure. Together, these measures are expected to achieve a primary fiscal surplus of 5 percent of GDP in 2011. In the event of a shortfall, we have identified contingency measures equivalent to 1 percentage point of GDP that would be taken to ensure that we achieve the primary fiscal surplus target. These include measures to increase revenue from the Housing and Social Development Levy (0.3 percent of GDP),

customs service charge (0.1 percent of GDP); and a reduction in capital expenditure (0.6 percent of GDP), if needed.

9. We estimate that the overall fiscal deficit will reach US$22.2 million (about 4.0 percent of GDP) in 2011. It is anticipated that net domestic financing (including proceeds from the sale of assets) will amount to a net repayment of US$19.6 million (3.5 percent of GDP) and our external obligations, net of expected disbursements for projects and already disbursed loans, will amount to a net repayment of US$21.3 million (3.8 percent of GDP). As a result, a financing gap of about US$63.1 million (11.3 percent of GDP) is expected in 2011.

B. Debt Restructuring

10. While the measures outlined above would bring about a sharp improvement in the fiscal accounts, they would not by themselves close the financing gaps and put the public debt on a sustainable path. Accordingly, we are in the process of negotiating a comprehensive and substantive public debt restructuring, which would ensure burden sharing by all. With the assistance of our debt advisors, we have developed a strategy that emphasizes information transparency and dialogue with all creditor groups. Overall, we expect that such a restructuring will yield substantial interest savings to put public debt on a firmly downward trajectory in the medium term. We have already taken substantive steps to resolve our outstanding arrears to creditors and significant balance of payments support from our international partners will be necessary.

C. Strengthening the Financial Sector

11. To further strengthen the financial system, we intend to establish a GOSKN Banking Sector Reserve Fund. This Fund will provide temporary liquidity to solvent local banks that face liquidity constraints and its operation will be governed by a Memorandum of Understanding between the Government and the Eastern Caribbean Central Bank (ECCB), who will administer the Fund on behalf of the Government.

D. Structural and Social Policies

12. We will take steps to enhance public financial management. To advance this important agenda, we will take the following steps in 2011–12: (i) update the mapping of publicly owned land; (ii) undertake a land valuation; (iii) rationalize public land sales and development agencies; (iv) make good faith efforts and demonstrate progress in the discussion with the creditors on debt restructuring; (v) submit to Cabinet a proposal to rationalize the subsidies on liquefied petroleum gas (LPG); (vi) submit the bill for the corporatization of the Electricity Department to Parliament; (vii) submit the draft of the new Procurement Act to Parliament; and (viii) establish a medium-term expenditure framework.

13. Civil service reform is a key pillar of our medium-term public sector transformation program. We plan to undertake a comprehensive civil service reform to improve the

efficiency of the public sector and are seeking technical assistance from our development partners (including the World Bank).

14. In line with the ongoing ECCU-wide new initiative, we are committed to further strengthening the social security scheme by drafting a proposal for a comprehensive pension reform and continue to carry out regular actuarial reviews.

15. Regarding debt management, we are committed to developing an explicit medium-term strategy that takes account of the cost-risk tradeoff of alternative financing options, within the context of the overall macroeconomic environment.

16. Protecting the most vulnerable social groups will continue to be a priority under the program. To promote efficiency, we intend to introduce a cash transfer program, with a view to better target the most vulnerable in society. In this context, we will present to Cabinet a social safety net reform strategy by March 2012. As a first step, we intend to compile an inventory of all social assistance programs, which would allow for the establishment of a central beneficiary system of all programs and have begun to solicit technical assistance from our development partners (including UNICEF and the World Bank). The plan entails the introduction of an objective and transparent targeting mechanism to effectively direct social assistance to the poor. In the medium term, we will rationalize social assistance programs on the basis of a coherent social protection strategy as well as link social assistance programs to actions that promote human capital.

E. Prior Actions

17. Prior actions under the program include: (i) public announcement of the Government's commitment to undertake a debt restructuring; (ii) appointment of legal advisors for the due diligence on the existing debt contracts; and (iii) taking stock of and putting in place a framework to monitor expenditure payment arrears on a regular basis with assistance from CARTAC; and (iv) agreement between the Government and the ECCB on the operating modalities of the GOSKN Banking Sector Reserve Fund. As of June 30, 2011, all of the measures have been implemented.

III. Program Monitoring and Safeguards Assessment

18. Progress in the implementation of policies under the program will be monitored quarterly through quantitative performance criteria and indicative targets, as well as structural benchmarks. The first and second program reviews should be completed after November 15, 2011 and February 15, 2012, respectively. At this stage, quantitative performance criteria are set for end-September and end-December 2011 and indicative targets for 2012. The phasing of access under the arrangement and the quarterly review schedule are set out in Table 1. The quantitative performance criteria and indicative targets are set out in Table 2. The understanding between the St. Kitts and Nevis Government and IMF staff regarding the quantitative performance criteria, as well as definitions of all relevant

variables and reporting requirements are contained in the attached Technical Memorandum of Understanding (TMU). The program also incorporates a continuous performance criterion on the non-accumulation of domestic and external arrears. The Government has plans for the clearance of external arrears through the debt restructuring process, and will provide quarterly reports on the outstanding stock of external arrears within 8 weeks of the end of each quarter. Prior actions and structural benchmarks are presented in Table 3.

19. In line with Fund policies, the government recognizes the importance of completing a safeguards assessment of the ECCB by end-2011. The ECCB has agreed to cooperate with Fund staff and provide the information required to complete such an assessment.

Table 1. St. Kitts and Nevis: Schedule of Review and Purchases

Availability date	Amount of Purchase: Millions of SDR	Amount of Purchase: Percent of Quota	Conditions
July 27, 2011	22.150	248.9	Approval of arrangement
November 15, 2011	11.470	128.9	First review and end-September 2011 performance criteria
February 15, 2012	3.161	35.5	Second review and end-December 2011 performance criteria
May 15, 2012	3.161	35.5	Third review and end-March 2012 performance criteria
August 15, 2012	3.161	35.5	Fourth review and end-June 2012 performance criteria
November 15, 2012	3.161	35.5	Fifth review and end-September 2012 performance criteria
February 15, 2013	1.105	12.4	Sixth review and end-December 2012 performance criteria
May 15, 2013	1.105	12.4	Seventh review and end-March 2013 performance criteria
August 15, 2013	1.105	12.4	Eight review and end-June 2013 performance criteria
November 15, 2013	1.105	12.4	Nineth review and end-September 2013 performance criteria
February 15, 2014	0.913	10.3	Tenth review and end-December 2013 performance criteria
May 15, 2014	0.913	10.3	Eleventh review and end-March 2014 performance criteria
Total	**52.510**	**590.0**	

Source: Fund staff estimates

Table 2. St. Kitts and Nevis: Quantitative Performance Criteria and Indicative Targets, 2011-12

	Performance Criteria		Indicative Targets			
	End Sep. 2011	End-Dec. 2011	End-Mar. 2012	End-Jun. 2012	End-Sep. 2012	End-Dec. 2012
Performance Criteria:						
Central government overall balance including grants (floor) 1/ 2/	-60	-60	-9	-10	-39	-51
Central government budget expenditure arrears accumulation (ceiling)	0	0	0	0	0	0
Stock of external short term debt (ceiling)	0	0	0	0	0	0
Central government or guaranteed external arrears accumulation (ceiling) 3/	0	0	0	0	0	0
Indicative Target:						
Central government primary balance (floor) 1/ 2/	42	76	24	65	67	86

Source: Fund staff estimates.
1/ Cumulative within each calendar year.
2/ See the TMU for a description of adjustors.
3/ To be monitored on a continuous basis.

Table 3. St. Kitts and Nevis: Prior Actions and Structural Benchmarks

Action	Target Date	Objectives
I. Prior Actions		
Authorities commit publicly to undertake a debt restructuring	End-June 2011	
Appointment of legal advisors for the due diligence on the existing debt contracts	End-June 2011	
Take stock of and put in place a framework to monitor expenditure payment arrears on a regular basis with assistance from CARTAC	End-June 2011	
Agreement between the authorities and the ECCB on the modalities of the GOSKN Banking Sector Reserve Fund	End-June 2011	
II. Fiscal and Public Sector Reforms		
Public financial management		
Update the registry of at least 600 acres of land	End-September 2011	Strenghten public financial management
Undertake a valuation of at least 600 acres of land	End-September 2011	Strenghten public financial management
Make substantial progress on the consultative phase of restructuring with creditors	End-September 2011	Strenghten public financial management
Submit the bill for the corporatization of the Electricity Department to Parliament	End-September 2011	Strenghten institutional framework
Submit to Cabinet proposal to rationalize the subsidy on liquefied petroleum gas (LPG)	End-March 2012	Streamline social safety
Submit draft of new Procurement Act to Parliament	End-June 2012	Strenghten institutional framework
Draft proposal for the establishment of an asset management company	End-June 2012	Strenghten public financial management
Establish a medium-term expenditure framework with agreed fiscal targets	End-June 2012	Improve medium-term orientation of the budget
Civil service reform		
Cabinet to approve a plan for civil service reform covering human resource policy, reviewing the organization and structure of the civil service and addressing wage policy and payroll management	End-June 2012	Strenghten public financial management
Actuarial review of Social Security		
Regular review of the Social Security Scheme.	End-September 2012	Strenghten public financial management
Public enterprise reform		
Review borrowing capacity of public enterprises	End-December 2011	Strenghten public financial management
Rationalize public land sales and development agencies	End-September 2012	
Strengthen social safety net		
Submit social safety net reform strategy to Cabinet	End-March 2012	Streamline social safety nets
III. Financial Sector Reforms		
Update the existing stress tests of financial institutions	End-September 2011	Financial sector stability
IV. Medium-term benchmark		
Develop and explicit medium-term debt management strategy that takes account of the cost-risk tradeoff of alternative financing options, within the context of the overall macroeconomic environment	to accompany the 2013 Budget	Improve medium-term orientation of the budget
Draft proposal for a comprehensive pension reform	End-June 2013	Strenghten public financial management

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

Attachment 2

St. Kitts and Nevis: Technical Memorandum of Understanding

1. St. Kitts and Nevis' performance under the Stand-By Arrangement (SBA) will be assessed on the basis of the quantitative performance criteria and indicative targets, as well as the structural benchmarks. This Technical Memorandum of Understanding (TMU) defines the variables set out in Table 2 of the Memorandum of Economic and Financial Policies (MEFP). It also lays down the reporting requirements to adequately monitor the program.

2. For the purposes of the program, the exchange rate of the East Caribbean dollar (EC$) to the U.S. dollar is set at EC$2.70 = US$1. Foreign currency accounts denominated in currencies other than the U.S. dollar, excluding SDRs, will be first valued in the U.S. dollar at actual end-of-period exchange rates used by the ECCB to calculate the official exchange rates. SDR-denominated accounts will be valued at the program exchange rate of U.S. dollar 1.6 per SDR.

I. Coverage

3. For the purpose of the program, **central government** will cover all items included in the government budgets of the Federation (both St. Kitts and Nevis).

4. The **nonfinancial public sector** is defined as the total central government and nonfinancial public enterprises. Public enterprises consist of the Development Bank of St. Kitts and Nevis, Financial Services Regulatory Commission, Frigate Bay Development Corporation, La Vallee Greens Ltd, National Housing Corporation, Nevis Air and Sea Port Authority, Nevis Cultural Development Foundation, Nevis Electricity Corporation, Nevis Housing and Land Development Corporation, Nevis Solid Waste Management Authority, Nevis Tourism Authority, St. Christopher and Nevis Solid Waste Management Corporation, St. Christopher Tourism Authority, St. Kitts Urban Development Corporation, St. Christopher Air and Sea Ports Authority, WhiteGate Development Corporation, and ZIZ Broadcasting Corporation.

5. **External debt** is defined as all debt owed to creditors residing outside of St. Kitts and Nevis, while **domestic debt** covers all debt owed to residents of St. Kitts and Nevis. The latter covers all T-bills, including those held by creditors residing outside of St. Kitts and Nevis.

II. Quantitative Performance Criteria

A. Central Government's Overall Deficit (PC)

6. The **central government overall balance** will cover all of its revenue, grants, expenditure, and transfers. Revenues will exclude any proceeds from the sale of public assets

such as land, which will be considered as financing below the line. Expenditures will exclude clearance of arrears, which will be considered as financing below the line.

7. The central government's overall balance will be measured from the financing side as the sum of the net domestic financing, net external financing, plus proceeds from the sale of public assets, minus clearance of arrears.

8. **Net domestic financing** of the central government is defined as the sum of:

- net domestic bank financing as measured by the change in the domestic banking system credit to the central government net of deposits, as reported by the consolidated balance sheet of the monetary authorities and commercial banks, including special tranches from the ECCB;

- net nonbank financing as measured by the net changes in holdings of government securities by nonbanks, and net borrowing from nonbank institutions;

- the changes in the stock of domestic arrears of the central government defined as net changes in unpaid checks issued, unprocessed claims, pending invoices, plus accrued interest payments, and other forms of expenditures recorded above the line but not paid;

- gross receipts from divestment defined as proceeds received from any privatization, divestment, and sale of asset (land); and

- any exceptional financing, including rescheduled principal and interest.

9. **Net external financing** of the central government is defined as the sum of:

- disbursements of project and non-project loans, including securitization;

- proceeds from bonds issued abroad (with an original maturity of one year or greater);

- net changes in short-term external debt (with an original maturity of less than one year), excluding exceptional financing;

- net changes in cash deposits held outside the domestic banking system;

- any changes in arrears on external interest payments and other forms of external expenditures recorded above the line but not paid;

- any exceptional financing, including rescheduled principal and interest;

less:

- payments of principal on current maturities for bonds and loans on a due basis, including any prepayment of external debt.

10. The **floor on the overall balance of the central government** will be adjusted as follows:

- **downward** (i.e., a larger overall deficit target would apply) to the extent that budgetary grants fall short of the programmed amounts by less than EC$3 million.

- **upward** to the extent that budgetary grants exceed the annual amounts specified in the program.

- **downward** by the cumulative amount of up to EC$15 million spent on bank recapitalization and support to the British American Insurance Companies or CLICO as part of a regional solution—any amounts spent in excess of this programmed contingency will need to be funded within the program limit on the overall deficit.

- **upward** to the extent that clearance of arrears fall short of the amounts specified.

- **upward** to the extent of exceptional financing achieved through debt restructuring.

Table 1. Programmed Disbursements of Budgetary Grants in 2011
(in EC$ millions)

Quarters	I	II	III	IV
Grants	0.1	4.6	4.6	36.2

Sources: St. Kitts and Nevis authorities; and Fund staff estimates.
Note: Values presented are cumulative and Euro 1 = US$1.3341.

B. Stock of Central Government Short-Term External Debt (PC)

11. The **limit on short-term external debt** applies to debt owed or guaranteed by the central government of St. Kitts and Nevis, with an original maturity of up to and including one year. Excluded from the limit are any rescheduling operations (including the deferral of interest on commercial debt) and normal import-related credits. Normal import credit is understood to be a self-liquidating operation where the proceeds from sales of imports are

used to retire the debt. Debt falling within the limit shall be valued in U.S. dollars at the time of the contract or guarantee becomes effective.

C. External Arrears of the Public Sector (PC)

12. The **non-accumulation of arrears to external creditors** will be a continuous performance criterion under the program. This performance criterion applies to arrears accumulated related to debt contracted or guaranteed by central government. External payment arrears consist of external debt service obligations (principal and interest) falling due after December 31, 2010 that have not been paid at the time due, taking into account the grace periods specified in contractual agreements. Arrears resulting from nonpayment of debt service for which a clearance framework has been agreed or a rescheduling agreement is being sought are excluded from this definition.

D. Budget Expenditure Arrears (PC)

13. A ceiling is set on central government budget expenditure arrears, equal to the stock of such arrears as at December 31, 2010 (Table 2). The ceiling applies to the increase in the sum of: (1) 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 contractually agreed period, or in the absence of a grace period, within 60 days; and (2) unpaid wages, pensions, or transfers, pending for longer than 60 days to domestic or foreign residents, irrespective of the currency denomination of the debt.

Table 2. Stock of Budget Expenditure Arrears at end-December, 2010
(in EC$ millions)

Stock of arrears	183
Unpaid checks issued	…
Unprocessed invoices	…
Pending invoices	…
Interest and amortization arrears on domestic debt	0
Total	183

Sources: St. Kitts and Nevis authorities; and Nevis Island Administration.

III. Indicative Target on the Primary Balance of the Central Government

14. The **central government's primary balance** is defined as revenue and grants minus non-interest expenditures. As in the definition of the overall balance, revenue will exclude any proceeds from the sale of public assets. Net lending is a non-interest expenditure item (negative net lending is a revenue item). Interest expenditures include interest payments on outstanding arrears, as defined above in sections IIC and IID (at their contractual rates) converted to a cash basis.

15. The **floor on the primary balance of the central government** will be monitored from the financing side as the sum of the net domestic financing, net external financing, proceeds from the sale of public assets, plus domestic and external interest payments on a due basis.

16. The floor on the primary balance of the central government will be adjusted as follows:

- **downward** (i.e., a smaller primary surplus target would apply) to the extent that budgetary grants fall short of the programmed amounts by less than EC$3 million.

- **upward** to the extent that budgetary grants exceed the annual amounts specified in the program.

- **downward** by the cumulative amount of up to EC$15 million spent on bank recapitalization and support to the British American Insurance Companies or CLICO as part of a regional solution.

- **upward** to the extent of exceptional financing achieved through debt restructuring.

IV. Data and Information

17. To enable monitoring of performance relative to the above quantitative performance criteria and indicative targets, the St. Kitts and Nevis authorities will provide Fund staff with the following specific data and information within 8 weeks after the end of each month.

Fiscal sector

- Central government budgetary accounts.

- Capital expenditure.

- Total monthly disbursements and grants receipts, disaggregated into: (a) budgetary support (by type—either loans, external "bonds" and/or other securities); (b) project loans; (c) budgetary grants; and (d) project grants.

- Central government domestic debt data (St. Kitts and Nevis).

- Stock of domestic arrears, including unpaid checks issued, stock of unprocessed claims due and invoices pending; interest and amortization on domestic debt.

- Stock of external arrears by creditor.

- Detailed monthly external debt report from the Debt Unit in the Ministry of Finance, showing fiscal year-to-date disbursements, amortization, interest payments and outstanding stocks, for the central government and public enterprises.

- Copies of loan agreements for any new loans contracted, including financing involving the issue of government paper, and of any renegotiated agreements on existing loans.

Financial sector

- Monetary survey for St. Kitts and Nevis as prepared by the Eastern Caribbean Central Bank.

Real sector

- Consumer price index.

18. Reporting on a **quarterly basis** will include the following:

Fiscal

- A detailed overview of capital expenditures on a project by project basis and the composition of financing.

- Financial position of the public enterprises (as listed in paragraph 4).

Real sector

- Economic indicators under the real sector.

External sector

- Economic indicators under the external sector.

19. Reporting on an **annual basis** will include the following:

External and real sectors

- GDP and its components.

- Balance of payments accounts.

20. **Other reporting** will include:

- Reports of legislative changes pertaining to economic matters.

- Notification of any establishment of new public enterprises.

- All disbursements and outstanding balances from the use of the Banking Sector Reserve Fund on a weekly basis.

Annex IV

Memorandum of Understanding between the Eastern Caribbean Central Bank and the Government of St Kitts and Nevis for the Operation of the Banking Sector Reserve Fund

THIS MEMORANDUM OF UNDERSTANDING (MOU) is made this 27 day of July 2011 **BY AND BETWEEN THE EASTERN CARIBBEAN CENTRAL BANK** a body established under Article 3 of the Eastern Caribbean Central Bank Agreement, 1983 and having its principal office at Bird Rock in the island of Saint Christopher, (hereinafter called "**the ECCB**" which expression shall where the context so requires or admits include its successors in title and assigns) **AND the Government of St. Kitts and Nevis** hereinafter referred to as the Government.

WHEREAS, as part of the International Monetary Fund's (IMF) Stand-by Arrangement with the Government, a Banking Sector Reserve Fund ("the Fund") will be established at the ECCB to provide liquidity support to solvent locally incorporated domestic banks;
AND WHEREAS, the Government has requested that the ECCB manages the Fund on its behalf;

NOW THEREFORE, the Government and the ECCB have reached the following understandings:

1.0 **GOVERNMENT UNDERTAKINGS**

1.1 The Government undertakes to:

1.1.1 Establish and maintain a dedicated account at the ECCB, for the duration of the Government's programme with the IMF, for the sole purpose of providing liquidity to solvent locally incorporated banks;

1.1.2 Transfer EC$ 46.1 million to the account after the initial disbursement under the IMF's Stand-by Arrangement (SBA);

1.1.3 Provide liquidity support to solvent locally incorporated banks in accordance with the Operational Guidelines set out in Schedule I and as may be amended from time to time.

1.2 The Government hereby authorizes and requests the ECCB to:

1.2.2 accept and hold on its behalf securities assigned by the banks to the Government as collateral for advances from the Fund;

1.2.3 release the securities upon repayment of the advance; in accordance with the

Operational Guidelines and without reference to or further authority from the Government.

2.0. ECCB UNDERTAKINGS

The ECCB undertakes to:

2.1 Administer the day-to-day operations of the Fund on behalf of the Government including

2.1.1 maintaining the books and records of the account;

2.1.2 receiving and processing applications from the banks to access the Fund in accordance with the Operational Guidelines;

2.1.3 approving requests for advances provided banks meet the conditions set out in the Operational Guidelines.

2.2 Report to the Government on Monday of every week that the Fund is in operation via SWIFT message on the usage of the Fund provided only that if the reporting day falls on a weekend, public holiday or other non-business day, the ECCB shall report on the next business day..

2.3 Remit any interest earned on the Fund to the Government quarterly on October 31st, January 31st, April 30th and July 31st of each year that the Fund is in operation.

2.4 The ECCB agrees to:

2.2.1 receive and hold on behalf of the Government securities assigned by the banks to the Government as collateral for advances from the Fund;

2.2.2 release the securities upon repayment of the advance; in accordance with the Operational Guidelines and without reference to or further authority from the Government.

GENERAL

The parties to this MOU may take practical measures as may be necessary to facilitate the implementation of this MOU. Accordingly, the parties may in writing and by consensus, waive, amend or alter any of the provisions of this MOU including the Operational Guidelines.

SIGNED on the 27 day of July 2011
by:

/s/
K Dwight Venner, Governor
For and on behalf of Eastern Caribbean Central Bank

SIGNED on the 27 day of July 2011
by:

/s/
Denzil L Douglas, Prime Minister
For and on behalf of the Government

Schedule I

Government of St Kitts and Nevis Banking Sector Reserve Fund Operational Guidelines

Introduction

This facility is made available by the Government to solvent locally incorporated domestic banks that face temporary liquidity constraints. The facility will remain available for the duration of the Government's SBA with the IMF (36 months).

All requests for a temporary advance must be signed by the Chairman of the Board of Directors and addressed to the Governor of the ECCB; and copied to the Minister responsible for Finance. Requests for an advance received at the beginning of the business day will generally be processed the same day; otherwise, requests will be processed within 24 hours.

All requests for an advance must be accompanied by the following:

1. The reasons for the request and sources of repayment;

2. The amount and tenor of the advance requested;

3. Evidence that the bank has been unsuccessful in its attempt to raise the required liquidity in the interbank market (IBM) or the repo market;

4. A balance sheet, a detailed listing of liquid assets with an indication of amounts hypothecated and details of undrawn commitments as at the date of the request;

5. Details of the assets being pledged to secure the advance.

In addition, where a bank is applying for an advance to be rolled over, the bank should provide a plan outlining how they expect to remedy their liquidity difficulties and reduce their dependence on this facility.

The Governor will approve the advance if (i) the liquidity need has arisen as a consequence of unanticipated client demands and (ii) subject to a determination by the ECCB that the bank is solvent.

Terms and Conditions

Advances are subject to the terms and conditions outlined below:

Security

All advances must be fully secured with securities assigned to the Government. Security may be in the form of: (i) fixed deposits; or (ii) Treasury bills.

For expediency, prior to any specific request being made for advances, locally incorporated banks requesting an advance are required to lodge collateral with the ECCB in accordance with the following provisions:

i. **Physical Securities**

A bank wishing to use ECCB's depository service must deposit securities with the ECCB's Head Office or Agency Office. The securities must be delivered with the memorandum of deposit. The following information must be included in the memorandum:

(a) the description of the securities;

(b) the nominal value of the securities;

(c) Authorized Signatory;

(d) Date.

A bank wishing to borrow from the Fund using securities deposited with the ECCB will be required to instruct the ECCB to assign these securities for a set period for the benefit of the Government of St Kitts and Nevis. .

ii. **Dematerialized Securities**

For Securities listed on the Regional Government Securities Market (RGSM), the borrowing bank must complete the Pledging form (available at www.**ecseonline**.com) by providing its contact details, terms of loan and description of the instruments being pledged.

Limits

Subject to the availability of resources, banks will be eligible to draw up to 90 percent of the amount of fixed deposits or the nominal value of Treasury bills.

Interest

The ECCB shall set the interest on advances not lower than the ECCB's discount rate. Without prejudice to the foregoing, the ECCB may change the interest at any time, effective, at the earliest, from the following business day. Any change in the interest rate will be communicated to the borrowing bank by the ECCB.

Interest will, in the first instance, be credited back to the Fund. Once per quarter, any interest received will be transferred to the government's consolidated fund to defray the costs of providing the liquidity advance.

Maturity of advance

Advances under this facility will be granted for a period up to fourteen (14) days. Unless otherwise agreed, advances are to be repaid in full on maturity. However, advances may be rolled over on request subject to the availability of sufficient collateral and the ECCB's affirmation of the ongoing solvency of the bank. All advances must be repaid on or before July 26, 2014.

On maturity date of the advance, the borrowing bank will be required to send a Swift message (MT202) to the ECCB requesting the transfer of funds to the Government of St Kitts Banking Sector Reserve Fund Account.

In instances where the advance is extended for an additional period of time, the borrowing bank and the ECCB will confirm the terms and conditions of the new arrangement. Additionally, the borrowing bank will be required to instruct the ECCB to continue to hold the securities on behalf of the Government of St Kitts and Nevis for a specified time.

Other

No dividends should be paid by the borrowing bank until all advances under this facility are fully repaid.

The ECCB will reconfirm to GOSKN its assessment that the bank remains solvent at each point an advance is rolled over.

INTERNATIONAL MONETARY FUND

ST. KITTS AND NEVIS

Staff Report for the 2011 Article IV Consultation and Request for Stand-By Arrangement

External and Public Debt Sustainability Analysis

Prepared by the Staff of the International Monetary Fund

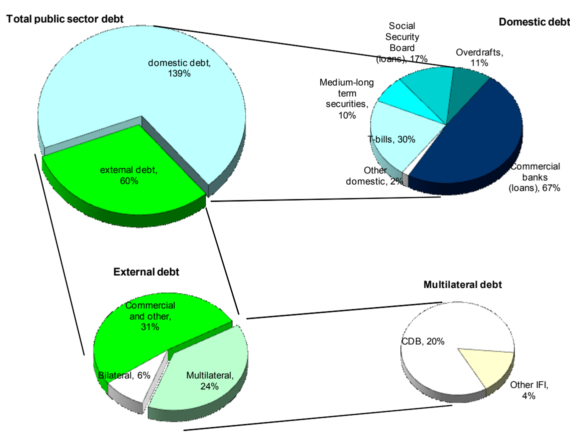
July 20, 2011

This debt sustainability analysis (DSA) indicates that St. Kitts and Nevis' public and publicly guaranteed (PPG) debt would be unsustainable even with the adoption of strong fiscal adjustment measures. The comprehensive debt restructuring currently pursued by the government (not included in the formal analysis), however, would restore public debt sustainability.

A. Introduction

1. **St. Kitts and Nevis has the highest public debt-to-GDP ratio among the ECCU member states**.[1] As of end-2010, the stock of public and publically guaranteed (PPG) debt[2] is estimated to be around 199 percent of GDP. About 69 percent of St. Kitts and Nevis' PPG debt is held domestically (139 percent of GDP), mostly by commercial banks (about 90 percent of GDP) and statutory bodies (20 percent of GDP). The remaining 31 percent of PPG debt is external debt (60 percent of GDP) and mainly comprised of obligations to commercial creditors including bond holders (31 percent of GDP). External debt is owed to multilateral creditors (24 percent of GDP), in particular to the Caribbean Development Bank (20 percent of GDP); non-Paris Club bilateral creditors (6 percent of GDP); and Paris Club members (1 percent of GDP). In 2010, the total outstanding borrowing from the Eastern Caribbean Central Bank was about 1.7 percent of GDP.

St. Kitts and Nevis: Public Sector Debt, Dec 2010
(In percent of GDP)



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

[1] St. Kitts and Nevis continued to have the highest public debt-to-GDP ratio in 2010 among the ECCU member countries even under the rebased GDP (once published: 156 percent of GDP). For the rest of the ECCU member countries, public debt-to-GDP ratios under the rebased GDP in 2010 stood at 97 percent in Grenada, 90 percent in Antigua and Barbuda, 75 percent in St. Lucia, 67 percent in Dominica, and 66 percent in St. Vincent and Grenadines

[2] Public and publically guaranteed debt includes all St. Kitts government, Nevis Island Administration, and statutory bodies, including debt to the social security system.

2. **The government has relied heavily on short-term financing from the captive domestic market**. As of December 2010, T-bills (mainly 91-day, with the next roll-over scheduled in mid-August 2011) and overdrafts constituted about 30 percent of total government domestic debt. This high share of short-term debt has, in turn, exposed the government to significant rollover risks. Approval of the SBA prior to the rollover, however, would instill confidence and significantly reduce the rollover risks. In addition, there is a concentration of principal repayment scheduled in 2011–13.

3. **Despite a tradition of timely servicing its debt, St. Kitts and Nevis is beginning to accumulate arrears.** St. Kitts has built up external arrears of about 5.2 percent of GDP (EC$ 74.3 million) during 2008–10, for which the authorities have engaged in discussions with a view to reaching a resolution. Nevis has accumulated external arrears of about 0.1 percent of GDP in 2010 (EC$ 2 million), which will be cleared in the process of the debt restructuring. Beginning June 2011, St. Kitts and Nevis has also started to miss payments to external private creditors but it does not have arrears to multilaterals or the Paris Club.

4. **The exchange rate risk stemming from the foreign-denominated debt in St. Kitts and Nevis is relatively low**. Reflecting the structure of its treasury operations, all domestic debt is denominated in local currency (Eastern Caribbean dollars). Moreover, about 71.7 percent of its external debt is denominated in U.S. dollars, to which the local currency has been pegged since 1976, and another 11.5 percent in EC dollars. The remaining portion of external debt is denominated mostly in SDRs (2.8 percent), Euros (2.2 percent), and Kuwaiti dinars (1.6 percent).

B. Macroeconomic Assumptions

5. In line with the macroeconomic framework presented in the staff report, the debt sustainability analysis is based on the following assumptions:

- **Real GDP Growth**: Real GDP growth is projected to reach 1½ percent and 1.8 percent, in 2011 and 2012 respectively, somewhat subdued due to continued high unemployment rates in advanced economies, particularly the U.S. (the main source market for St. Kitts and Nevis' tourism). Growth is expected to reach 3.5 percent in the medium term, mirroring improvements in both domestic and external economies.

- **Inflation**: Inflation is projected to peak at about 3.9 percent in 2011, reflecting the pass-through of higher international prices of oil and food, gradually reverting to its historical average of 2½ percent in the medium term, anchored by the currency board arrangement**.**

- **External Sector**: The external sector is expected to mark in 2011 the inception of a gradual recovery, albeit below the pre-crisis levels. In the medium term, exports of goods as a percentage of GDP are expected to reach about 11.9 percent. Tourist receipts are expected to gradually recover, reaching 19.5 percent of GDP in the medium term, in line with economic developments in the main source markets for tourism (the USA and the UK), but still below the pre-crisis levels. FDI inflows are also assumed to partially recover to the pre-crisis levels, averaging about 22 percent of GDP during 2011–16. The external current account deficit is expected to widen in 2011 due to the impact of higher energy and food prices. It will converge to about 21.4 percent of GDP in the medium term.

- **Fiscal Balance**: The primary surplus of the central government is expected to reach 5 percent of GDP in 2011, reflecting three key projections: (i) revenue from the implementation of a VAT and the increase in the electricity tariff; (ii) constraining of capital expenditure; and (iii) two tranches of EU sugar grant will be disbursed in the second-half of the year. Furthermore, the primary surplus is expected to increase to 5.4 percent of GDP in 2012 through freezing the public wage bill and containing expenditure on goods and services. Financing gaps will be filled almost exclusively by recourse to the domestic banking system (we assume 90 percent domestic financing by commercial banks at a market interest rate with the remaining 10 percent externally financed).

- **Fund program**: We consider public debt developments in the context of a three-year SBA with access of SDR 52.5 million (590 percent of quota). The disbursements are programmed to become available on a quarterly basis following the Board's approval after each review. Exceptional access will be required as disbursements in 2011 will be about 378 percent of quota, exceeding the normal access limit of 200 percent of quota on an annual basis.

C. Evaluation of External and Public Debt Sustainability under the Non-Restructuring Scenario

6. **Although external public debt is projected to decline over the medium term and can sustain most shocks, the adoption of strong fiscal adjustment measures will not be enough to place St. Kitts and Nevis's total PPG on a sustainable path.** External debt is projected to fall from the current level of about 60 percent of GDP to about 23 percent of GDP in the medium term (Figure 1 and Table 1). Shocks to the economy will not deter its downward trajectory although it will converge to a higher debt level in the medium term. Total public debt is set to decrease from 199 percent of GDP in 2010 to 162 percent of GDP by 2016 (Figure 2 and Tables 2). The bound tests show that a growth shock will reverse the downward trajectory of public debt causing it to be on an explosive path despite adoption of strong reforms. The range of shocks would cause the PPG debt-to-GDP ratio to range between 160 to 201 percent of GDP in the medium term.

7. **A comprehensive and substantive debt restructuring is needed to put St. Kitts and Nevis' total PPG debt on a sustainable path.** Even with the substantial fiscal measures contemplated, PPG debt would not decline significantly as a share of GDP in the absence of a

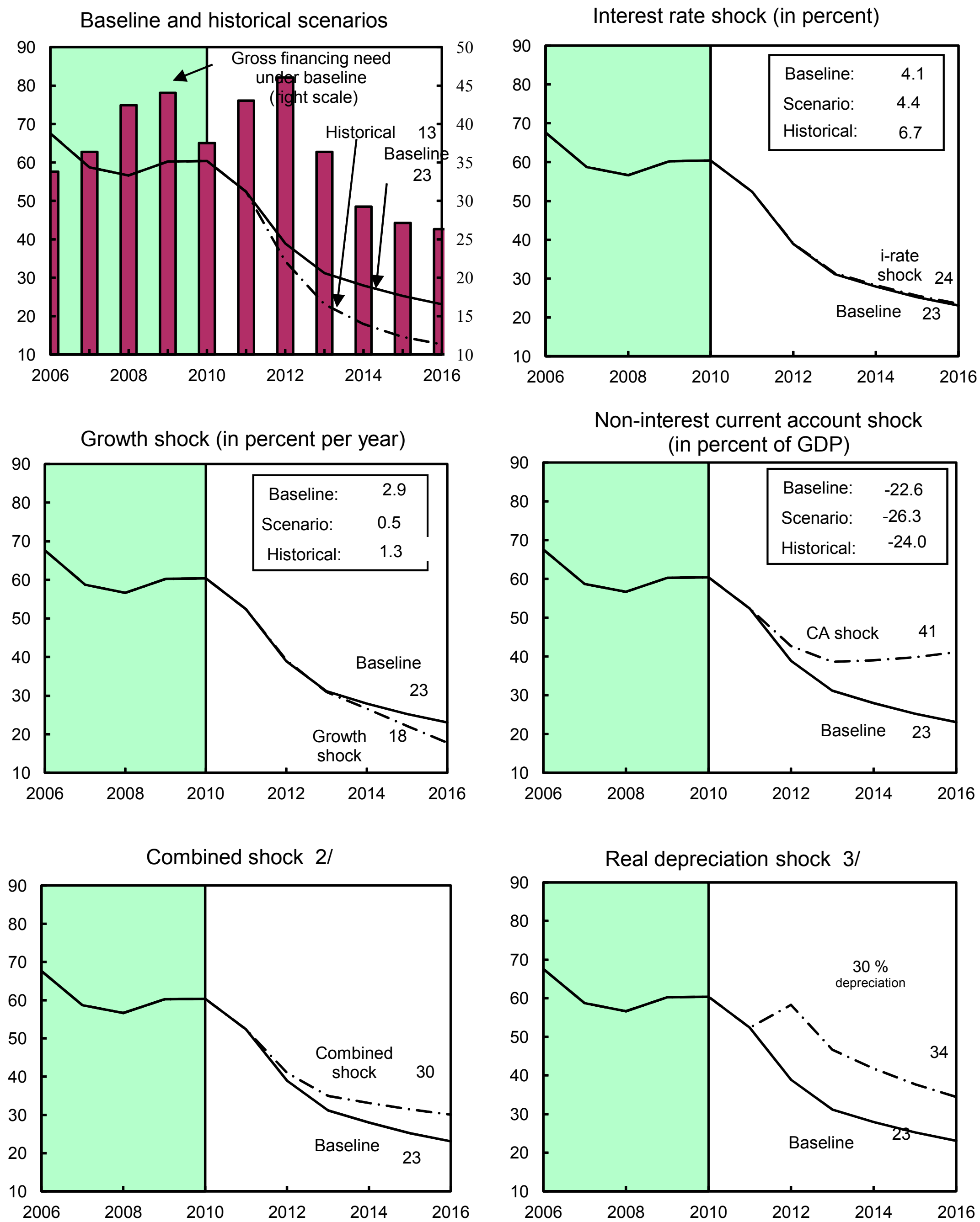
comprehensive debt restructuring. In this context, the authorities have retained debt and legal advisors, publicly announced to seek a comprehensive and substantive debt restructuring, initiated discussions with creditors, and obtained financing assurances from the Paris Club. The authorities' strategy, developed with the assistance of their debt advisors, would bring public debt levels closer to the ECCU target of 60 percent of GDP by 2020.[3]

D. Conclusion

8. **This DSA illustrates that St. Kitts and Nevis' PPG debt is unsustainable even in the presence of strong fiscal adjustment measures, thus making a comprehensive debt restructuring critical.** The adoption of strong fiscal adjustment measures will put debt on a downward trajectory but it will still be at an uncomfortably high level, achieving a public debt-to-GDP ratio of about 162 percent by 2016. Furthermore, growth shocks can cause the PPG debt to switch to an explosive path. A comprehensive and substantive debt restructuring, therefore, is critical to ensure fiscal sustainability. The authorities' debt restructuring scenario currently under discussion is expected to bring the debt-to-GDP ratio down towards the ECCU's target level of 60 percent by 2020.

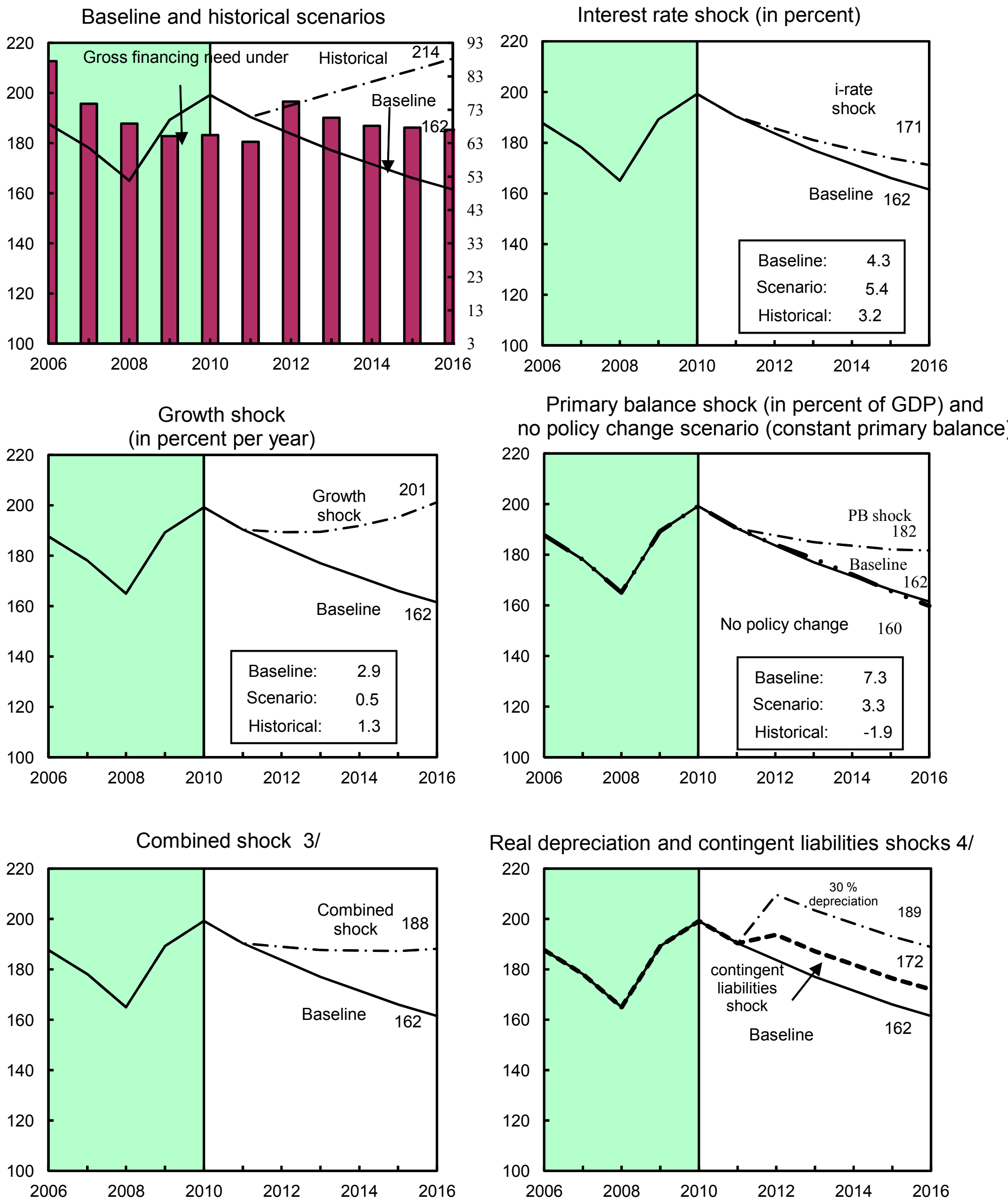
[3] The debt-to-GDP target would remain the same under the rebased GDP.

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



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2010.

Figure 2. St. Kitts and Nevis: Public Debt Sustainability: Bound Tests 1/ 2/
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
4/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 1. St. Kitts and Nevis: External Debt Sustainability Framework, 2006-2016
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2006	2007	2008	2009	2010			2011	2012	2013	2014	2015	2016	Debt-stabilizing non-interest current account 6/
Baseline: External debt	67.6	58.7	56.6	60.2	60.4			**52.4**	**38.9**	**31.2**	**28.0**	**25.2**	**23.1**	**-21.2**
Change in external debt	-8.8	-8.9	-2.1	3.6	0.2			-8.0	-13.4	-7.7	-3.2	-2.7	-2.2	
Identified external debt-creating flows (4+8+9)	-3.4	-4.2	-5.7	14.7	7.6			8.9	6.4	4.2	2.3	0.8	-0.2	
Current account deficit, excluding interest payments	15.9	20.5	29.6	30.2	23.9			26.8	25.3	23.7	22.3	21.1	20.4	
Deficit in balance of goods and services	17.4	21.5	30.8	31.4	25.3			28.5	26.9	25.3	23.8	22.4	21.7	
Exports	48.4	44.9	40.4	35.3	35.7			36.7	37.6	38.4	39.1	39.8	40.6	
Imports	65.8	66.5	71.2	66.6	60.9			65.2	64.5	63.6	63.0	62.3	62.3	
Net non-debt creating capital inflows (negative)	-18.4	-23.7	-33.0	-22.8	-19.6			-19.8	-20.0	-20.1	-20.3	-20.5	-20.8	
Automatic debt dynamics 1/	-1.0	-1.1	-2.2	7.4	3.3			1.9	1.2	0.6	0.3	0.1	0.2	
Contribution from nominal interest rate	4.6	3.7	3.6	3.7	3.6			2.7	2.1	1.5	1.1	1.1	1.0	
Contribution from real GDP growth	-1.8	-2.6	-2.4	5.8	0.9			-0.9	-0.9	-0.9	-0.9	-0.9	-0.8	
Contribution from price and exchange rate changes 2/	-3.8	-2.1	-3.4	-2.1	-1.2			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-5.3	-4.7	3.6	-11.1	-7.5			-17.0	-19.9	-12.0	-5.5	-3.5	-2.0	
External debt-to-exports ratio (in percent)	139.7	130.6	140.3	170.7	169.3			142.6	103.4	81.3	71.5	63.4	56.8	
Gross external financing need (in billions of US dollars) 4/	0.2	0.2	0.2	0.2	0.2			0.2	0.3	0.2	0.2	0.2	0.2	
in percent of GDP	33.8	36.4	42.4	44.1	37.5	10-Year	10-Year	43.0	46.0	36.4	29.3	27.1	26.3	
Scenario with key variables at their historical averages 5/								**52.4**	**34.3**	**23.1**	**17.9**	**14.6**	**12.7**	**-24.6**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	2.6	4.2	4.6	-9.6	-1.5	1.3	4.8	1.5	1.8	2.5	3.0	3.5	3.5	
GDP deflator in US dollars (change in percent)	5.2	3.3	6.2	3.9	1.9	3.3	1.5	4.0	3.5	2.5	2.6	2.6	2.6	
Nominal external interest rate (in percent)	6.5	5.9	6.8	6.1	5.9	6.7	0.6	4.8	4.2	4.0	3.9	4.0	4.3	
Growth of exports (US dollar terms, in percent)	4.0	-2.1	-0.3	-19.3	1.5	2.8	10.6	8.7	7.9	7.1	7.7	8.1	8.2	
Growth of imports (US dollar terms, in percent)	14.5	6.4	19.0	-13.6	-8.2	3.1	11.0	12.9	4.2	3.6	4.5	5.0	6.2	
Current account balance, excluding interest payments	-15.9	-20.5	-29.6	-30.2	-23.9	-24.0	7.5	-26.8	-25.3	-23.7	-22.3	-21.1	-20.4	
Net non-debt creating capital inflows	18.4	23.7	33.0	22.8	19.6	24.8	9.1	19.8	20.0	20.1	20.3	20.5	20.8	

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

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

3/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

Table 2. St. Kitts and Nevis: Public Sector Debt Sustainability Framework, 2006-2016
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	**Debt-stabilizing primary balance 9/**
Baseline: Public sector debt 1/	187.7	178.2	165.0	189.3	199.2	**190.4**	**183.7**	**177.1**	**171.6**	**166.1**	**161.5**	**2.1**
o/w foreign-currency denominated	67.6	58.7	56.6	60.2	60.4	52.4	38.9	31.2	28.0	25.2	23.1	
Change in public sector debt	-7.8	-9.6	-13.1	24.3	10.0	-8.8	-6.7	-6.6	-5.5	-5.5	-4.6	
Identified debt-creating flows (4+7+12)	-6.4	-10.6	-16.1	12.5	8.0	-6.4	-6.4	-6.3	-5.1	-5.1	-4.2	
Primary deficit	-2.9	-4.3	-4.0	-5.9	-2.7	-7.6	-7.9	-8.8	-6.7	-6.5	-6.4	
Revenue and grants	48.0	47.8	45.6	51.5	48.3	52.9	51.3	51.7	49.1	48.9	48.8	
Primary (noninterest) expenditure	45.1	43.5	41.6	45.6	45.6	45.2	43.4	42.9	42.3	42.4	42.5	
Automatic debt dynamics 2/	-3.0	-3.7	-8.0	20.6	11.6	1.4	1.7	2.7	2.1	2.0	2.7	
Contribution from interest rate/growth differential 3/	-3.0	-3.7	-8.0	20.6	11.6	1.4	1.7	2.7	2.1	2.0	2.7	
Of which contribution from real interest rate	1.7	3.6	-0.6	3.7	8.8	4.3	5.0	7.1	7.2	7.6	8.2	
Of which contribution from real GDP growth	-4.7	-7.3	-7.4	16.8	2.8	-2.8	-3.3	-4.4	-5.0	-5.7	-5.5	
Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	
Other identified debt-creating flows	-0.5	-2.6	-4.0	-2.2	-0.9	-0.3	-0.3	-0.3	-0.5	-0.5	-0.5	
Privatization receipts (negative)	-0.5	-2.6	-4.0	-2.2	-0.9	-0.3	-0.3	-0.3	-0.5	-0.5	-0.5	
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	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	-1.4	1.0	3.0	11.8	1.9	-2.4	-0.3	-0.3	-0.4	-0.4	-0.4	
Public sector debt-to-revenue ratio 1/	391.4	372.8	361.8	367.4	412.2	360.3	358.2	342.6	349.8	339.4	330.7	
Gross financing need 6/	87.6	74.8	68.9	65.1	65.4	63.4	75.4	70.6	68.2	67.7	67.0	
in billions of U.S. dollars	0.4	0.4	0.4	0.3	0.3	0.4	0.4	0.4	0.4	0.5	0.5	
Scenario with key variables at their historical averages 7/						**190.4**	**195.1**	**199.9**	**204.5**	**209.1**	**213.7**	**3.2**
Scenario with no policy change (constant primary balance) in 2011-2016						**190.4**	**184.0**	**178.5**	**172.2**	**165.7**	**159.8**	**2.1**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	2.6	4.2	4.6	-9.6	-1.5	1.5	1.8	2.5	3.0	3.5	3.5	
Average nominal interest rate on public debt (in percent) 8/	6.3	5.5	6.1	5.6	6.6	6.3	6.3	6.6	6.9	7.4	7.9	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	1.1	2.2	-0.1	1.7	4.6	2.3	2.8	4.1	4.3	4.8	5.3	
Nominal appreciation (increase in US dollar value of local currency, in percent)	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	5.2	3.3	6.2	3.9	1.9	4.0	3.5	2.5	2.6	2.6	2.6	
Growth of real primary spending (deflated by GDP deflator, in percent)	-5.9	-1.5	0.0	-2.5	-1.5	0.6	-2.3	1.3	1.6	3.7	3.6	
Primary deficit	-2.9	-4.3	-4.0	-5.9	-2.7	-7.6	-7.9	-8.8	-6.7	-6.5	-6.4	

1/ Public sector covers general government and gross debt is used.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

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

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

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

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

INTERNATIONAL MONETARY FUND

ST. KITTS AND NEVIS

Staff Report for the 2011 Article IV Consultation and Request for Stand-By Arrangement

Informational Annex

Prepared by the Western Hemisphere Department

July 20, 2011

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Annexes

Annex I. St. Kitts and Nevis—Fund Relations

(As of May 31, 2011)

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

II.	**General Resources Account:**	**SDR Million**	**Percent of Quota**
	Quota	8.90	100.00
	Fund holdings of currency	11.04	124.09
	Reserve position in the Fund	0.08	0.92

III.	**SDR Department:**	**SDR Million**	**Percent of Allocation**
	Net cumulative allocation	8.50	100.00
	Holdings	8.47	99.61

IV.	**Outstanding Purchases and Loans:**	**SDR Million**	**Percent of Allocation**
	Emergency Assistance	2.23	25.00

V. **Latest Financial Arrangements:** None

VI. **Projected Payments to Fund[1/]:** None

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2011	2012	2013	2014	2015
Principal		0.56	1.11	0.56	
Charges/Interest	0.02	0.03	0.02	0.00	0.00
Total	0.02	0.59	1.13	0.56	0.00

[1/] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

VII. **Implementation of HIPC Initiative:** Not Applicable

VIII. **Implementation of MDRI Assistance:** Not Applicable

IX. **Exchange Arrangement**

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

X. **Safeguards Assessment**

Under the Fund's safeguards assessment policy, the Eastern Caribbean Central Bank (ECCB) is subject to a full safeguards assessment under a four-year cycle. The most recent assessment was completed in July 2007 and concluded that the ECCB continues to have appropriate control mechanisms in place, which have strengthened since the first safeguards assessment was completed in 2003. ECCB management places emphasis on good governance and sound controls, and has enhanced the bank's transparency and accountability since the last assessment, including publications of financial statements that comply with International Financial Reporting Standards. The assessment made some recommendations to sustain the ECCB’s safeguards framework going forward.

XI. **Last Article IV Consultation**

St. Kitts and Nevis is on the standard 12-month consultation cycle. The last Article IV consultation was concluded by the Executive Board on July 7, 2010.

XII**. FSAP Participation, ROSCs, and OFC Assessment**

St. Kitts and Nevis participated in the regional ECCU FSAP conducted in September and October 2003. The Financial System Stability Assessment is available at www.imf.org/external/pubs/ft/scr/2004/cr04293.pdf. A review of St. Kitts and Nevis AML/CFT Assessment was conducted by a team of assessors representing the Caribbean Financial Action Taskforce (CFATF) in September 2008.

XIII. **Technical Assistance: (2005–Present)**

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

- Experts from CARTAC and the IMF's Statistics Department (STA) advised the Central Statistics Office on rebasing and improving the national accounts, rebasing the consumer price index, and developing export-import price indices. In response to a request from the authorities, experts from CARTAC assisted in compiling separate production-based measures of GDP for St. Kitts and Nevis.

- Experts from CARTAC, the IMF's Monetary and Capital Markets Department (MCM), and the IMF's Legal Department (LEG) advised the authorities on strengthening financial regulation and supervision, including risk-based supervision. With assistance from the Office of the Superintendent of Financial Institutions in Canada (OSFI), experts from CARTAC have provided technical assistance to the ECCB on drafting the OECS Insurance Act. They have also, in conjunction with LEG, provided technical assistance to the ECCB in finalizing the drafting of the OECS Money Services business Act. Experts from CARTAC also assisted in the development of the Single Regulatory Unit.

- Experts from CARTAC and MCM also provided technical assistance on public debt management to improve debt management capacity of the government.

- Experts from CARTAC, the IMF's Fiscal Affairs Department (FAD) and LEG provided assistance to improve cash management and tax administration—including collection enforcement. Experts from CARTAC have also provided assistance in Property Tax reform to move the property tax base from rental value to market value, and in improving central government fiscal and debt data.

- CARTAC, FAD and LEG have provided assistance for implementation of a value-added tax (VAT). CARTAC and FAD have provided extensive assistance, through frequent expert visits, to sensitize politicians and technicians from the Ministry of Finance on the VAT. This provided a general explanation on VAT, a VAT sensitivity study, and the main steps in its introduction. Experts from CARTAC assisted with the preparation of a VAT Implementation Project Plan, and experts from LEG assisted in the drafting of the VAT and excise tax legislation.

- Experts from LEG also provided assistance in tax legislation in the areas of Social Service Levy and Corporate Income Tax.

- Experts from CARTAC provided assistance in the administration and design of a new pension plan for public sector employees.

- A capacity building exercise was conducted to train new officers in the preparation of fiscal and debt projections.

As part of the Stabilization and Adjustment Technical Assistance Program (SATAP), St. Kitts and Nevis have benefited from capacity building in macroeconomic analysis.

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

(As of June 13, 2011)

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. It sets 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 will support 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 will focus 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 will provide urgent 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 $120 million on IBRD terms and up to $73 million of IDA financing for the six Bank Members of the OECS, including St. Kitts and Nevis. St. Kitts and Nevis graduated from access to IDA resources in 1994.

A. Projects

There is one active Bank project in St. Kitts and Nevis for a net commitment of approximately US$0.54 million.

The **Telecommunications & ICT Development Project**, approved in May 2005 for US$0.54 million, aims at improving the access, quality, and use of telecommunications and ICT services to achieve socio-economic development in the Organization of Eastern Caribbean States (OECS). The project has four components. Component 1 will strengthen the national and regional regulatory frameworks and promote additional competition in the telecommunications sector. Emphasis will be given on providing capacity building to the Eastern Caribbean Telecommunications Authority (ECTEL) and the National Telecommunications Regulatory Commissions (NTRCs) by assisting them in revising the regional and national sector legislation, and in developing a modem interconnection regime. Component 2 will review current universal access policy, create related guidelines, and provide financial support to establish a Universal Service Fund (USF). Component 3 will improve growth and competitiveness in ICT-enabled services through utilization of broadband infrastructure. Component 4 will finance the management and administration of the overall project. The project will finance related technical assistance by providing complementary resources.

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 St. Kitts and Nevis.

The Bank's program in St. Kitts and Nevis is further supported by a comprehensive series of completed, ongoing and planned analytical and advisory activities, including the following: "Towards a New Agenda for Growth" – OECS growth and competitiveness study (2005); An OECS Skills Enhancement Policy Note (2006); a Caribbean Air Transport Report (2006); a regional study on Crime, Violence, and Development: Trends, Costs, and Policy Options in the Caribbean (2007); an OECS Private Sector Financing Study (2008); the OECS Tourism Backward Linkages Study (2008); the report 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).

C. Financial Relations

(In millions of U.S. dollars)

Operation	**Original Principal**	**Available[1]**	**Disbursed[1]**
OECS Telecommunications and ICT Development Project	0.54	0.20	0.23

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 Ending June 30)

	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011***
Total disbursements	1.38	1.9	4.12	2.38	1.66	1.35	1.85	2.04	2.66	0.36	0.03
Repayments	0.05	0.12	0.36	0.67	0.89	1.18	1.75	2.56	2.65	2.57	2.30
Net disbursements	1.32	1.78	3.76	1.71	0.77	0.17	0.1	-0.52	0.003	-2.22	-2.26
Interest and fees	0.34	0.4	0.64	0.6	0.65	0.70	0.76	0.75	0.52	0.28	0.14

***Note: Data as of June 13, 2011**

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

(As of May 31, 2011)

The Caribbean Development Bank (CDB) supports the economic and social development of St. Kitts and Nevis through the financing of priority capital projects and technical assistance, and by undertaking policy dialogue on major developmental issues. CDB's involvement with St. Kitts and Nevis covers such areas as: the formulation and implementation of macroeconomic, social and sectoral policies; development of infrastructure to facilitate economic growth and diversification; direct and indirect lending to agriculture and industry; and emergency disaster rehabilitation. At the end of May 2011, CDB had approved loans totalling US$166.9 million to St. Kitts and Nevis, of which US$21.2 million were undisbursed.

A. Major Projects Currently Under Implementation

1. *Basic Education Project*—to assist Government of St. Kitts and Nevis (GOSKN) in the provision and maintenance of a more appropriate learning environment for a greater number of students in the system (including those with learning disabilities) who are pursuing basic education at primary and secondary schools; and enhancement of the education system in the areas of management, in particular, planning, data collection and analysis, student assessment, school management, curriculum development and pedagogy.

2. *West Basseterre By-Pass Road*—to construct approximately 3.8 kilometres of road to relieve traffic congestion in the city of Basseterre. The proposed road runs to the north of Basseterre and along the boundary fence of the Robert L. Bradshaw International Airport.

3. *Second Power Project*—consists of the installation of a generator of approximate size 2.5MW and ancillary switchgear and the establishment of an operations facility at the Nevis Electricity Company Limited (NEVLEC). The project will provide additional generating capacity to satisfy projected electricity demand and to replace existing engines that are past their useful life.

4. *Student Loan Scheme* (Sixth Loan)—to assist the National Bank of St Kitts- Nevis-Anguilla in financing loans to students attending local, regional and extra-regional institutions for programmes in technical, vocational and academic studies.

5. *Child Development Project*—to provide a comprehensive framework for addressing the care and protection of children and the reform of juvenile offenders. The project will enhance the life chances of children in St. Kitts and Nevis by improving their connectedness with the school system and providing rehabilitative care for those at risk and those who have committed offences.

6. *Natural Disaster Management Project*—to contribute to the rehabilitation of economic infrastructure damaged by Hurricane Lenny. The project consists of rehabilitating 8.66 metres of sea defence structures with rock armouring and stone on geo-textile sheeting; reconstruction of a reinforced concrete ramp; and repairs to other infrastructure and public buildings. The project promotes the reduction of vulnerability to natural disasters through support for the development and adoption of mitigation policies, standards and practices.

7. *Policy-based Guarantee*—to support a bond issue of up to EC$150 million by the Government to refinance high cost debt thereby supporting ongoing macroeconomic reforms and structural reforms in St. Kitts and Nevis. The refinancing would also improve the debt dynamics, thus lowering the time-path of the debt-to-GDP ratio.

8. *National Disaster Management—Immediate Response Loan—Tropical Storm Otto*—to contribute to the rehabilitation of economic infrastructure damaged by Tropical Storm Otto. The Project consists of the restoration of part of Basseterre Bay Road, the reconstruction of 200 metres of sea defence wall and associated roadworks.

B. Current Portfolio

(In millions of U.S. dollars)

	Approved	**Undisbursed**
Basic Education Project	14.25	1.34
Natural Disaster Management Project	6.70	3.47
Student Loan Scheme (Sixth Loan)	6.20	6.20
Second Power Project	8.43	8.38
West Basseterre By-Pass Road	13.85	2.39
Child Development Project	2.64	1.49
Corporatisation of the Electricity Department	0.66	0.20
Policy-Based Guarantee	8.30	8.30
National Disaster Management - Immediate Response Loan	0.75	0.75

C. Loan Disbursement

(In millions of U.S. dollars)

	2006	2007	2008	2009	2010
Net Disbursement	4.32	6.44	9.26	2.16	8.21
Disbursement	7.38	10.41	15.43	6.91	13.65
Amortization	3.06	3.97	6.71	4.75	5.44
Interest and charges	3.35	3.77	3.93	3.59	3.44
Net resource flow	0.97	2.67	5.33	-1.43	4.77

Source: Caribbean Development Bank

Annex IV. St. Kitts and Nevis: Statistical Issues

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

A. Real Sector

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

B. Public Finances

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

C. Balance of Payments and External Debt

Estimates are currently provided on an annual basis by the Eastern Caribbean Central Bank (ECCB). The latest data published in *IFS* are for 2010. Data on external trade (especially exports) are not comprehensive, as they omit important categories of goods. Most components of the financial account also need improvement. It would be useful to reconcile the data on the public sector investment plan for external loans with the public external debt database. There are no data on private external debt.

D. Monetary and Financial Statistics

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

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

St. Kitts and Nevis: Table of Common Indicators Required for Surveillance

(As of June 30, 2011)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	Fixed Rate	n.a.	n.a.	n.a.	n.a.
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	04/11	06/13/11	M	M	M
Reserve/Base Money	04/11	06/13/11	M	M	M
Broad Money	04/11	06/13/11	M	M	M
Central Bank Balance Sheet	04/11	06/13/11	M	M	M
Consolidated Balance Sheet of the Banking System	04/11	06/13/11	M	M	M
Interest Rates[2]	04/11	06/13/11	M	M	M
Consumer Price Index	12/10	05/19/11	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	04/11	05/20/11	M	M	A
Stocks of Central Government and Central Government-Guaranteed Debt[5]	12/10	05/23/11	Q	Q	A
External Current Account Balance	2009	04/14/10	A	A	A
Exports and Imports of Goods and Services	2009	04/14/10	A	A	A
GDP/GNP	2009	04/14/10	A	A	A
Gross External Debt	12/10	05/23/11	Q	Q	A

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] Central government only.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).

INTERNATIONAL MONETARY FUND

St. Kitts and Nevis—Assessment of the Risks to the Fund and the Fund's Liquidity Position

Prepared by the Finance and Strategy, Policy, and Review Departments

(In consultation with other Departments)

Approved by Andrew Tweedie and Jan Kees Martijn

July 21, 2011

1. **This paper assesses the risks to the Fund arising from the proposed Stand-By Arrangement (SBA) for St. Kitts and Nevis and its effects on the Fund's liquidity, in accordance with the policy on exceptional access.**[1] The authorities are requesting a three-year SBA with access of SDR 52.5 million (590 percent of quota). The arrangement would be front-loaded with a first purchase of SDR 22.150 million (248.9 percent of quota) upon approval, followed by 11 purchases of diminishing size in 2011–14, with the final purchase in May 2014 (Table 1).

Table 1. St. Kitts and Nevis: Proposed SBA—Access and Phasing

			Percent of quota	
Availability	Date 1/	SDR mn	Purchase	Cumulative
2011	July 27, 2011	22.150	248.9	248.9
	November 15, 2011	11.470	128.9	377.8
2012	February 15, 2012	3.161	35.5	413.3
	May 15, 2012	3.161	35.5	448.8
	August 15, 2012	3.161	35.5	484.3
	November 15, 2012	3.161	35.5	519.8
2013	February 15, 2013	1.105	12.4	532.2
	May 15, 2013	1.105	12.4	544.7
	August 15, 2013	1.105	12.4	557.1
	November 15, 2013	1.105	12.4	569.5
2014	February 15, 2014	0.913	10.3	579.7
	May 15, 2014	0.913	10.3	590.0
	Total	**52.510**	**590.0**	

Source: Finance Department.

1/ Starting July 27, 2011, purchases will depend on the completion of a review.

[1] Decision No. 14284-(08/18), February 22, 2008, as amended by Decision No. 1418-(08/93), October 29, 2008, and Decision No. 14284-(09/29), March 24, 2009.

I. Background

2. **St. Kitts and Nevis received emergency natural disaster assistance from the Fund in May 2009.** This assistance, SDR 2.225 million (25 percent of quota), was the first drawing on Fund resources since the country joined the Fund in August 1984. St. Kitts and Nevis has met all its obligations to the Fund in a timely manner.

3. **Public debt and its external component are extremely high.** Reflecting chronic deficits and assumption of liabilities (and assets) of the former sugar company, total public debt rose to an estimated near 200 percent of GDP at end-2010.[2] According to preliminary data for last year, external debt, mostly owed to the Caribbean Development Bank and commercial creditors, exceeded 60 percent of GDP (Table 2),[3] and the external debt service, of which interest payments represent one third, was more than 20 percent of exports of goods and services.

4. **The balance of payments situation of St. Kitts and Nevis differs markedly from that of recent capital account crisis cases.** Accordingly, in this paper, the proposed program with St. Kitts and Nevis is compared with two groups: (i) all recent exceptional access arrangements; and (ii) a sub-group of exceptional access cases that did not experience a sudden stop in capital inflows.[4] Compared with all exceptional access arrangements approved since September 2008, St. Kitts and Nevis's public external debt as a share of GDP would be above the mean, and the country's total public debt as a share of GDP would rank by far the highest (Figures 1b and 1d). Compared with recent exceptional access countries which did not face a sudden stop of capital inflows, St. Kitts and Nevis ranks the highest by a significant margin on all relevant ratios (Figure 2).

[2] The ratio is based on current GDP series. The national accounts of the ECCU member states have been rebased with a base year of 2006. For St. Kitts and Nevis, this will result in a 28 percent increase in the 2009 nominal GDP, mainly reflecting a broader coverage of financial, communication, and offshore education services. Under the rebased GDP, public sector debt is estimated at 155.8 percent of GDP in 2010.

[3] All reported external debt is owed by the public sector. Staff believes external private sector debt to be minimal.

[4] The reference group includes, in addition to St. Kitts and Nevis, Armenia, Belarus, Costa Rica (precautionary SBA), El Salvador (precautionary SBA), Georgia, Guatemala (precautionary SBA), Mongolia, Pakistan and Sri Lanka.

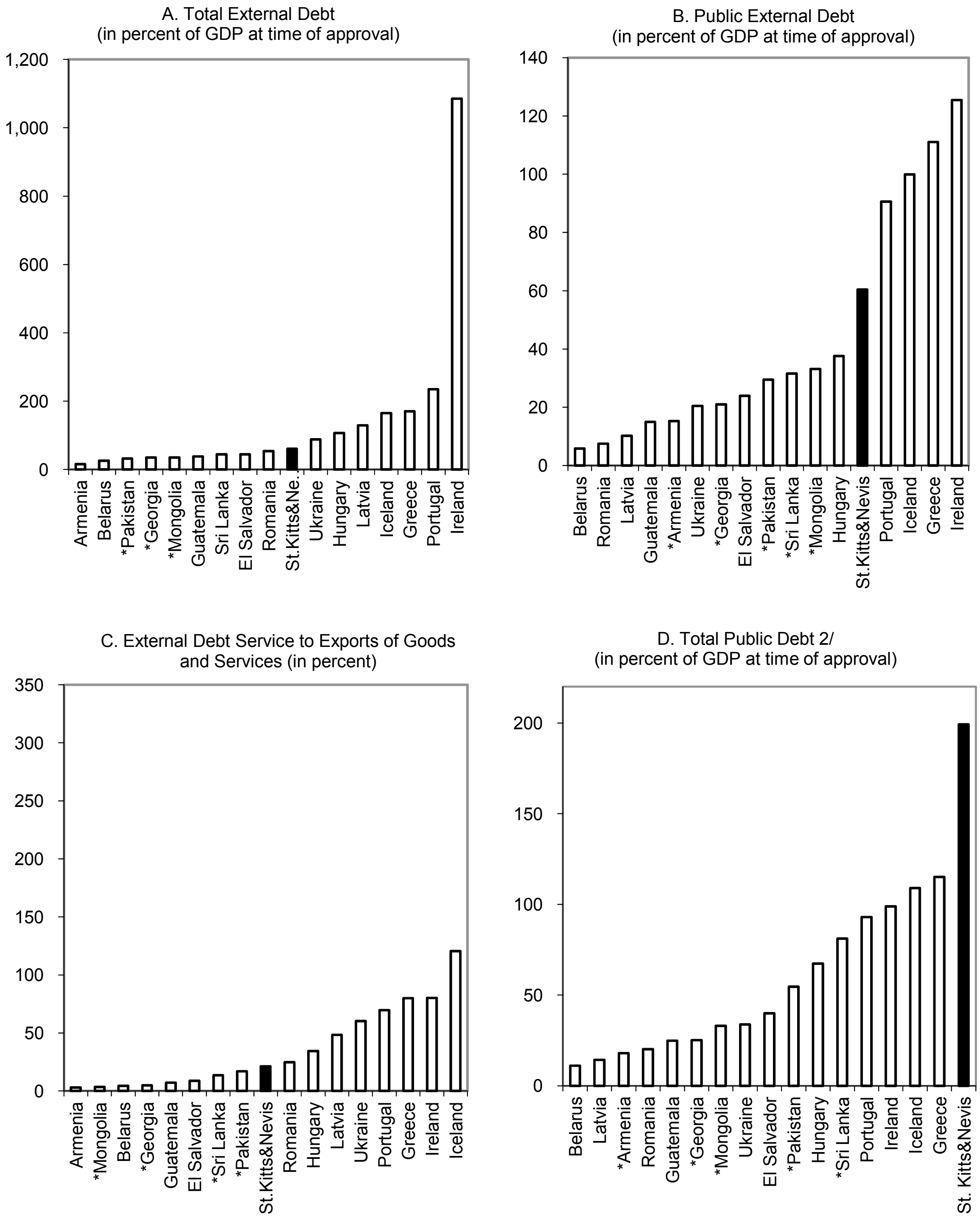
Table 2. St. Kitts and Nevis: Total External Debt, 2004–2010

	2004	2005	2006	2007	2008	2009	2010
	(In millions of U.S. dollars)						
Total External Debt	339	335	329	301	323	317	319
of which: Bonds	13	13	16	16	38	38	38
Loans	0	0	0	0	0	0	0
Public	326	322	313	285	285	279	282
Multilateral	98	99	106	107	115	120	124
IMF	0	0	0	0	0	3	3
IBRD/IDA	13	13	15	15	15	14	11
Other multilateral	84	86	91	92	100	103	110
Bilateral	46	40	45	42	38	34	30
Commercial	183	183	163	136	132	125	127
Private 1/							
	(In percent of GDP)						
Total External Debt	85	76	68	59	57	60	60
of which: Bonds	3	3	3	3	7	7	7
Loans	0	0	0	0	0	0	0
Public	82	73	64	56	50	53	53
Multilateral	24	23	22	21	20	23	24
IMF	0	0	0	0	0	1	1
IBRD/IDA	3	3	3	3	3	3	2
Other multilateral	21	20	19	18	18	20	21
Bilateral	12	9	9	8	7	6	6
Commercial	0	0	0	0	0	0	0
Memorandum item:							
Nominal GDP (in USD mn)	0	0	0	0	0	0	0

Source: St. Kitts and Nevis' authorities and IMF staff estimates.

1/ No data is available on private debt, which Staff believes is minimal.

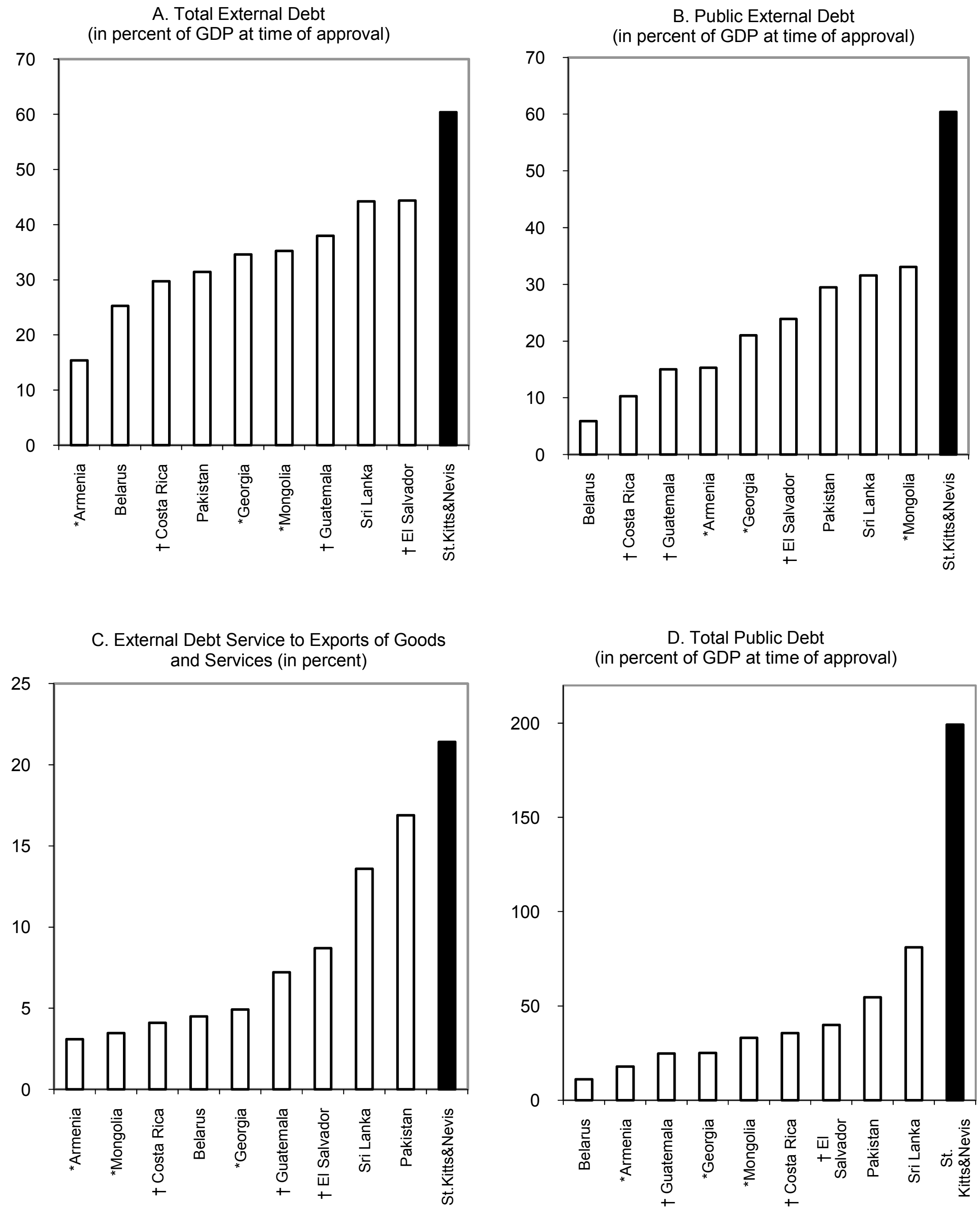
Figure 1. Debt Ratios for Recent Exceptional Access Arrangements 1/



Source: St. Kitts and Nevis authorities and IMF staff estimates, and World Economic Outlook.

1/ For arrangements approved since September 2008, estimates as reported in each staff report on the request of the Stand-By Arrangement or Extended Fund Facility.
* Indicates countries that are PRGT-eligible.
† Indicates countries with precautionary arrangements.

Figure 2. Debt Ratios for Selected Recent Exceptional Access Arrangements 1/



Source: St. Kitts and Nevis authorities and IMF staff estimates, and World Economic Outlook.

1/ For arrangements approved since September 2008 that did not involve a sudden capital inflows stop, estimates as reported in each staff report on the request of the Stand-By Arrangement or Extended Fund Facility.
* Indicates countries that are PRGT-eligible.
† Indicates countries with precautionary arrangements.

5. **Domestic banks are the largest investors in public debt.** The domestic banking system holds about 46 percent of total public debt. Other important debt holders include commercial external creditors, with a share of around 15 percent, and statutory bodies and the Caribbean Development Bank, each with a share of around 10 percent.

II. NEW STAND-BY ARRANGEMENT—RISKS AND IMPACT ON THE FUND'S FINANCES

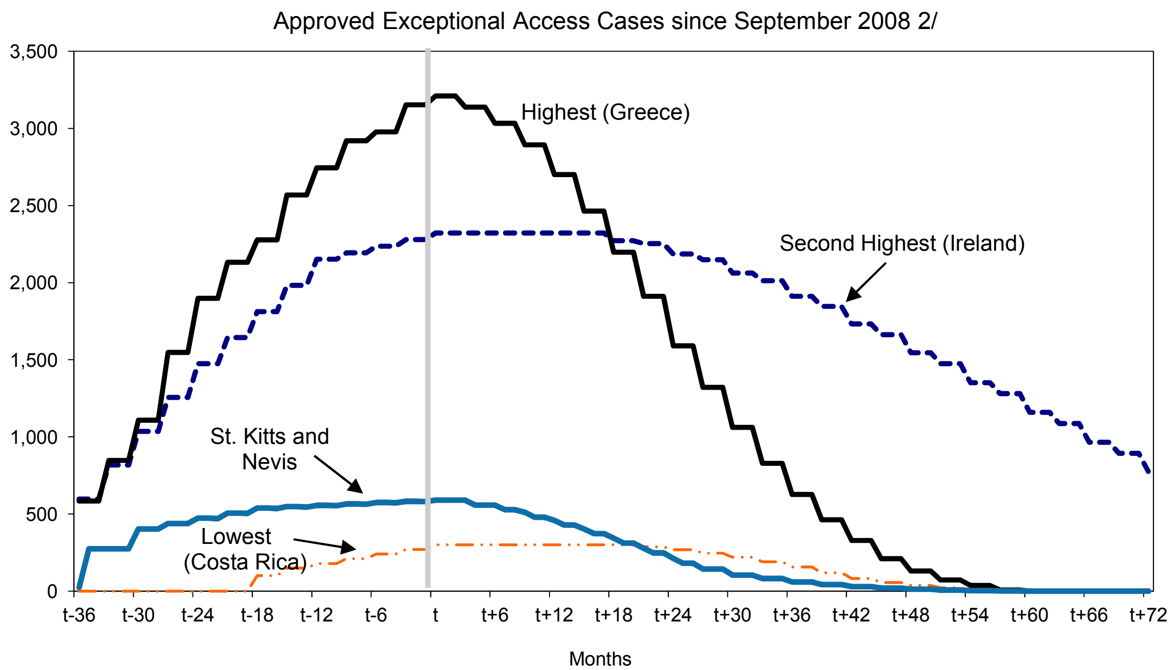
A. Risks to the Fund

6. **Access under the proposed arrangement would be exceptional on account of the first drawing:**

- The proposed phasing of the disbursement is substantially front-loaded. The drawing of 22.150 SDR million (248.9 percent of quota) on Board approval of the SBA would be very large as a share of quota and significantly exceed the annual access limit. St. Kitts and Nevis' initial drawing as a share of quota would be less than the ones in the recent exceptional access arrangements with euro area members (Figure 3), but would be the highest in the reference group of exceptional access countries which did not face a capital account crisis (Figure 4).

- If all purchases were made as scheduled, St. Kitts and Nevis's outstanding use of GRA resources would rise to 448.8 percent of quota during the first year of the arrangement. Fund exposure on account of the arrangement would increase to 544.7 percent of quota by the end of the second year, and peak at 590 percent of quota at the end of the third year, slightly below the cumulative access limit. The projected peak exposure would remain much smaller than the ones for recent exceptional access arrangements with euro area members (Figure 3). However, it would be the highest peak level of Fund exposure, in terms of quota, in the reference group of countries facing no "sudden stop" (Figure 4).

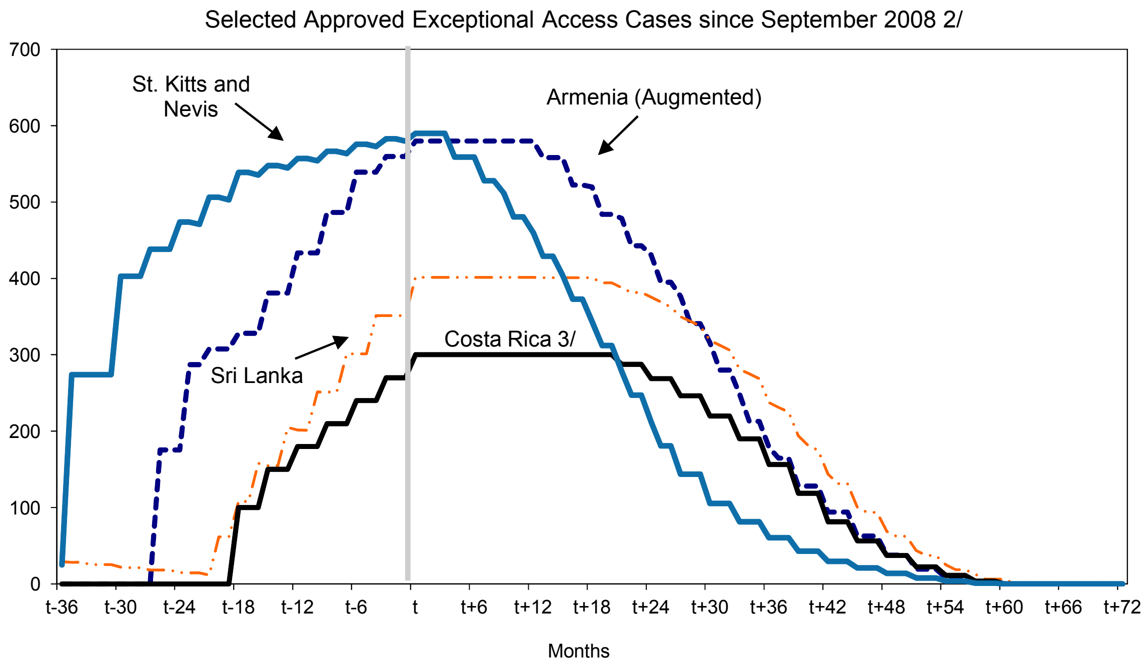
Figure 3. Fund Credit Outstanding in the GRA around Peak Borrowing 1/
(In percent of quota at the time of approval)



Source: IFS, Finance Department, and IMF staff estimates.

1/ Peak borrowing 't' is defined as the highest level of credit outstanding for a member. Repurchases are assumed to be on an obligations basis.
2/ Median credit outstanding at peak is 836.7 percent of quota; average is 1089.1 percent of quota.

Figure 4. Fund Credit Outstanding in the GRA around Peak Borrowing 1/
(In percent of quota at the time of approval)



Source: IFS, Finance Department, and IMF staff estimates.

1/ Peak borrowing 't' is defined as the highest level of credit outstanding for a member. Repurchases are assumed to be on an obligations basis.
2/ Arrangements approved since September 2008 that did not involve a sudden capital inflows stop.
3/ Precautionary arrangement.

7. **If the SBA is fully disbursed, GRA credit ratios would be relatively high by the standard of comparable exceptional access cases (Table 3).**

- GRA credit would peak in 2013 at around 13 percent of GDP and at near 54 percent of gross international reserves. Both ratios are above the median of all recent exceptional access cases (Figure 5), and at or near the top of the exceptional access cases that did not face a sudden capital inflows stop (Figure 6).

- The share of GRA credit in external debt would reach its highest level in 2014, at near 44 percent, the top of all recent exceptional access cases (Figures 5e and 6e).

8. **If all purchases under the SBA are made as scheduled, debt service obligations to the Fund would substantially increase the country's total external debt service burden.**[5] Table 3 shows debt service to the Fund projected under the assumption that the SDR interest rate remains at its current level and that no debt restructuring is implemented. St. Kitts and

[5] Debt service to the Fund is calculated assuming that all repurchases are made as scheduled. Surcharges apply to outstanding credit above 300 percent of quota.

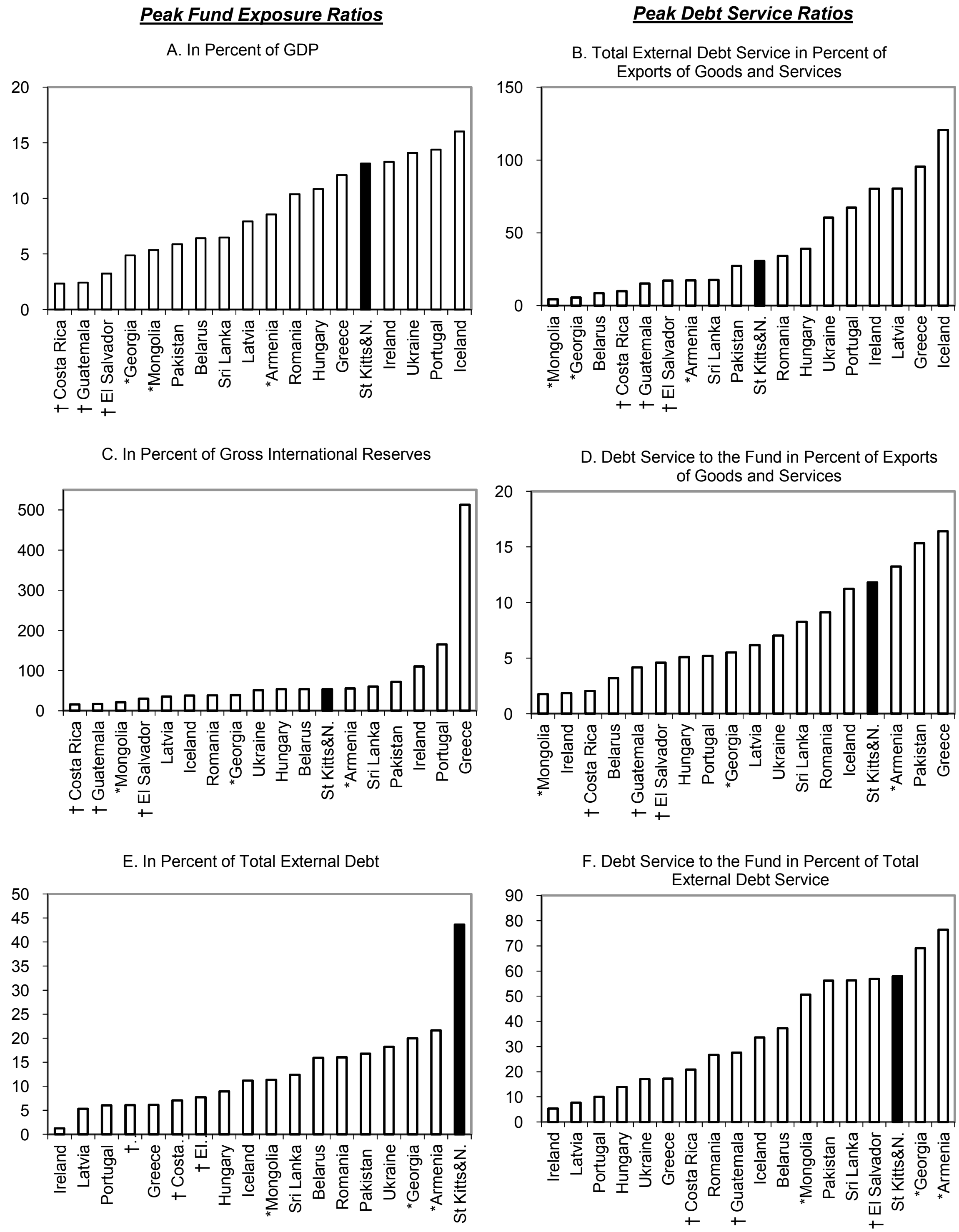
Nevis's projected debt service to the Fund would peak at near 12 percent of goods and services exports in 2015, at which time it would account for around 58 percent of total external debt service. Debt service to the Fund in percent of exports of goods and services (Figure 5d) and in percent of total external debt service would both be among the highest of all recent exceptional access cases. From the point of view of the "no sudden stop" reference group, St. Kitts and Nevis's would have the highest peak Fund exposure both in percent of GDP (Figure 6a) and in percent of total external debt (Figure 6e). Debt service to the Fund in percent of exports of goods and services and in percent of total external debt service would both be near the top of this reference group (Figures 6d and 6f). However, historically, St. Kitts and Nevis has demonstrated the ability to make large external debt service payments—7.6 percent of GDP on average over the last 5 years.

Table 3. St. Kitts and Nevis—Capacity to Repay Indicators 1/

	2010	2011	2012	2013	2014	2015	2016
Exposure and Repayments (In SDR millions)							
GRA credit to St. Kitts and Nevis 2/	-	33.6	46.3	50.7	49.7	30.6	9.4
(In percent of quota)	-	402.8	538.6	575.7	558.9	343.4	105.3
Charges due on GRA credit 3/	-	0.3	0.9	1.2	1.4	1.2	0.5
Debt service due on GRA credit 4/	-	0.3	1.4	2.3	4.7	20.4	21.7
Debt and Debt Service Ratios 5/							
In percent of GDP							
Total external debt	60.4	62.0	51.5	44.3	40.2	32.3	25.1
External debt, public	60.4	62.0	51.5	44.3	40.2	32.3	25.1
GRA credit to St. Kitts and Nevis	-	9.6	12.6	13.1	12.2	7.1	2.0
Total external debt service 6/	7.6	10.6	11.3	9.3	4.3	3.7	3.6
Public external debt service 6/	7.6	10.6	11.5	9.6	5.1	8.1	8.2
Debt service due on GRA credit	-	0.09	0.39	0.60	1.15	4.71	4.71
In percent of Central Government Revenues							
Public external debt service 6/	19.3	24.0	27.0	22.3	12.7	20.2	20.5
Debt service due on GRA credit	-	0.2	0.9	1.4	2.8	11.7	11.7
In percent of Gross International Reserves							
Total external debt	205.0	224.6	198.8	181.9	176.5	152.8	128.0
External debt, public	205.0	211.5	180.6	161.7	156.4	140.3	124.1
GRA credit to St. Kitts and Nevis	-	34.9	48.6	53.9	53.6	33.4	10.4
Debt service due on GRA credit	-	0.3	1.5	2.5	5.0	22.3	24.0
In percent of Exports of Goods and Services							
Total external debt service 6/	21.4	28.8	30.6	25.0	13.1	20.4	20.3
Public external debt service 6/	21.4	28.8	30.6	25.0	13.1	20.4	20.3
Debt service due on GRA credit	-	0.2	1.0	1.6	2.9	11.8	11.6
In percent of Total External Debt							
GRA credit to St. Kitts and Nevis	-	18.4	32.4	42.1	43.6	28.0	8.8
In percent of Total External Debt Service							
Debt service due on GRA credit	-	0.8	3.4	6.3	22.4	57.9	57.2
In percent of Total Public External Debt							
GRA credit to St. Kitts and Nevis	-	18.4	32.4	42.1	43.6	28.0	8.8
In percent of Total Public External Debt Service							
Debt service due on GRA credit	-	0.8	3.4	6.3	22.4	57.9	57.2

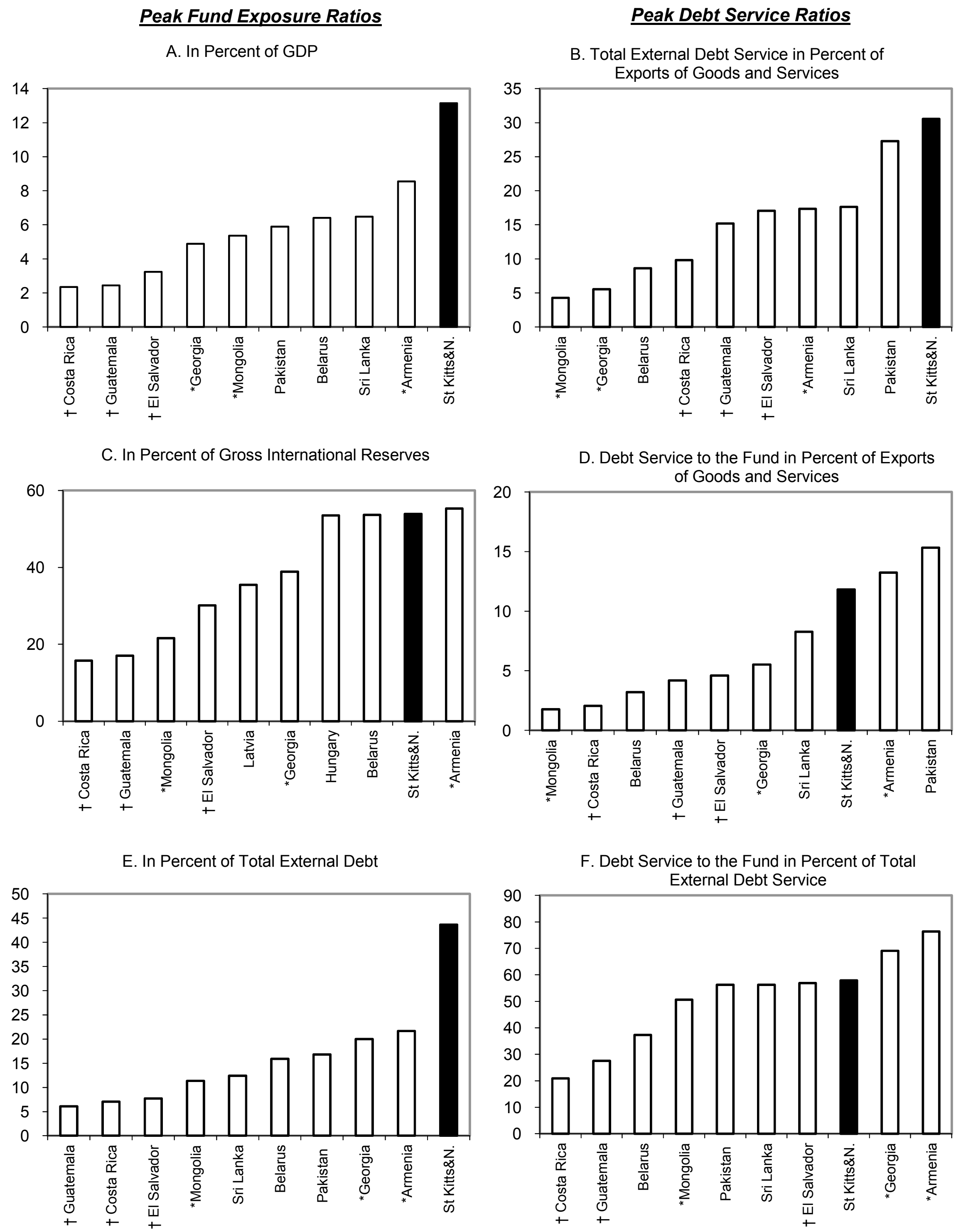
Sources: St. Kitts and Nevis' authorities, Finance Department, World Economic Outlook, and IMF staff estimates.
1/ Assumes full drawings.
2/ Repurchases are assumed to be made as scheduled.
3/ Includes GRA basic rate of charge, surcharges and service fees.
4/ Includes charges due on GRA credit and payments on principal.
5/ Staff projections for external debt, GDP, gross international reserves, and exports of goods and services, as used in the staff report that requests the proposed SBA.
6/ Interest on and amortization of medium and long-term debt.

Figure 5. Peak Fund Exposure and Debt Service Ratios for Recent Exceptional Access Cases



Source: St. Kitts and Nevis and IMF staff estimates, and World Economic Outlook.
* Indicates countries that are PRGT-eligible.
† Indicates countries with precautionary arrangements.

Figure 6. Peak Fund Exposure and Debt Service Ratios for Selected Recent Exceptional Access Cases 1/



1/ Arrangements approved since September 2008 that did not involve a sudden capital inflows stop.
Source: St. Kitts and Nevis and IMF staff estimates, and World Economic Outlook.
* Indicates countries that are PRGT-eligible.
† Indicates countries with precautionary arrangements.

III. IMPACT ON THE FUND'S LIQUIDITY POSITION AND RISK EXPOSURE

9. **The direct impact of the proposed arrangement on the Fund's liquidity and credit risk exposure is minimal:**

- The proposed arrangement would have an insignificant impact on Fund liquidity (Table 4). Commitments under the proposed arrangement would reduce the one-year forward commitment capacity (FCC), which currently stands at about SDR 246 billion, by about 0.02 percent.[6]

- The projected peak GRA exposure of SDR 52.5 million would be very small compared with the reference group of exceptional access countries (Figure 7). As a share of total GRA credit, exposure to St. Kitts and Nevis would peak at a mere 0.07 percent. The share of the top five users of Fund resources in terms of total outstanding credit would not be materially affected.

- In case of arrears on charges under the proposed arrangement, the Fund's remaining burden sharing capacity would be reduced modestly. Projected charges on GRA obligations will peak at SDR 1.4 million in 2014, or about 2.6 percent of the Fund's current estimated residual burden-sharing capacity.

- Potential GRA exposure would remain very limited relative to the level of precautionary balances. After the first purchase, Fund credit to St. Kitts and Nevis would be about 0.27 percent of the Fund's current precautionary balances, and total access would peak at around 0.65 percent of these balances.

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[6] The FCC is the principal measure of Fund liquidity. The (one-year) FCC indicates the amount of GRA resources available for new financing over the next 12 months, and is calculated taking into account recent supplementary resources; as of April 1, 2011, it reflects activation of the enlarged NAB for the six-month period through end-September 2011. See The Fund's Liquidity Position—Review and Outlook (EBS/11/55, April 13, 2011).

Table 4. St. Kitts and Nevis —Impact on GRA Finances
(In millions of SDR unless otherwise noted)

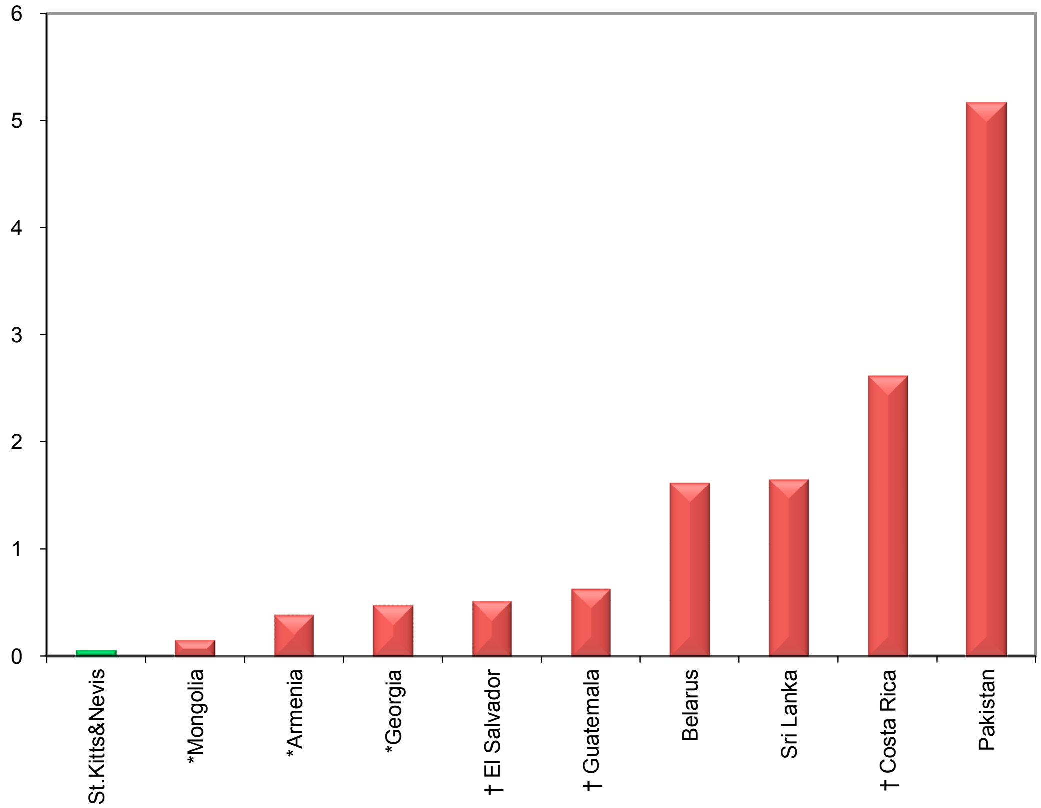
	as of 7/13/2011
Liquidity measures	
Forward Commitment Capacity (FCC) 1/	246,669
Impact on FCC on approval 2/	53
Prudential measures	
Fund GRA commitment to St. Kitts and Nevis	
in percent of current precautionary balances	0.65
in percent of total GRA credit outstanding	0.07
Fund GRA credit outstanding to top five borrowers	
in percent of total GRA credit outstanding	65
in percent of total GRA credit outstanding including first purchase by St. Kitts and Nevis	65
St. Kitts and Nevis' annual GRA charges in percent of the Fund's residual burden sharing capacity for 2011	0.57
Memorandum items	
Fund's precautionary balances (as of April 30, 2011)	8,100
Total FCL commitments 3/	70,328
Fund's Residual Burden Sharing Capacity 4/	53

Sources: St. Kitts and Nevis authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ IMF Key Financial Statistics, June 16, 2011. The FCC is defined as the Fund's stock of usable resources less undrawn balances under existing arrangements, plus projected repurchases during the coming 12 months, less repayments of borrowing due one year forward, less a prudential balance. As of April 1, 2011, reflects activation of the enlarged NAB for the six-month period through end-September 2011.
2/ A single country's negative impact on the FCC is defined as the country's sum of Fund credit and undrawn commitments minus repurchases one-year forward.
3/ Includes the FCL commitments for Colombia, Mexico and Poland.
4/ Burden-sharing capacity is calculated based on the floor for remuneration at 85 percent of the SDR interest rate. Residual burden-sharing capacity is equal to the total burden-sharing capacity minus the portion being utilized to offset deferred charges and takes into account the loss in capacity due to nonpayment of burden sharing adjustments by members in arrears.

Figure 7. Exceptional Access Levels in selected cases 1/

In billions of SDRs 2/



Source: Finance Department.
1/ Arrangements approved since September 2008 that did not involve a sudden capital inflows stop.
2/ Does not include FCL arrangements.
* Indicates countries that are PRGT eligible.
† Indicates countries with precautionary arrangements.

IV. Assessment

10. **The proposed SBA for St. Kitts and Nevis seeks to address an unsustainable public debt dynamics through a combination of significant fiscal adjustment and debt restructuring.** Staff is confident that the fiscal consolidation efforts and the debt restructuring process can restore debt sustainability, and on balance considers that there is a high probability that public debt is sustainable in the medium-term. However, the extremely high pre-arrangement public debt-to-GDP ratio and the country's very small and undiversified economy turn this into a particularly challenging task. Risks to the authorities' program are extensive and include:

- the major challenges, including capacity constraints, the authorities face to implement the fiscal consolidation and structural reforms that are needed to achieve a resumption of growth and generate a primary surplus on the order of 5 percent of GDP, on average, during 2012–16. However, St. Kitts and Nevis's track record of running substantial primary fiscal surpluses (4.2 percent of GDP on average during the last five years) provides some assurance, and efforts to strengthen implementation capacity are under way;

- uncertainties surrounding the outcome of the debt restructuring;
- vulnerabilities to external shocks and natural disasters, in particular in view of the small size of the economy and the undiversified tourism sector.

11. **Overall, the proposed access entails substantial risks concerning St. Kitts and Nevis's ability to fully meet its scheduled debt service obligations to the Fund.**

- The Fund stands as the main source of financing to the program, with a likely limited role of other possible public sector (bilateral and multilateral) contributors given that St. Kitts and Nevis is not a member of the Inter American Development Bank and a middle income country.
- High access and front-loaded phasing result in heavy and bunched debt service obligations to the Fund.
- Absent any prior SBA, the country does not have a demonstrated track record of discharging large obligations to the Fund in a timely way.
- The direct impact of arrears on the Fund's liquidity and burden sharing capacity would remain very limited, but significant reputational risks could materialize.

12. **The risks of the Fund are mitigated:**

- to the extent that the proposed Reserve Fund to be supported with Fund resources will only provide temporary liquidity to solvent banks;
- considering that St. Kitts and Nevis has a strong track record of being able to meet high external debt service obligations in general (7.6 percent of GDP on average during 2005-10);
- by the significant progress in the debt restructuring process, including indications that key domestic creditors support the overall aim of the debt restructuring and financing assurances from the Paris Club, and the associated prospects for restoring debt sustainability.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 11/113
FOR IMMEDIATE RELEASE
August 15, 2011

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

IMF Executive Board Concludes 2011 Article IV Consultation with St. Kitts and Nevis

On July 27, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with St. Kitts and Nevis.[1]

Background

St. Kitts and Nevis' tourism-dependent and highly indebted economy is recovering slowly from a two year-long recession. Activity is estimated to have declined both in 2009 and 2010, due to a fall in tourism receipts and FDI-related construction activities. A mild recovery is underway in 2011, driven primarily by the outlook for the United States (St. Kitts and Nevis' major export market) and the reopening of the Four Seasons Hotel in Nevis. Inflationary pressures, which remained subdued in 2009, have begun to intensify towards the end of 2010, as a result of oil and food price increases.

Faced with increasing fiscal imbalances in 2010, the authorities started to implement a strong fiscal adjustment program at the end of the year and beginning of 2011. In response to a rising fiscal deficit, the authorities implemented revenue reforms and expenditure cuts, with yields starting to materialize in 2011. On the revenue front, a VAT and excise tax reforms were

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[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.

implemented in November 2010. Other measures implemented include streamlining import duty exemptions, strengthening auditing and monitoring of duty free shops and introduction of an environment levy on new vehicles. They also changed the structure of the Housing and Social Development Levy and increased electricity tariffs in January 2011. On the expenditure side, the authorities froze public wages, but increased capital expenditure to acquire two new electricity generators in order to stem island-wide black outs. The primary fiscal balance deteriorated by 5.4 percentage points of GDP to a deficit of -0.5 percent of GDP in 2010 and the public debt-to-GDP ratio increased to about 200 percent in 2010.

Reflecting the recession, the external current account deficit improved in 2010. Available data suggest that, while exports of goods and services remained broadly stable, imports of goods and services declined by about 6 percentage points of GDP. As a result, the external current account imbalance is estimated to have narrowed by about 6½ percentage points of GDP. The deficit was financed by official inflows, FDI, commercial banks, and a further accumulation of arrears on fuel imports.

The authorities have requested IMF's financial assistance in support of their economic reform program. The main objective of the authorities' program is to put public debt on a firmly downward trajectory, thereby creating a virtuous cycle of lower debt and higher growth. The authorities' reform agenda encompasses a three-pronged approach. The first priority is fiscal consolidation—allowing revenue to rise upfront and containing spending increases, while at the same time, making efforts to protect the most vulnerable groups. The second priority is a comprehensive debt restructuring to address the debt overhang. The third priority is to further strengthen the financial sector, including through the establishment of a Banking Sector Reserve Fund as a backstopping mechanism for liquidity support, if needed. The authorities have also outlined a structural reform agenda to help strengthening fiscal management, improving the effectiveness and efficiency of the public sector, and removing obstacles to growth. The authorities' economic reform program is expected to catalyze financing from international and regional financial institutions and is supported by a Stand-By Arrangement with the IMF, which was also approved by the Executive Board on July 27.

Executive Board Assessment

The Executive Directors noted that the St. Kitts and Nevis economy is gradually recovering from a prolonged downturn but that the elevated public debt-to-GDP ratio poses significant risks to the outlook. Against this background, Directors agreed that urgent action is needed to restore debt sustainability and achieve a higher growth path. They encouraged the authorities to pursue their ambitious fiscal adjustment plans, including a comprehensive debt restructuring, and the wide-ranging reform agenda at the core of the economic program to be supported by a Stand-By Arrangement with the Fund.

Directors commended the authorities for embarking on front-loaded fiscal consolidation, which includes introduction of a VAT, implementation of an excise tax and electricity tariff reform, and a freeze of the public wage bill. They agreed that fiscal adjustment must be sustained over the medium term and welcomed the authorities' commitment to adopt further measures in case of a revenue shortfall.

Directors underscored that, in addition to fiscal adjustment, a comprehensive debt restructuring is key to a sustainable fiscal position. They commended the authorities for taking steps in this direction through public announcements and initial discussions with creditors.

Directors noted that further strengthening of the financial sector is also a critical element of the authorities' economic program. They looked forward to the establishment of a Banking Sector Reserve Fund for temporary liquidity support to solvent banks, if needed. Directors also welcomed the ongoing efforts to strengthen the oversight of non-bank financial institutions, including establishment of the Single Regulatory Unit.

Directors encouraged the authorities to fully implement their structural reform agenda. These forms should aim at strengthening public financial management, improving the business climate, enhancing the social safety nets, removing obstacles to growth, and restoring lost competitiveness

St. Kitts and Nevis: Selected Economic Indicators

	2007	2008	2009	Prel. 2010	Proj. 2011
	(Annual percentage change; unless otherwise specified)				
Output and prices					
Real GDP (factor cost)	4.2	4.6	-9.6	-1.5	1.5
Consumer prices, end of period	2.1	7.6	1.0	3.9	3.9
Banking system					
Net foreign assets [1/]	6.9	11.6	-8.4	1.1	4.1
Net domestic assets [1/]	5.0	-10.0	14.3	3.9	1.5
Of which: Credit to private sector	0.1	-1.7	1.5	0.9	-3.6
	(In percent of GDP; unless otherwise specified)				
Public sector [2/]					
Total revenue and grants	39.4	37.2	42.7	39.5	44.1
Total expenditure and net lending	44.1	42.2	46.5	49.0	48.1
Current expenditure	35.9	35.4	39.8	39.9	41.5
Capital expenditure and net lending	8.2	6.8	6.7	9.1	6.6
Overall balance	-4.8	-5.0	-3.8	-9.4	-4.0
Of which: primary balance	3.6	3.3	4.9	-0.5	5.0
Total public sector debt (end-of-period)	178.2	165.0	189.3	199.2	190.4
Of which: Central government	134.5	125.4	145.4	154.7	150.3
Public enterprises	43.7	39.6	43.9	44.5	40.1
External sector					
External current account	-24.3	-33.2	-34.0	-27.5	-29.5
Trade balance	-35.4	-38.0	-37.5	-31.0	-35.0
Services, net	13.9	7.2	6.1	5.7	6.5
Of which: Tourism receipt	24.3	19.3	15.9	15.6	16.3
FDI (net)	25.7	34.8	34.9	31.0	16.1
External public debt (end-of-period)	58.7	56.6	60.2	60.4	52.4
External public debt service					
In percent of exports of goods and services	21.0	18.8	21.8	21.4	28.6
Real effective exchange rate (-: depreciation)					
Percentage change	-5.6	12.5	-3.9	0.8	…

Sources: St. Kitts and Nevis authorities; ECCB; and IMF staff estimates and projections
[1/] In relation to broad money at the beginning of the period.
[2/] Central government unless otherwise noted.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No.11/295
FOR IMMEDIATE RELEASE
July 28, 2011

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves Three-Year US$84.5 Million Stand-By Arrangement with St. Kitts and Nevis

The Executive Board of the International Monetary Fund (IMF) has approved a three-year Stand-By Arrangement (SBA) for an amount equivalent to SDR 52.51 million (about US$84.5 million) with St. Kitts and Nevis. The arrangement will support the authorities' economic program, coupled with a comprehensive debt restructuring, to restore debt and external sustainability and set the stage for sustained growth.

As a result of the Board's decision, an amount equivalent to SDR 22.15 million (about US$35.6 million) is available for immediate disbursement. The three-year SBA arrangement represents 590 percent of St. Kitts and Nevis' (SDR 8.9 million) IMF quota. St. Kitts and Nevis joined the Fund in August 1984.

Following the Executive Board's decision of St. Kitts and Nevis on July 27, 2011, Ms. Nemat Shafik, Deputy Managing Director and Acting Chair, made the following statement

"The St. Kitts and Nevis economy is gradually recovering from a prolonged recession. However, fiscal imbalances and structural fragilities pose significant risks to the economic outlook.

"The authorities have started to implement an economic program to address these challenges over the medium term. The main objectives of this program are achieving higher growth and a sustainable fiscal position. The authorities' plans include front-loaded fiscal consolidation, a comprehensive debt restructuring, and further steps to strengthen the financial sector.

"The authorities have already taken important revenue and expenditure measures. These include an introduction of a value added tax, implementation of an excise tax and electricity tariff reform, and a freeze of the public wage bill. Given the magnitude of the targeted adjustment, sustained consolidation is critical.

“In addition to fiscal adjustment, a comprehensive and timely debt restructuring is needed to achieve a sustainable fiscal position. The authorities have publicly announced their intention to restructure the public debt and have initiated discussions with creditors to this end.

“Further strengthening of the financial system is also a critical element of the authorities’ economic program. In this respect, the forthcoming Banking Sector Reserve Fund would be able to provide temporary liquidity support to solvent financial institutions, if needed.

“Over the medium term, the structural reforms envisaged by the authorities will complement fiscal adjustment. These reforms aim at strengthening public financial management, improving the business climate, enhancing the social safety nets, removing obstacles to growth, and restoring competitiveness.”

ANNEX

Recent Economic Development

St. Kitts and Nevis’ economy was severely impacted by the global financial and economic crisis causing the economy to contract both in 2009 and 2010. This reflected a sharp decline in stay-over tourist arrivals and FDI inflows. The fiscal position deteriorated in 2010 as tax revenue declined by 13½ percent. The global downturn also coincided with the collapse of two large regional insurance companies.

Faced with increasing fiscal imbalances in 2010, the authorities started implementing a strong fiscal adjustment program towards the end of last year and the beginning of 2011, including the introduction of a VAT and the increase in electricity tariffs by about 80 percent. Despite those efforts, the public debt increased further to about 200 percent of GDP in 2010.

Program Summary

The authorities have requested Fund assistance to support their economic program. The main objectives of the program are to substantially strengthen public finances, significantly reduce public debt levels and set the stage for sustained economic growth.

Key reform objectives include:

- Continued implementation of fiscal adjustment measures.
- Strengthening fiscal management and improving the effectiveness and efficiency of the public sector.
- Continued support to the most vulnerable social groups.

- Removing obstacles to growth.

These reform efforts, however, will need to be complemented by a comprehensive debt restructuring. The authorities have announced their intention to seek a comprehensive and substantive restructuring of the public debt in June 2011. To address the financing difficulties and help set the public debt firmly on a downward path toward the ECCU debt target of 60 percent of GDP by 2020, a substantial reduction in the debt service burden consistent with the country's payment capacity will be needed.

Statement by Thomas Hockin, Executive Director for St. Kitts and Nevis and Mathew Sajkunovic, Advisor to the Executive Director

July 27, 2011

At the outset, our authorities from St. Kitts and Nevis wish to express their appreciation to the staff for a very constructive policy dialogue. This spans not only these Article IV and Standby Arrangement discussions, but also the important engagement that has taken place throughout the challenging period stemming from the global crisis. This close dialogue and mutual understanding is reflected in a well-written document that accurately reflects not only the risks and challenges that our authorities face but also the opportunity for a fundamental transformation of the growth and development outlook for this small twin-island federation.

The commitment of the Government of St. Kitts and Nevis and ownership of this program is without question. It is illustrated by the significant up-front fiscal measures they have taken thus far, their focused efforts to restructure their unsustainable domestic and external debts, and their clear actions to strengthen the structures underpinning their fiscal activities.

With modest recovery now taking hold, the principal objective of the authorities' program is to foster macroeconomic stability and create a virtuous circle of sustainable public debt and strong economic growth. To achieve this, a program of fiscal consolidation, cooperative debt restructuring, and efficiency-enhancing structural reforms is underway.

As the staff paper identifies, in support of the authorities' macroeconomic and structural reform program, they are seeking the Board's support for an SDR 52.5 million (590 percent of quota) loan under a 36-month Stand-By Arrangement. Other multilateral and bilateral partners are expected to support the authorities' efforts with financial and technical assistance.

Background

Following a period of strong growth, the economy was hit very hard by the global economic crisis. A significant drop in tourism, a slowdown in tourism-related construction and FDI, as well as the closure of the largest tourism resort in Nevis following Hurricane Omar, all contributed to a significant decline in growth in 2009 and 2010. The crisis also took a major toll on public finances. Tax revenue declined 13.5 percent in 2010 and the deficit widened to 9.4 percent of GDP. With public debt hitting approximately 200 percent of GDP and arrears emerging, the downturn also exposed clearly that the longstanding debt overhang was not sustainable.

Beginning with the 2010 budget and reinforced by the 2011 budget, the authorities have taken decisive steps to substantially strengthen public finances, launch the process for debt reduction, and establish the conditions for sustained economic growth. It is this home-grown program for which the authorities are seeking IMF support.

The Authorities' Program

Fiscal Consolidation

Fiscal adjustment has been frontloaded and key measures are beginning to bear fruit. In 2010, the authorities implemented the VAT and the unincorporated business tax, streamlined import duty exemptions, introduced an environmental levy on new vehicles, and increased monitoring and auditing of duty-free shops. Building on these efforts, further steps were taken in 2011, including adjusting the structure of the housing and social development levy as well as the politically difficult decision to raise the electricity tariff by 80 percent. On the expenditure side, civil service wages have been frozen until 2013 (implying a notable reduction in real wages over the period) and capital spending has been prioritized.

Taken together, the measures implemented in 2010 and 2011 should be sufficient to achieve the 2011 primary fiscal surplus target of 5 percent of GDP targeted in the program. That said, the authorities are mindful that given the scale of the fiscal adjustments that they have undertaken, certain aspects could potentially underperform. Therefore, to be prudent, they have identified a further 1 percent of GDP in contingency measures that could be taken if needed to meet the primary fiscal surplus target under their program.

Debt Sustainability

While the authorities have moved decisively to sharply improve the fiscal accounts and the people of St. Kitts and Nevis have made considerable sacrifices, these actions will not be sufficient on their own to close the financing gaps and put public debt on a sustainable trajectory. It has also become increasingly clear that the unsustainable debt overhang is constraining both growth-enhancing public investments and also domestic and external investor confidence. Accordingly, the authorities have moved forward on a process of negotiating a comprehensive and substantive public debt restructuring, which will ensure that the burden of adjustment is shared by all. This process is being undertaken very transparently and is well in train. Debt and legal advisors have been hired. An official announcement detailing the authorities' intentions and information sharing and outreach with creditors have occurred. Financing assurances from the Paris Club were also received in July.

As part of the overall restructuring exercise, the authorities are also moving ahead decisively to resolve the collateralized debts of the St. Kitts Sugar Manufacturing Corporation, which were assumed by the government following the collapse of the sugar industry in 2005 under the weight of trade liberalization and the erosion of preferential market access. A working group has been established to facilitate the debt-for-land swap. Mapping and valuation of land is underway (a structural benchmark for September) and a plan is being prepared to establish a government-owned asset management company.

Taken together, the authorities expect that debt restructuring will yield substantial interest savings to put public debt on a sustainable trajectory over the medium term and play an important role in closing the financing gap. Finally, it should also be noted that substantive good faith efforts have already been undertaken with an aim to resolving outstanding arrears to creditors in line with the Fund's lending into arrears policy.

Safeguarding Financial Sector Stability

In moving ahead with their ambitious strategy to foster macroeconomic stability and create a virtuous circle of sustainable public debt and strong economic growth, the authorities are also very cognizant of the central need to safeguard banking sector stability during the debt restructuring exercise. The banking sector is very well capitalized and stress tests indicate that banks can absorb significant shocks, including the impact of the debt restructuring. Notwithstanding these findings, the authorities feel that it is prudent to have a precautionary liquidity backstop for the sector in order to meet any sustained deposit outflows. Accordingly, they intend to establish a Banking Sector Reserve Fund (BSRF), which would be able to provide temporary liquidity (backed by collateral), if required, to solvent indigenous banks that face liquidity constraints. The BSRF will be managed by the Eastern Caribbean Central Bank (ECCB) and is governed by a detailed Memorandum of Understanding between the government and the ECCB (a prior action for the program).

The authorities also remain strongly committed to strengthening supervision and oversight of the non-bank financial sector where they have lead responsibility. The new Single Regulatory Unit (SRU) is now operational and has benefitted from technical assistance from CARTAC. On-site inspections have been increased and licensing procedures have been tightened. Parliament is also expected to approve an important new bill in the second part of the year governing credit unions and cooperatives.

Structural Reform Agenda

The authorities of St. Kitts and Nevis are aware that securing additional yields from their home-grown program and safeguarding vulnerable segments of society will require substantial structural reforms. Therefore, the authorities' policy framework incorporates structural measures aimed at strengthening the efficiency and effectiveness of public spending, civil service reform, as well as pension and social safety net reforms.

To enhance public financial management, the authorities intend to establish a medium-term fiscal framework. They also plan to move ahead with the rationalization of subsidies on liquefied petroleum gas. In recognition of the fiscal risks of the Electricity Department, the department will be corporatized and forced to stand on its own. A new medium-term debt management strategy will also be developed with the support of technical assistance.

Civil service reform is also a key priority for the government's public sector transformation program. The authorities recognize the significant impact of the size of the wage bill on the fiscal position and have taken steps aimed at limiting the public sector wage bill. Work is also underway on a comprehensive civil service reform plan that will cover human resource policy, the organizational structure of the civil service and address wage policy and payroll management. Technical assistance has been sought from the World Bank and other development partners.

Finally, the protection of vulnerable groups will remain an essential priority for the authorities throughout the program period and beyond. A strategy for a more targeted social safety net system will be presented to Cabinet by March 2012. As part of this plan, the authorities will introduce an objective and transparent targeting mechanism to more effectively get assistance to the poor. The ultimate goal over the medium term is a coherent social protection strategy that will rationalize programs and better link social assistance to actions aimed at building human capital in the country.