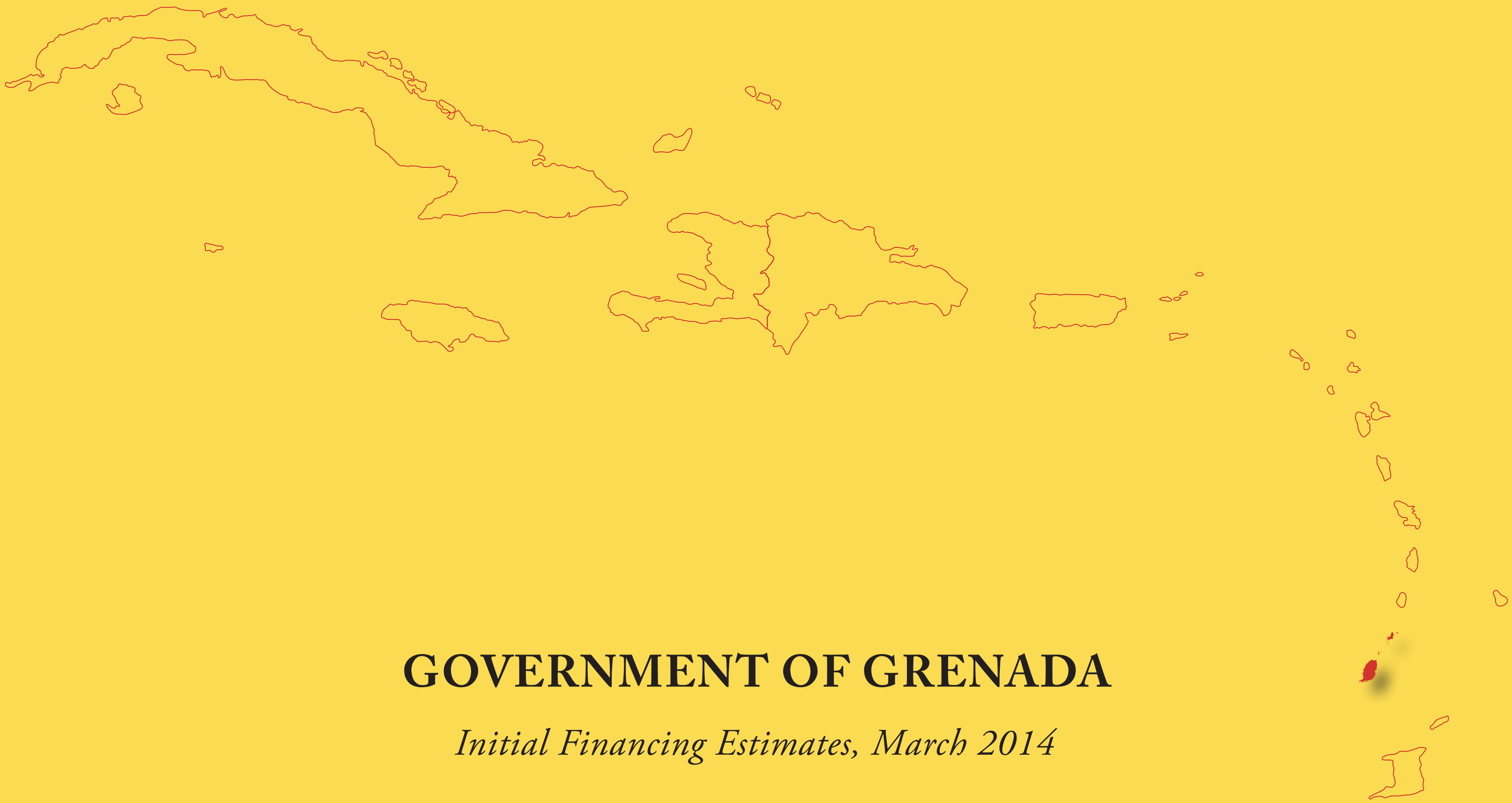

GOVERNMENT OF GRENADA

Initial Financing Estimates, March 2014

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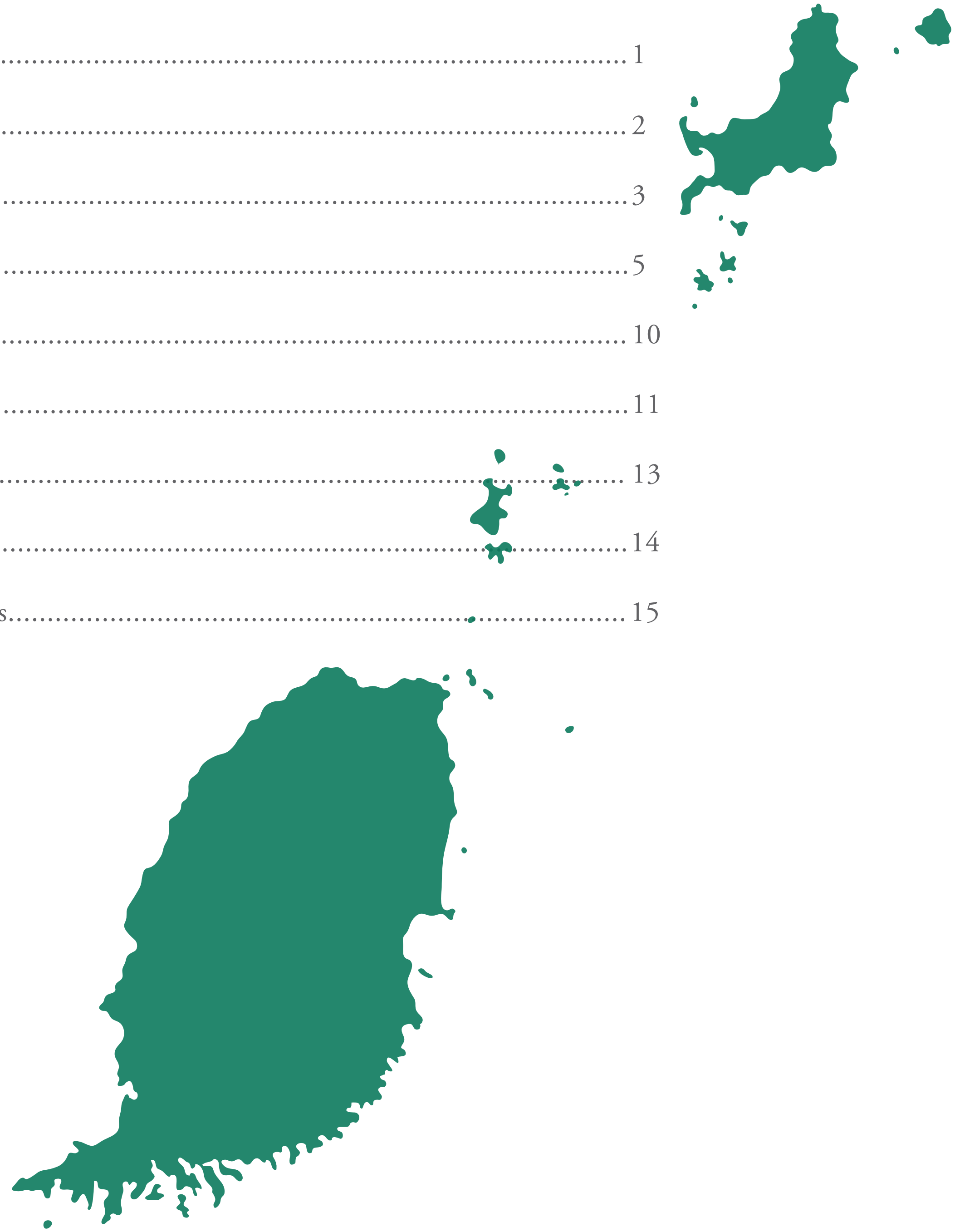


Overview

- Already vulnerable after the devastation of hurricanes Ivan and Emily, Grenada was severely affected by the global economic crisis. This year the economy will remain smaller in real terms than it was in 2007; the failure of the economy to grow even in the face of an expansion of the public sector has left more than one-in-three Grenadians without work.

- Coupled with the derailment of the program agreed with the International Monetary Fund (IMF) in 2010, the crisis curtailed the Government's access to concessional and non-concessional external financing. By mid-2010 the Government was being forced to run arrears to domestic and bilateral creditors, and intermittently to multilateral institutions; by 2013 the exhaustion of cash led to the missed payments on the 2025 bonds.

- Upon taking office in March 2013, the administration led by Prime Minister Keith Mitchell recognized the need for a once-and-for-all adjustment to be based on a shared sacrifice on the part of Grenadian stakeholders, reflecting the lessons learned from previous Fund programs. The Government is now in a position to share details of the reform program that it believes will—in combination with a comprehensive restructuring of its debt stock—place the public finances firmly on a sustainable footing.

- At the core of the program are fiscal measures designed to raise the primary balance into surplus while improving the focus and efficiency of both revenue collection and government expenditure. The program also aims to consolidate the forthcoming fiscal adjustment by creating a medium-term framework for public sector discipline and by ensuring underlying weaknesses in the financial sector do not become an impediment to growth.

- The Government's reform effort is expected to receive extensive financial backing from the IMF, World Bank, and Caribbean Development Bank (CDB). However, despite an unprecedented level of indicated commitments from these key multilateral partners and the projected positive impact of the Government's planned reforms on the fiscal accounts, Grenada faces large residual financing gaps.

- Grenada will require the support of its external and domestic creditors in order to close these residual financing gaps in a sustainable manner through a comprehensive restructuring of its public debt stock on terms that are compatible with the country's expected capacity to pay.

Economic Growth

Background

- Grenada's economy was among the hardest-hit by the global financial crisis, with gross domestic product (GDP) contracting by 6.7% in 2009 and then contracting by an additional 0.1% in aggregate in real terms over the subsequent four years.

- Of the 187 countries monitored by the IMF, only eight posted lower average real growth over the period.

- The recent slowdown has been associated with an extremely high unemployment rate that is estimated at around 33%—one of the very highest levels in the world. Unemployment is particularly acute among younger persons, with more than half of youths of working age currently unemployed. Such a longstanding dislocation has caused social disruption and pressure on Government for public sector jobs and support.

- The inability of the economy to grow and generate jobs is believed to be the result of several interrelated factors: a stalled recovery period after Hurricane Ivan, weak competitiveness due to limited transport and hotel infrastructure, an inability to adjust external competitiveness under the currency union, an inability to provide a meaningful counter-cyclical fiscal response due to the public debt overhang and the already-bloated size of the public sector, and a significant decline in foreign grants and concessional lending.

- After entering office in March 2013, the administration led by Prime Minister Keith Mitchell recognized the need to take a proactive approach to address Grenada's unsustainable public finances. The administration has designed a comprehensive home-grown adjustment program that reflects shared sacrifice of all stakeholders, lessons learned from previous Fund programs, and the need to ensure broad-based support for implementation.

Reform Program

A Focus on Growth

- The Government's reform program has three pillars that, together, are expected to generate meaningful, inclusive, and sustainable economic growth.

    1. A bold attempt to redirect economic activity away from the public sector through a correction of the fiscal deficit and an overhaul of inefficient revenue and expenditure drivers.

    2. Structural reforms to ensure fiscal discipline going forward, and to promote an environment in which the private sector can invest with confidence.

    3. Measures to strengthen financial system stability.

- Together with a comprehensive restructuring of the public sector debt, these three pillars are intended to place Grenada's public finances firmly on a sustainable footing, in the process restoring confidence following the most difficult period in the country's economic history.

Reflecting Lessons Learned

- On 13 January 2014, the IMF Executive Board completed a review of the Fund's two previous programs in Grenada: the Poverty Reduction and Growth Facility (PRGF) approved in April 2006 and the Extended Credit Facility (ECF) approved in April 2010. While noting the supportive role that the programs had played in advancing tax and financial reform and donor coordination, the review highlighted the significant underperformance of the economy, as well as a failure to place the public finances on a sustainable path.

Reform Program (Lessons Learned)

- As described in the *Ex-Post Assessment of Longer Term Program Engagement*:

  "In general, performance under the Fund-supported programs was weak and most program objectives were not met. This outcome illustrates the difficulties of program implementation in the midst of major shocks and the need to reflect the macroeconomic and institutional challenges of small countries in program design. In particular, program growth projections were too optimistic and the large number of structural reform measures, which were largely unmet, did not sufficiently take into account Grenada's significant capacity and institutional constraints. Program ownership was also in question during both the first and second PRGF/ECF arrangements manifested in difficulties in meeting both the fiscal and structural reform objectives of the programs." Source: http://www.imf.org/external/pubs/ft/scr/2014/cr1419.pdf

- Since taking office in March, the administration led by Keith Mitchell has launched a concerted effort to build a truly home-grown set of structural and institutional reforms that incorporate the lessons learned from previous attempts at reform implementation.

- Through the Ministry of Finance, the Government has conducted a series of meetings with social, union, and private sector partners to both understand their preferences and explain why the program can be successful only through the shared sacrifice of all stakeholders.

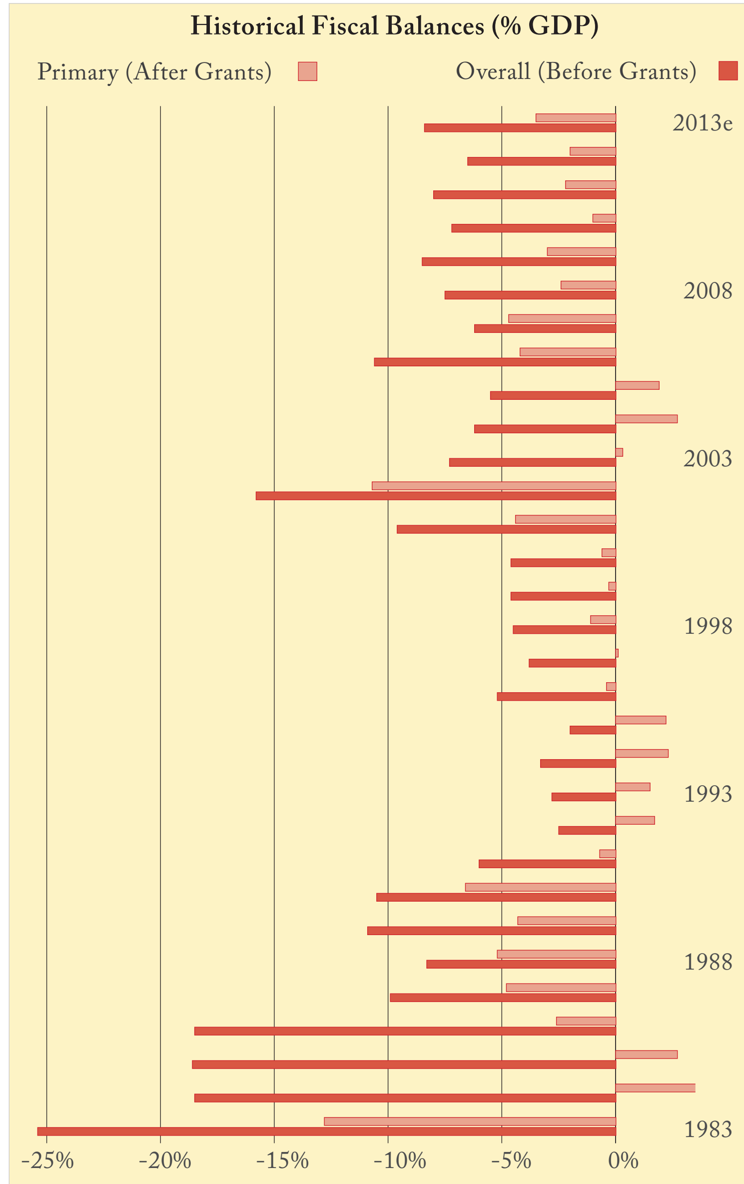
Background

- The Government's plans to achieve a permanent fiscal correction represent an effort to reverse more than three decades of unsustainable fiscal policy and grant dependency. Since 1983 (when data first is available), the Government's overall fiscal deficit before foreign grants has averaged a staggering 8.6% of GDP, an average that is little changed against the last decade's 7.5% of GDP average deficit.

- The Government has never achieved a primary fiscal surplus before foreign grants are factored in; Grenada's average primary fiscal deficit excluding grants since 1990 is 5.6% of GDP.

- Since 2006, grants have declined significantly but continue to fund a critical component of the budget. After spiking to average nearly 9% of GDP from 2004 to 2006, grants fell to the equivalent 1.4% of GDP in 2013; grants have averaged 2.5% of GDP since 2007—slightly below the pre-2004 average of 3.3% of GDP.

- Even after grants are included, Grenada has posted steady and material primary and overall fiscal deficits over an extended timeframe: since 1990, these have averaged 1.9% and 4.1% of GDP, respectively; since the collapse of the ECF in 2011, these fiscal deficits have deteriorated, averaging 2.8% and 6.2% of GDP in 2012 and 2013, respectively.



Source: Government of Grenada

Expenditure Measures

- Expenditure reform measures in the program are to be driven by a reduction in the wage bill to nine percent of GDP by 2016, from a projected 10.3 percent in 2013 (excluding retroactive payments):

    a) The nominal wage bill will be capped through 2016 at December 2013 levels (excluding retroactive payments).

    b) Only a third of departing employees are to be replaced; a public service review will be used to further streamline the workforce.

- Non-personnel expenditure will be reduced by 20%.

Revenue Measures

Measure	Timing
1. Lower the income tax threshold to EC$36,000 from EC$60,000. A lower rate of 15% will apply to income below EC$60,000, while the rate for income above EC$60,000 will remain at 30%.	2014
2. Reduce tax exemptions:	
a) Include winnings from lotteries	2014
b) Reduce exemptions by half for GRENLEC, statutory bodies, St. George's University, and returning nationals	2014, 2016
c) Reduce tax rebate to manufacturers by half in 2014 and completely by 2016	Ongoing
d) Reform the tax incentive regime to ensure the integrity of the tax base going forward.	Ongoing
3. Increase property tax collections by more than tripling the rate on buildings and land to an average of 0.5%, as well as through a revaluation of assessed property values.	2014, 2016
4. Introduce a property tax of 5% on luxury goods, vehicle parts, tires, batteries, and motor oil.	2016
5. Improve tax administration and collection efforts.	Ongoing
6. Increase VAT receipts by widening the VAT base to include all items other than basic staples and agricultural inputs (including private accomodations) and applying the full 15% VAT rate to construction.	2014, 2016

7. Other revenue-enhancing measures will include:
   - a) Introducing a flat rate tax of 5% on sales of small businesses that fall below the VAT threshold of EC$120,000 (but above EC$30,000)
   - b) Introducing a 10% tax on financial activities (wages and profits of financial institutions)
   - c) Increasing fees on motor vehicle, professional, and gun licenses
   - d) Increasing the customs service charge from 5% to 6%.

Summary Impact of Adjustment Measures

	2014	2015	2016	TOTAL
Revenue Measures	**1.6**	**1.2**	**0.9**	**3.7**
Personal income tax	0.4	0.1	-	0.5
Corporate income tax	-	-	-	-
Property tax	0.3	0.1	0.6	1.1
Value-added tax	0.1	0.4	0.1	0.6
Excises	-	0.1	-	0.1
Customs exemptions	0.4	0.2	0.1	0.7
Other	0.4	0.3	0.1	0.7
Current Expenditure Measures	**0.4**	**0.7**	**1.0**	**2.1**
Wage and pension bill	0.3	0.5	0.7	1.5
Goods and services	0.1	0.2	0.2	0.5
Transfers and subsidies	0.0	0.0	0.0	0.1
Capital Expenditure Measures	**0.8**	**0.7**	**0.4**	**1.9**
TOTAL	**2.8**	**2.6**	**2.2**	**7.6**

Source: Government of Grenada

Medium-Term Consolidation

- The Government will also ensure that the fiscal correction is consolidated and built upon over the medium-term by undertaking several fundamental changes to the legislative framework:

  1. *Fiscal responsibility legislation*. Real spending growth will be capped at trend GDP growth, while revenues will be allowed to absorb cyclical fluctuations; this will ensure that once the desired fiscal target is achieved it can be broadly maintained over the cycle. The rules will also set caps on personnel spending as a share of tax revenue.

  2. *Public financial management legislation*. Changes will be made to:
     a) Limit the use of executive orders to spend above budget;
     b) Approve all extra-budgetary spending through mid-year budget reviews in parliament;
     c) Introduce meaningful contingency funds and contingency appropriations within the budget;
     d) Strengthen control over expenditure, including through strict personal and institutional penalties;
     e) Prohibit implementation of changes to the tax system without parliamentary approval.

  3. *Performance of the statutory bodies*. The Government will undertake a financial and strategic review of existing statutory bodies. A strategic plan will be created that will:
     a) Provide up-to-date information on the financial viability of each statutory body;
     b) Classify each as being in line for liquidation, privatization, or retention;
     c) Lay out concrete plans to restructure financially-weak statutory bodies that have been retained.

  4. *Public sector modernization*. In addition to the planned reduction in public sector employment through attrition, the Government will undertake a strategic review of the public sector with a view to ultimately reducing the size of the public sector and making it more efficient. This review will include government functions, public hiring, as well as civil service size, composition, and remuneration structure.

Financial Sector Stability

- The Government will take a proactive approach to ensuring the continued stability of the financial system, and will support ongoing regional efforts to strengthen financial regulation and supervision. It will assess the impact of the debt restructuring on the financial sector's capitalization needs; in keeping with the Eastern Caribbean Currency Union (ECCU)'s stabilization and growth program, it will strengthen non-banking sector regulatory frameworks.

- The Government has been at the forefront of regional efforts to revamp insurance regulation and supervision, and has worked proactively to identify and address weaknesses in the non-bank sector. The Government will continue to promote the consolidation of the credit union sector as a means of strengthening the financial safety net, support the establishment of the proposed Eastern Caribbean Financial Services Regulatory Commission, and enact the new uniform ECCU Credit Union Regulations currently being finalized.

- In the banking sector, the Government will support regional efforts to strengthen banking regulation and supervision, bolster the Eastern Caribbean Central Bank (ECCB)'s resolution powers, and strengthen loan classification and provisioning requirements. The Government will also present to Parliament a revised Banking Act and ECCB Agreement once these are approved by the ECCU Monetary Council.

Debt Stock and Service

- Government debt has increased steadily due to ongoing fiscal deficits and a decline in foreign assistance. As of end-2013, Central Government and guaranteed debt was estimated at US$978 million, or 120% of GDP (US$813.5 million at end-2013).
  - External debt accounted for 69% of the total, a share that has decreased from roughly 80% at end-2010 due to an increasing reliance on Treasury Bills for financing as arrears have spread throughout the economy and across creditor categories.
  - Interest and principal arrears accounted for 12% of the total debt stock at end-2013; in late 2013 the Government cleared arrears with the World Bank and CDB to allow these institutions to resume disbursements.
  - Central Government guarantees amounted to US$51 million.

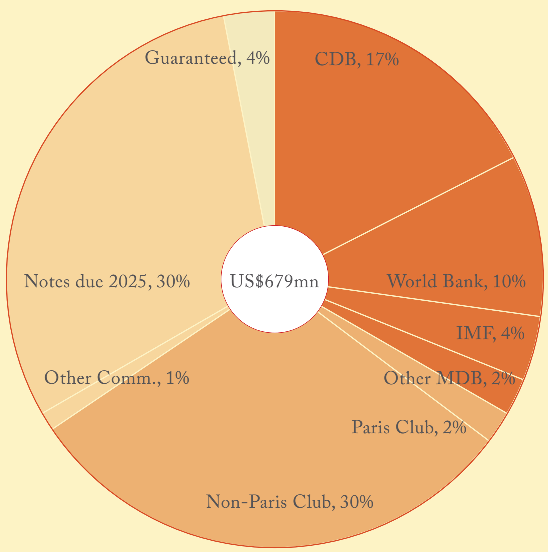
Estimated Central Government and Guaranteed Debt by Creditor (Including Arrears), end-2013[(1)]

External

US$ Million

Multilateral	
Carib. Dev. Bank	$118
World Bank	$65
IMF	$28
Other Creditors	$12
Bilateral	
Paris Club Creditors	$12
Other Creditors	$205
Commercial	
US$ Notes due 2025	$206
Other Creditors	$6
Guaranteed	$28
EXTERNAL TOTAL	$679

As % Total

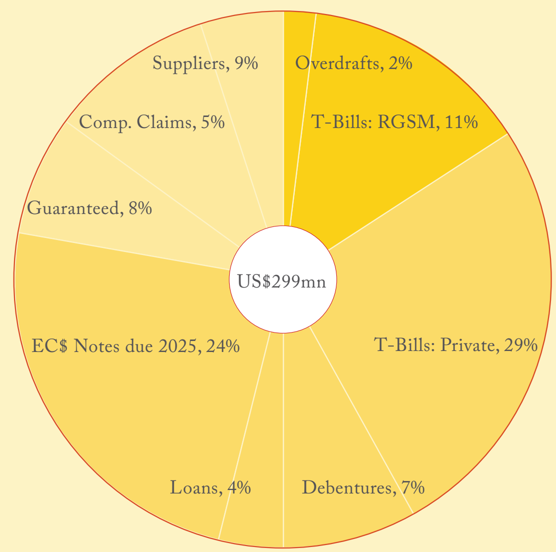


Domestic

US$ Million

Short-Term Instruments	
Overdrafts	$6
T-Bills: RGSM	$34
T-Bills: Private	$85
Medium & LT Instruments	
EC$ Notes due 2025	$72
Debentures	$22
Loans	$11
Other	
Guaranteed	$24
Compensation Claims	$15
Arrears (Suppliers)	$28
DOMESTIC TOTAL	$299

As % Total



(1) Guarantee estimates are as of July-2013; Stock of debt and arrears subject to reconciliation

Source: Government of Grenada

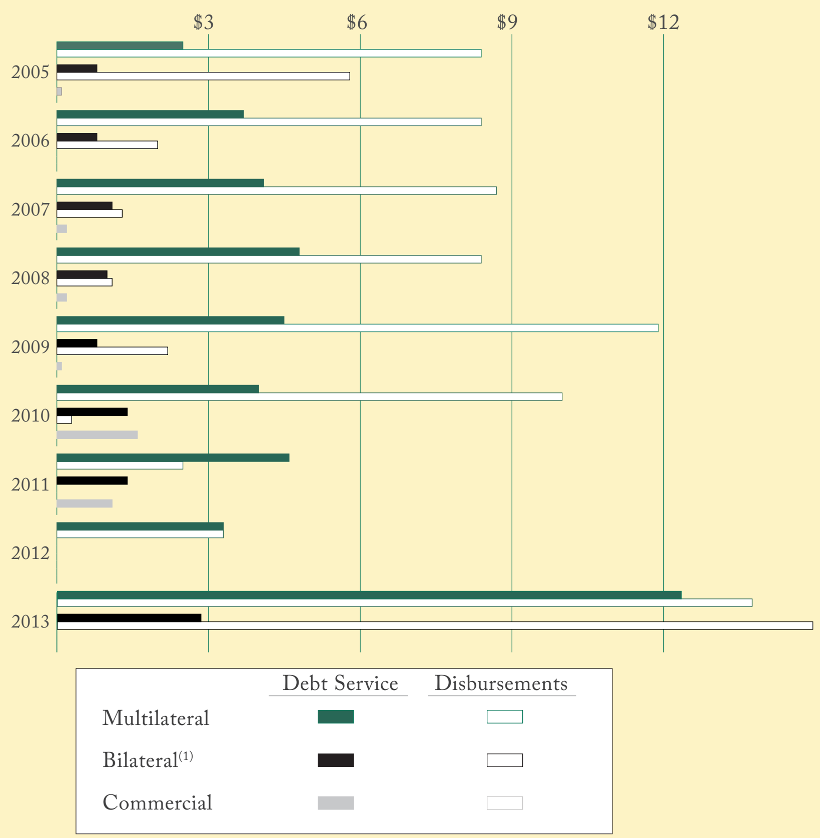
- Since 2005, disbursements have averaged US$11 million. Annual disbursements have been driven by multilateral creditors, which have provided US$8 million on average over the period; bilateral creditors made significant disbursements in 2005 and 2013.

- Going forward, debt service requirements on the existing debt stock are dominated by an assumed clearance of arrears in 2014 as well the amortization of the EC$ and US$ Notes due 2025 from 2021-2025.

Historical Debt Service and Disbursements, 2005-13

Actual Central Government Disbursements and Debt Service

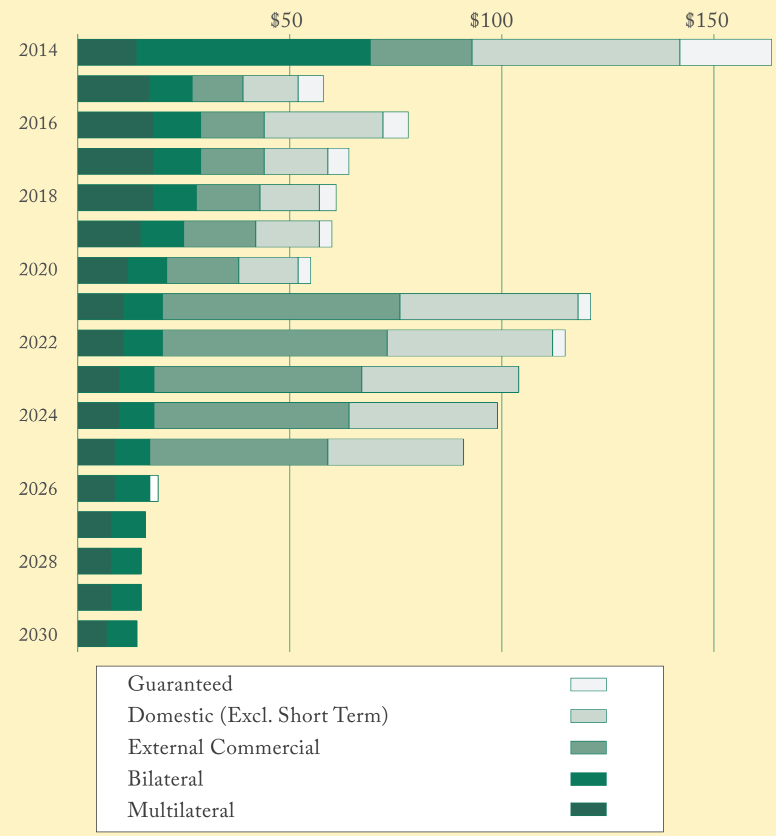
US$ Million



Projected Debt Service, 2014-2030f

Estimates for Central Government Debt at end-2013

US$ Million, Includes Arrears



(1) Excludes oil-related debt service and disbursements

Source: Government of Grenada

Financing Projections (% GDP)

	2014	2015	2016	2017	2018[1]	2019[1]	2020[1]
A. Primary balance[1]	-2.4	1.3	3.5	3.5	3.5	3.5	3.5
B. Total interest	3.9	3.9	4.4	4.1	3.9	4.0	3.8
Multilateral	0.4	0.4	0.4	0.3	0.3	0.3	0.2
Bilateral	0.1	0.1	0.1	0.1	0.1	0.1	0.1
External commercial	1.4	1.3	1.7	1.6	1.6	1.7	1.6
Other	1.2	1.2	1.3	1.0	0.9	0.9	0.8
New debt incurred after-2013	0.8	0.9	0.9	1.0	1.1	1.1	1.1
C. Overall balance	-6.3	-2.6	-0.8	-0.6	-0.4	-0.5	-0.3
D. Amortizations	13.3	13.5	15.1	13.9	13.7	13.5	13.1
Multilateral	1.2	1.6	1.6	1.6	1.5	1.2	0.9
Bilateral	0.4	0.4	0.4	0.3	0.3	0.3	0.1
External commercial	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.6	0.3	1.7	0.4	0.3	0.2	0.2
New debt incurred after-2013	11.1	11.2	11.4	11.6	11.7	11.7	11.9
E. Arrears payable from previous years	12.6						
F. Gross financing requirement (C+D+E)	32.2	16.1	16.0	14.5	14.1	14.0	13.4
G. Financing sources	10.1	11.0	10.2	10.4	10.6	10.8	10.9
Official (existing pipeline)	0.6	1.1	0.0	0.0	0.0	0.0	0.0
Domestic (rollover)	8.6	9.2	9.5	9.7	9.9	10.1	10.2
Domestic (new)	0.9	0.7	0.7	0.7	0.7	0.7	0.7
H. Financing gap	22.1	5.1	5.8	4.0	3.5	3.2	2.5
Exceptional financing	3.1	3.0	2.9	0.3	0.0	0.0	-0.1
IMF	0.7	0.7	0.7	0.3	0.0	0.0	-0.1
World Bank	1.2	1.2	1.1	0.0	0.0	0.0	0.0
CDB	1.2	1.2	1.1	0.0	0.0	0.0	0.0
RESIDUAL GAP BEFORE RESTRUCTURING	**19.0**	**2.0**	**2.9**	**3.7**	**3.5**	**3.2**	**2.6**

(1) Includes projected revenues from Citizenship by Investment Program from 2017-2020 on the following basis: 2017-18, 1.5% of GDP; 2019-20, 2.0% of GDP

Source: Government of Grenada

Debt Restructuring Process

- The Government's medium-term financing projections presented on the previous page incorporate the planned fiscal correction of 7.6% of GDP over the program period, as well as unprecedented levels of support from the IMF, World Bank, and CDB. The multilateral financing package, which will be on concessional terms, is conditional upon a comprehensive restructuring being agreed with creditors that both reduces the stock of debt outstanding and places the remaining balances firmly on a sustainable footing.

- With the support of creditors, the debt restructuring process aims to replace once-and-for-all an unsustainable debt service profile with one that is in line with the country's payment capacity, thereby restoring viability to the public finances.

- It is expected that all of Grenada's public and publicly guaranteed debt owed to both private and official sector creditors—with the exception of the Treasury Bills listed on the Regional Government Securities Market, overdrafts, and multilateral claims—will fall within the scope of the restructuring.

- Discussions with affected creditor categories will proceed in parallel; the authorities have already made significant process in engaging multilateral lenders to secure a significant increase in concessional financing. The claims of certain bilateral lenders may be settled (on comparable terms) with the same new debt instruments that will be issued to settle the claims of private creditors.

- The restructuring process will be guided by the following principles:
  - Transparency;
  - Full and open dialogue with creditors;
  - Inter-creditor equity.

- The IMF is conducting a debt sustainability analysis that includes projections for the medium- to long- term; the Government will make this available for discussion with creditors at the earliest opportunity.

ANNEX A: FISCAL PROJECTIONS (% GDP)

Fiscal Projections Table

	2010	2011	2012	2013	2014	2015	2016	2017[1]	2018[1]
Total revenue and grants	**24.6**	**23.6**	**20.8**	**21.3**	**24.8**	**24.7**	**24.6**	**25.2**	**25.2**
Revenues	20.6	20.3	19.7	19.9	20.2	21.4	22.3	22.9	22.9
Tax revenue	18.7	18.4	17.9	17.0	18.5	19.8	20.7	19.8	19.8
Taxes on income and profits	3.8	3.5	3.5	3.1	3.5	3.7	3.8	3.8	3.8
Taxes on property	0.8	0.7	0.8	0.6	0.9	1.0	1.7	1.7	1.7
Taxes on goods and services	8.2	8.3	8.1	7.8	8.2	8.9	9.0	8.1	8.1
Consumption taxes	7.5	7.7	7.1	7.2	7.6	8.3	8.4	8.1	8.1
Excises (domestic)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.7	0.6	1.0	0.6	0.6	0.6	0.6	0.0	0.0
Taxes on international trade	5.9	5.9	5.6	5.5	5.9	6.1	6.3	6.3	6.3
Nontax revenue	1.9	1.8	1.7	2.9	1.7	1.7	1.7	3.2	3.2
Grants	4.0	3.4	1.1	1.4	4.6	3.3	2.3	2.3	2.3
Total expenditure and net lending	**27.8**	**28.3**	**26.1**	**28.3**	**31.1**	**27.3**	**25.5**	**25.8**	**25.6**
Current expenditure	20.5	20.5	21.1	21.0	21.5	19.6	19.1	18.9	18.7
Wages and salaries	9.4	11.0	10.5	11.1	11.1	9.7	9.0	9.0	9.0
Pensions and NIS contributions	2.0	1.9	2.0	2.1	2.3	2.0	2.0	2.0	2.0
Goods and services	5.2	3.6	4.0	3.1	3.0	2.8	2.6	2.6	2.6
Transfers	1.7	1.5	1.2	1.2	1.2	1.1	1.1	1.1	1.1
Interest payments	2.2	2.5	3.4	3.5	3.9	3.9	4.4	4.1	3.9
Capital expenditure and net lending	7.3	7.8	5.0	7.2	9.7	7.7	6.3	6.9	6.9
OVERALL BALANCE[1]	**-3.1**	**-4.7**	**-5.4**	**-6.9**	**-6.3**	**-2.6**	**-0.8**	**-0.6**	**-0.4**
Memorandum items:									
Primary balance[1]	-1.0	-2.2	-2.0	-3.5	-2.4	1.3	3.5	3.5	3.5
Nominal GDP (EC$ millions)	2,082	2,102	2,164	2,196	2,265	2,338	2,436	2,550	2,681

(1) Includes projected revenues from Citizenship by Investment Program in 2017-18

Source: Government of Grenada