GOVERNMENT OF GRENADA

Fiscal Risk Statement

Submitted To:

The Parliament

By:

The Minister of Finance

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PURPOSE

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

> "*The Minister of Finance shall prepare and submit to Parliament, with the annual Budget Bill, a fiscal risk statement that shall reflect all decisions by Cabinet and the Minister and circumstances that may have a material effect on the economic and fiscal outlook. This statement must contain the following information:*
>
> *i. the sensitivity of economic and fiscal forecasts to changes in the economic outlook and economic shocks;*
>
> *ii. the exposure of the Government to contingent liabilities, including guarantees and obligations arising from judicial proceedings in progress;*
>
> *iii. fiscal risks arising from the financial sector, statutory bodies, state-owned enterprises, public-private partnerships, and any other institutions;*
>
> *iv. any commitment unaccounted for in the economic and fiscal forecasts;*
>
> *v. any other circumstance that may have a material effect on the economic and fiscal forecasts and is unaccounted for in the economic and fiscal forecasts; and*
>
> *vi. any measures implemented by Cabinet, or the Minister, to manage fiscal risks.*"

INTRODUCTION

The medium-term macroeconomic and fiscal projections that are presented in the 2023 Budget are formulated considering expected developments in the domestic and global economy, based on information available at the time of their preparation. There are various risks that if they were to materialise, could cause the macroeconomic projections to vary from those presented. The most significant of these would result from unanticipated macroeconomic developments as well as adverse weather events that negatively impact public finances.

This Fiscal Risk Statement outlines the Government's assessment of key risks that can adversely affect public finances and by extension, the Government's planned transformational programme. The main categories of risks discussed are (i) Macroeconomic Risks; (ii) Budget Implementation Risks; (iii) State-owned Enterprises Risks; and (iv) Climate Risks. Other potential sources of risks are also flagged.

Macroeconomic Risks

The October 2022 release of the International Monetary Fund's World Economic Outlook states that the "global economy is experiencing several turbulent challenges." The main challenges are high global inflation; rising interest rates in many regions of the world; Russia's invasion of Ukraine and its consequential socio-economic impacts; geo-political tensions; and the lingering COVID-19 pandemic. All these factors weigh on global growth and as such, world output is projected to decelerate from 6.0 percent in 2021 to 3.2 percent in 2022 and 2.7 percent in 2023.

Growth in Grenada's major source markets for goods and services is projected to be anemic at best in the near term. In the United States (US), the largest source market for Grenada's tourists, growth is projected to slow down from 1.6 percent in 2022 to 1.0 percent in 2023. In the United Kingdom (UK), another major source market for tourists, growth is forecasted to be flat (0.3 percent) relative to the estimated 3.6 percent in 2022. In Canada, economic growth of 1.5 percent is estimated for 2023, a softening relative to 3.3 percent in 2022. In China, a major source market for manufactured goods, growth is projected to be 4.4 percent in 2023, a marked deceleration in the context of exceptionally high rates in China pre-pandemic.

The global economic situation could be worse than what is projected in the baseline scenario should China's economic slowdown be steeper than expected and should tighter global monetary and financial conditions trigger a full-blown debt crisis in emerging markets and developing economies. A prolonged war in Ukraine that keeps prices of food and energy higher for longer adds more gloominess to the global economic outlook.

A protracted global economic slowdown would adversely affect tourist arrivals, remittances, foreign direct investment, external grant receipts, and public finances. Meanwhile, high and rising international commodity prices (especially fuel and food) will stoke domestic inflationary pressures in the near term. Domestic inflation is projected to moderate over the medium term; the underlying assumption is that US monetary policy tightening will eventually take hold and tamp down inflation. However, there is a real risk that high inflation could become entrenched.

Table 1 presents key baseline macroeconomic projections over the period 2023-2025.

Table 1: Baseline Macroeconomic Projections

	2023	2024	2025
Real GDP Growth (%)	3.6	4.0	4.8
Total Revenue (% of GDP)	30.1	29.8	30.8
Total Grants (% of GDP)	1.9	1.9	1.9
Total Expenditure (% of GDP)	30.3	29.7	29.0
Overall Fiscal Balance (after grants) (% of GDP)	1.8	2.1	3.7
Primary Balance (after grants) (% of GDP)	3.6	3.6	5.1
Public Debt (% of GDP)	64.0	62.6	60.5

Source: Ministry of Finance

Table 2 illustrates the sensitivity of the overall fiscal balance and primary balance to changes in key economic parameters.

Table 2: Sensitivity of Key Fiscal Variables to Economic Shocks

Economic Assumptions	Fiscal Variables			
	Overall Fiscal Balance		**Primary Balance**	
2023 Baseline	*$62.7m*	*1.8% of GDP*	*$124.4m*	*3.6% of GDP*
Illustrative Scenarios:	**Estimated Impact in 2023**			
Scenario 1: GDP growth is 2 percentage points lower than the 2023 forecast	$51.2m	1.5% of GDP	$112.9m	3.2% of GDP
Scenario 2: Inflation increases by 2 percentage points relative to the 2023 forecast	$44.1m	1.3% of GDP	$105.8m	3.0% of GDP
Scenario 3: GDP growth is 2 percentage points lower and inflation increases by 2 percentage points relative to the 2023 forecast	$31.4m	0.9% of GDP	$93.1m	2.7% of GDP

Source: Ministry of Finance

Table 2 illustrates the vulnerability of key fiscal variables in the baseline to economic shocks. Scenario 1 assumes that the baseline end-of-period inflation remains unchanged whilst supply disruptions and the ongoing Russian-Ukrainian conflict are extended. This intensifies the unavailability of production inputs that causes GDP growth in 2023 to be lower by 2 percentage points relative to the baseline. Under this scenario, tax revenues decline, ceteris paribus, and the overall fiscal balance worsens by $11.5 million to 1.5 percent of GDP. Additionally, the primary surplus narrows from 3.6 percent of GDP under the baseline to 3.2 percent, below the FRA's stipulated floor of 3.5 percent of GDP.

The second scenario assumes that rising and volatile food and energy prices continue to surge in 2023 raising the inflation rate by 2 percentage points higher than the baseline forecast. All other things equal, primary expenditure increases by $19.9 million and the overall and primary balances deteriorate to 1.3 percent and 3.0 percent of GDP respectively, falling below the FRA's primary balance target.

Scenario 3 simulates a combined shock in which 2023 GDP growth is 2 percentage points lower and inflation is 2 percentage points higher than the baseline forecasts. Consequently, total outlays increase and revenue intake declines, weakening the overall and primary balances from 1.8 percent and 3.6

percent of GDP to 0.9 percent and 2.7 percent of GDP respectively, considerably less than the FRA's primary balance floor.

These stylized scenarios highlight the need for Government to continue to monitor and manage fiscal risks, build fiscal buffers, and maintain fiscal prudence even as it continues the implementation of targeted measures to cushion the socioeconomic impact of high inflation and an economic slowdown on the most vulnerable in the society.

<u>Budget Implementation Risks</u>

Receipts from the Citizenship-by-Investment (CBI) programme, which is a major source of non-tax revenue, are particularly at risk in the context of the pending legislation in both the European Union and the US to penalise nations offering CBI programmes. In March 2022, legislation (No Travel for Traffickers Bill) intending to prevent countries that offer CBI beyond 2025 from accessing the US Visa Waiver Programme, was introduced in the US Congress. Should the legislation become law in the US, it would essentially mean that countries such as Grenada with a CBI programme will be banned from participating in the US Visa Waiver Programme, which can have serious negative implications for Government revenues and economic growth, if not mitigated. This development is being closely monitored by the authorities with strategic efforts afoot to safeguard the CBI programme beyond 2025.

Near-term uncertainties about CBI inflows, especially inflows into the National Transformation Fund (NTF) will complicate Budget programming and execution. The fiscal outlook can be negatively affected should the anticipated NTF receipts not materialise. Lower-than-forecasted receipts can adversely affect project implementation. Moreover, high inflation can potentially complicate Budget execution by eroding any possible windfall revenue from duties and border taxes (because of imported inflation) through possibly expanded fiscal support to citizens especially the most vulnerable, and higher cost of goods and services for the Government.

Moreover, costs of construction inputs are likely to remain high, which can trigger cost overruns of infrastructure projects in the Public Sector Investment Programme (PSIP). Active contract management by implementing ministries will be necessary to mitigate this risk. Additionally, the

Government will continue to strengthen implementation capacity through training and hands-on support as part of the roll-out of a comprehensive implementation strategy for its PSIP. The performance of the PSIP is anticipated to be substantially improved with the creation of the new Ministry of Mobilisation, Implementation and Transformation (MIT) whose mandate is to support the delivery of the Government's priorities through the robust implementation of programmes and projects.

The March 29th High Court Ruling on the Pension Disqualification Act poses significant risk to budget execution if various scenarios, in particular, the worst case scenario, were to materialize. Under the worst case scenario, where roughly 2,000 public officers can opt to retire immediately based on years of service, the fiscal costs will rise significantly.

State-Owned Enterprises (SOEs) Risks

Contingent liabilities refer to non-guaranteed debt and other sources of liabilities. These contingent liabilities do not add to Central Government's expenditure immediately; however, an unexpected future exogenous shock could require direct payments from Government. SOEs are encouraged to report timely and complete information to avoid the realisation of potential risks to public finances should they become insolvent at any time. Table 3 provides a quantitative summary of the risks associated with SOEs at the end of September 2022.

Table 3: Fiscal Risk Matrix of SOEs

Sources of Fiscal Risk from SOEs for Central Government	***Direct Liabilities (Millions EC$)*** *(Obligations in any event)*			***Contingent Liabilities (Million EC$)*** *(Obligations if a particular event occurs)*		
	Categories	**Fiscal Cost Estimates**	**Risks**	**Categories**	**Contingent Liability**	**Risks/ Risk Rating (RR)**
Explicit Liabilities	-	-	-	Actuarial Deficit of NIS (National Insurance Scheme)	Deficit by 2048 (based on 2018 NIS Actuarial Review[1])	Liquidity Risk, Sustainability Risk. **RR**: **Medium**
Implicit Liabilities	-	-	-	Total SOEs Debt (Unguaranteed)	$141.4 million 4% GDP	Interest Rate Risk, Risk to domestic prices for services provided by relevant SOEs. **RR: Low**
	-	-	-	o/w Debt in arrears	$20.7 million 0.6% of GDP	Interest Rate Risk, Risk to domestic prices for services provided by relevant SOEs. **RR: Low**
	-	-	-	o/w Debt Service due in 2023	$17.8 million 0.6% of GDP	Interest Rate Risk, Risk to domestic prices for services provided by relevant SOEs.

[1] Latest published actuarial report.

						RR: Low
	-	-	-	Increased employee remuneration as a result of Salary negotiations	TBD	Sustainability Risk. **RR: TBD**
	-	-	-	Unfunded SOE Pension Scheme	TBD	Sustainability Risk. **RR:TBD**

Source: Ministry of Finance

Contingent liabilities concerning SOEs remain low; however, SOEs and Statutory Bodies still pose a risk to the Central Government especially when they don't maintain prudent financial management. SOEs' involvement in investment initiatives could pose a serious risk to the Government's fiscal accounts especially if substantial losses are incurred. At the end of September 2022, SOEs non-guaranteed debt was $141.1 million. Most non-guaranteed debts are issued domestically at fixed interest rates. These borrowing arrangements are generally long-term, with an amortising structure and fixed interest rates, which limit vulnerability to interest rate changes. Lending facilities are created through commercial banks, regional banking institutions (such as the Caribbean Development Bank), other SOEs or through on-lending arrangements with the Government. Importantly, debt owed to other SOEs also represents implicit contingent liabilities because the risk of non-repayment can ultimately be borne by the Government should these arrangements result in losses for the lenders.

Climate Risks

Grenada's vulnerability to natural hazards is an inherent risk. Climate change is a predominant driver of more intense and frequent natural events that can affect all sectors especially tourism, agriculture, and construction, at substantial fiscal cost. 2019 estimates of the IMF indicate that of 182 countries in the Climate Risk Index, *"Grenada was in the top 2 percent for losses to climate-related natural disasters as a percent of GDP during 1997–2017 and the top 5 percent of climate-related disaster fatalities."* The IMF also estimates that *"Grenada's annual average loss from wind-related events and floods averages just under US$20 million, or 1.7 percent of GDP."* According to the IMF, the estimated loss includes total direct and indirect losses of both the public and private sectors, on average in any given year over the long run.

Government continues to build resilience to climate change as demonstrated in its ongoing and planned adaptation and mitigation actions, consistent with its Disaster Resilience Strategy, its National Adaptation Plan, and its updated Nationally Determined Contributions. Moreover, the Government has adopted a risk-layering approach to natural hazard financing that includes insurance, contingencies, lines of concessional credit, and budgetary set-asides. Additionally, as part of Government's 2015 debt restructuring, hurricane clauses have been included in its restructured bonds, which would trigger an automatic reprofiling following a hurricane and other types of natural events.

Other Potential Sources of Risks

Financial Sector

Though some financial vulnerability may exist because households and businesses have been adversely affected by the back-to-back shocks of COVID-19, Russia's invasion of Ukraine, and global inflation, banks have remained strong and adequately capitalised. However, enhanced financial sector surveillance and continued efforts to safeguard financial stability would be required as uncertainties surrounding the macroeconomic outlook persist. Stepped-up supervision and monitoring of credit unions will be particularly important given elevated non-performing loans at some institutions, which can potentially increase in the context of the projected economic slowdown.

Public-Private Partnerships

Concerning Public-Private Partnerships (PPPs), there were two such existing arrangements in place in 2022: (i) a 15-year agreement with Digicel, which is part of the Caribbean Regional Communication Programme that is a World Bank-funded regional project between the Governments of Grenada, Saint Lucia and St. Vincent and the Grenadines and Digicel to support the countries' digital transformation agenda. Grenada's contribution to the regional projects is a current liability (i.e. concessional loan financing) and as such, there are no explicit related contingent liabilities associated with the PPP arrangement.(ii) the Grenville Commercial Complex, which is an arrangement between the Government and a private partner to construct commercial spaces for rent, costing an estimated EC$18.8 million, with Government owning 51% of the shares of the venture.

Table 4 provides a Risk Summary.

Table 4: Risk Assessment Summary

Risk Description	Source of Risk	Risk Rating	Measures to Manage/Mitigate Risks
Macroeconomic	An acute deceleration in global economic growth High global inflation Geopolitical tensions		Continue to implement targeted measures to support sectors most directly affected by the economic slowdown. Prudent use of the Contingency Fund to provide financial resources to facilitate counter-cyclical fiscal policy should the slowdown be steeper than estimated. Continue to implement structural reforms to diversify the economy to boost economic competitiveness and resilience.
Budget Implementation	Lower-than-expected NTF receipts		Prioritise capital expenditure on projects tailored to generate employment and target building resilient infrastructure through the PSIP. Ensure that discretionary outlays adhere to budgeted expenditures and continue to strengthen revenue administration.
	Capacity and institutional constraints affecting project implementation		Continue to strengthen the Public Investment Management System to improve the execution of the capital budget. Continuous capacity building in project management, greater coordination among implementing ministries, and the work of MIT should help mitigate this risk.
	Larger-then-anticipated pension liabilities		Systematic sensitisation of public workers of fiscal and economic implications should a worse-case pension scenario materialise. Systematic efforts at dissuading early retirement, through non-monetary incentives and other morale-building and worker-centering initiatives.
Fiscal Risks from State-own Enterprises	Contingent liabilities of SOEs		Ensure that up-to-date audited financial statements are submitted on time and closely monitor the management performance of SOEs to ensure that they pursue their respective stipulated mandates in the most cost-efficient and cost-effective manner.
Climate	Adverse effects of climate change		A comprehensive disaster risk financing strategy has been developed that includes: a Contingency Fund; a Line of Credit for which the drawdown trigger is an unforeseen natural event; and insurance (CCRIF). Debt instruments with hurricane clauses.

Key	
	High Risk
	Medium Risk