



GOVERNMENT OF GRENADA

Fiscal Risk Statement

Submitted To

The Parliament

By

**The Minister of Finance, Economic Development, Physical Development,
Public Utilities and Energy**

November 2020

PURPOSE

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

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

- i. the sensitivity of economic and fiscal forecasts to changes in the economic outlook and economic shocks;*
- ii. the exposure of the Government to contingent liabilities, including guarantees and obligations arising from judicial proceedings in progress;*
- iii. fiscal risks arising from the financial sector, statutory bodies, state-owned enterprises, public-private partnerships, and any other institutions;*
- iv. any commitment unaccounted for in the economic and fiscal forecasts;*
- v. any other circumstance that may have a material effect on the economic and fiscal forecasts and is unaccounted for in the economic and fiscal forecasts; and*
- vi. any measures implemented by Cabinet, or the Minister, to manage fiscal risks.”*

INTRODUCTION

This Fiscal Risk Statement outlines the Government's assessment of key risks that can affect the achievement of its development priorities in the short-to-medium term. The categories of risks discussed are (i) Macroeconomic Risks; (ii) Budget Risks; (iii) Public Enterprises Risks; and Climate Risks.

Macroeconomic Risks

According to the International Monetary Fund's World Economic Outlook Report released in October 2020, the global economy is recovering from the depths to which it had entered during the first half of this year because of the COVID-19 pandemic. Despite this gradual rebound, the world economy is projected to contract by an estimated 4.4%, and the attainment of pre-pandemic growth levels is prone to risks and uncertainties. A mix of upside and downside risks remain for the global outlook over the mediumterm as uncertainty persists regarding the evolution of the pandemic. Downside risks include; a more persistent, stronger and longer-lasting pandemic than assumed in the baseline; recurrence of outbreaks in countries; tightening of global financial conditions; a resurgence of geopolitical tensions and premature withdrawal of policy support by authorities. The projected contraction in global economic activity particularly in the economies of Grenada's main trading partners will negatively affect tourist arrivals, remittances, and foreign direct investments. Additionally, uncertainties regarding a vaccine and the protocols in place for visitors to the island will continue to affect the tourism sector, which contributes significantly to the local economy. Rising international oil prices is also a significant risk to the economic outlook. Despite these downside risks, the robust macro-fiscal position of Grenada before the pandemic offers some level of mitigation.

Table 1 presents the main baseline economic assumptions underpinning the Medium-Term Fiscal Framework (2021-2023); and of which shock scenarios are analyzed.

Table 1: Baseline Macroeconomic Assumptions

	2021	2022	2023
Real GDP Growth (%)	6.0	4.8	3.0
Total Revenue (% of GDP)	21.5	22.3	22.4
Total Expenditure (% of GDP)	30.8	26.5	21.9
Overall Fiscal Balance (after grants) (% of GDP)	-0.6	1.6	4.7
Primary Balance (after grants) (% of GDP)	1.5	3.5	6.4
Public Debt (% of GDP)	65.7	63.7	62.7

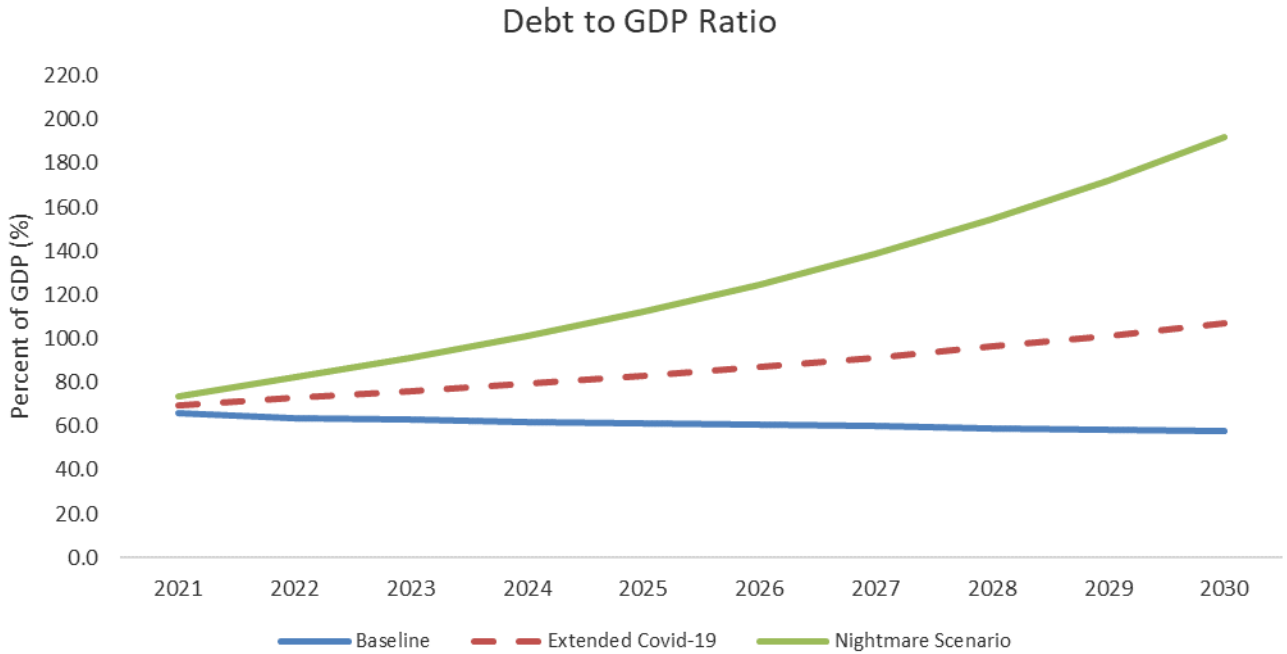
Source: Ministry of Finance

Macroeconomic Shocks:

GDP Shock

Figure 1 shows how vulnerable the baseline debt-to-GDP ratio is to two illustrative stylized shocks. The first scenario assumes that the currently forecasted outturns of the COVID-19 pandemic for 2020 continue strongly throughout 2021 resulting in a decline in GDP equivalent to its 10-year historical average (2011-2020) minus one standard deviation. Under this illustrative scenario, the ratio of public debt-to-GDP upticks to 69.3 percent in 2021, which is 3.6 percentage points higher than the baseline projection. The debt dynamics worsen over time, with the ratio increasing to 106.8 percent in 2030, well above the baseline projection of 57.7 percent. The second shock assumes the ‘nightmare scenario’ in which the projected effects of the COVID-19 for 2020 continue with the same intensity throughout 2021 coupled with a natural disaster (hurricane) causing a contraction in GDP equivalent to its historical 10-year average minus two standard deviations. Under this scenario the ratio of public debt-to-GDP increases to 73.6 percent in 2021, 7.9 percentage points above the baseline projection. By 2030, public debt as a ratio of GDP hikes to 191.8 percent, almost four times the baseline projection. These vulnerabilities necessitate that the Government continues to accord high priority to entrenching fiscal and debt sustainability by returning to the fundamental criteria of the FRL once the economic recovery takes hold, and building resilience to economic, environmental, and other shocks. The Government will continue to strengthen its debt management operations and systems.

Figure 1: Illustrative Scenarios for Public Debt



Source: Ministry of Finance

Budget Risks

Expectations about external receipts pose fiscal risks. The fiscal outlook can be negatively affected should the anticipated inflows to the National Transformation Fund (NTF), as well as external grant financing not be as strong as anticipated considering the global financial market turmoil. This can negatively impact the pace of implementation and completion of capital projects programmed within the capital budget. The Government commits to scaling-up public sector investment projects reflective of some improvements made in staffing and capacity to execute projects within the PSIP and will continue to strengthen its management systems.

Public Enterprises Risks

The key fiscal risks that arise from SOEs are summarised as follows:

- *Large-scale future capital commitments* – Financing for major capital expenditure in some SOEs is above their capacity. Potentially this poses a fiscal risk for Government, either through direct funding or guaranteed lending.
- *Commercial risks* – If the current pandemic deepens, some SOEs may suffer revenue losses and face liquidity pressures but at the same time still have to meet fixed costs and cover debt obligations. Any prolonged liquidity shortfalls could potentially impact on the viability of these enterprises.
- *Guaranteed debts* – Implicit contingent liabilities exist in cases where SOEs cannot service their contracted debts. Though the Government liquidated all explicit guarantees of SOEs during the last quarter of 2019, should any SOE default on their debt payments the burden falls on the Government to assume this responsibility and this creates a potential risk on the budget.
- *Insufficient subvention funding / unfunded mandates* - Where SOEs fail to remain within their funding constraints, either through deliberate action or because of obligations imposed on them, the shortfall will ultimately fall on Central Government.
- *Non-reporting/ inadequate reporting information* – In instances where SOEs fail to meet financial reporting requirements, because of late reporting, the incompleteness of reports or bluntly not reporting, this poses a risk on the budget should an SOE becomes insolvent.

Governance Arrangements

The current quarterly reporting mechanism seeks to reduce these risks as Government is better able to monitor the operations of SOEs. As the monitoring system improves, Government aims to quantify and provision for contingent liabilities arising from SOEs. Additionally, stricter enforcement with regards to the requirement to provide audited financial statements is being implemented. However, unaudited reports are still being used to quantify fiscal risks because of the lack of capacity within SOEs to prepare audited financials.

Assessments of the non-guaranteed debt of SOEs (excluding Petrocaribe) reveal that as at June 2020, some \$171.2 million or 6.1 percent of GDP represent contingent liabilities that could arise and ultimately impact the Government’s fiscal accounts. Accordingly, the Government continues to focus on improving its monitoring mechanisms of all state-owned enterprises.

Climate Risks

Grenada's vulnerability to natural disasters is an inherent risk. The adverse effects of climate change are a perennial threat that can negatively affect infrastructure, tourism, and agriculture in particular. Building resilience to climate change remains a pressing development priority. The Line of Credit approved by the World Bank, for which the drawdown trigger is an unforeseen natural event and coverage by CCRIF adds to the Government's risk-layering approach to disaster rehabilitation financing. Additionally, the Contingency Fund was operationalized before the Supplementary Budget in April and was partly utilized to cushion the adverse effects on government finances due to the onset of the pandemic.

Other Potential Sources of Risks:

Financial Sector

The outlook for the financial sector remains stable and sound. As part of their suite of measures to mitigate against the COVID-19 crisis, commercial banks in collaboration with the Eastern Caribbean Central Bank have extended loan moratoria and late fee waivers to eligible customers during the six months March-September. This offer was further extended for a maximum period of twelve months beginning October this of year. Despite the impact of the COVID-19 pandemic on the wider economy, especially the tourism sector, the financial sector has not been severely affected and banks have remained highly liquid and adequately capitalized. However, enhanced financial sector surveillance and continued efforts to safeguard financial stability would be required if uncertainties surrounding the pandemic shock persist and spread to other major sectors of the economy.

Public-Private Partnerships

Concerning Public-Private Partnerships (PPPs), there is still only one such existing arrangement in place in 2020 that is a 15-year PPP agreement with Digicel. The PPP agreement is part of the Caribbean Regional Communication Program, which is a World Bank-funded regional project between the Governments of Grenada, St. 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 financed) and as such, there are no explicit related contingent liabilities associated with the PPP arrangement. Table 2 provides a Risk Summary.

Table 2: Risk Assessment Summary

Risk Description	Source of Risk	Risk Rating	Measures to Manage/Mitigate Risks
Macroeconomic	<ul style="list-style-type: none"> • Contraction of the global economy • Longer-lasting Covid-19 pandemic shock. • The resurgence of geopolitical uncertainties 		Continue to implement structural reforms to diversify the economy to boost economic resilience. Targeted measures to support sectors most directly affected by the COVID-19 pandemic. Prudent use of the Contingency Fund to provide financial resources to facilitate counter-cyclical fiscal policy should the crisis persists. Update and improve protocols at various entry ports regularly to ameliorate the further spread and exposure of the virus .
Budget	Lower-than-expected external inflows and Grants.		Prioritize capital expenditure on projects tailored to support employment generation 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 its capital budget. Continuous capacity building in project management and greater coordination among implementing ministries should help mitigate this risk.
Public Enterprises	Fiscal risks from SOEs		Ensure that up-to-date audited financial statements are submitted on time and closely monitor management performance within the SOEs to ensure that they pursue their respective stipulated mandates in the most cost-efficient and cost-effective manner.
Climate	Adverse effects of climate change		A comprehensive disaster risk financing strategy has been developed that includes: a Contingency Fund; a Line of Credit (approved by the World Bank in 2019) for which the drawdown trigger is an unforeseen natural event; and CCRIF.

Key	
	High Risk
	Medium Risk