GOVERNMENT OF GRENADA

Fiscal Risk Statement

Submitted To

The Parliament

By

The Minister of Finance, Economic Development, Physical Development, and Energy

November 2021

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 Implementation Risks; (iii) Public Enterprises Risks; and Climate Risks.

Macroeconomic Risks

The October 2021 release of the International Monetary Fund's World Economic Outlook states that global recovery is progressing despite the resurgence of the COVID-19 pandemic. Accordingly, world output is projected to expand 5.9 percent in 2021 and 4.9 percent in 2022. The medium-term outlook is susceptible to a mix of upside and downside risks, and the escalation of the Delta variant and the threat of new variants, have increased uncertainty about the path of the pandemic. Downside risks emanate from: more transmissible and lethal variants of the disease; rising inflation because of the pandemic-induced supply-demand mismatches inclusive of higher oil and commodity prices; tightening financial conditions and market volatility; adverse climate-related shocks; and geopolitical risks arising from trade and technology tensions between the United States and China, all of which can have reverberating repercussions on the local economy. Vaccine hesitancy remains a hurdle to a return to normalisation and a premature relaxation of protocols increases the threat of a domestic outbreak and second wave of the COVID-19. Grenada's high vulnerability to natural disasters is an inherent risk and its susceptibility to the adverse effects of climate change can retard agricultural production as well as adversely affect tourism and activity in other sectors. On the upside, further improvements in the fiscal position through enhanced revenue mobilisation can boost public investment and spur job creation and growth .

Table 1 presents the baseline Medium-Term Fiscal Framework (2022-2024) against which shock scenarios are analysed.

Table 1: Baseline Macroeconomic Projections

	2022	**2023**	**2024**
Real GDP Growth (%)	4.5	4.4	4.0
Total Revenue (% of GDP)	22.7	22.8	22.9
Total Expenditure (% of GDP)	31.2	26.3	21.8
Overall Fiscal Balance (after grants) (% of GDP)	-2.9	1.7	5.4
Primary Balance (after grants) (% of GDP)	-0.9	3.6	7.0
Public Debt (% of GDP)	67.0	65.2	63.5

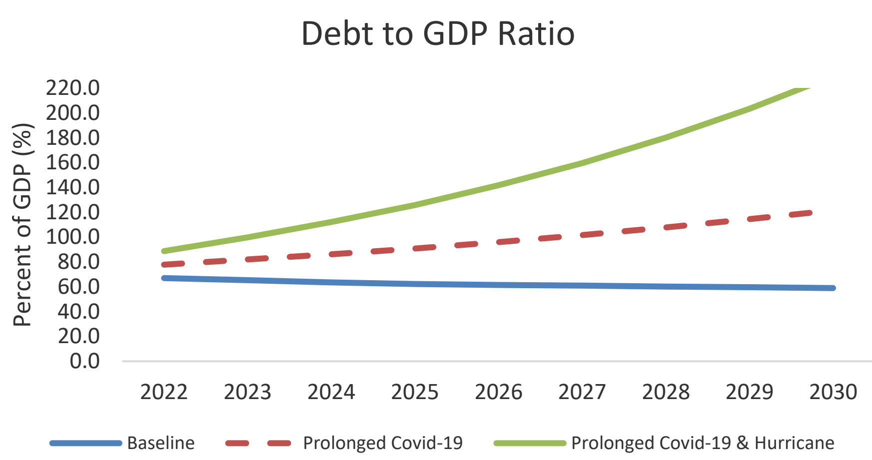
Source: Ministry of Finance

Macroeconomic Shocks:

GDP Shock

Figure 1 shows how vulnerable the baseline debt-to-GDP ratio is to two illustrative stylised shocks. The first scenario assumes a decline in GDP equivalent to its 10-year historical average (2012-2021) minus one standard deviation. Under this illustrative scenario, the ratio of public debt-to-GDP climbs to 77.8 percent in 2022, which is 10.8 percentage points higher than the baseline projection. The debt dynamics deteriorate over time, with the ratio reaching to 121.5 percent in 2030, far exceeding the baseline projection of 58.9 percent. The second shock assumes that projected effects of the COVID-19 for 2021 continue with the same intensity throughout 2022 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 rises to 88.7 percent in 2022, 21.7 percentage points above the baseline projection. By 2030, public debt as a ratio of GDP explodes to 229.7 percent, almost quadrupling the baseline projection. Given these vulnerabilities, the Government will continue to accord high priority to entrenching fiscal and debt sustainability by returning to the fiscal rules and targets of the FRL once the economic recovery takes hold, and building resilience to economic, environmental, and other shocks. Importantly also, the Government will also continue to strengthen its debt management operations and systems.

<u>Figure 1: Illustrative Scenarios for Public Debt</u>



Source: Ministry of Finance

Budget Implementation Risks

Heightened uncertainties 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 materialise given the continuing pandemic. Lower-than-forecasted grant receipts can adversely affect project implementation as well as completion and Budget execution by extension. To mitigate the risks posed by the possibility of lower-than-expected grant inflows, Government will be actively monitoring inflows and reprioritising execution of Public Sector Investment Programmes (PSIP) as the situation warrants. 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.

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 expenditures 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 2 provides a quantitative summary of the risks associated with SOEs.

Table 2: 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**
Explicit Liabilities	-	-	-	Actuarial Deficit of NIS (National Insurance Scheme)	Deficit by 2048 (based on 2018 NIS Actuarial Review[1])	Liquidity Risk, Sustainability Risk
Implicit Liabilities	-	-	-	Total SOEs Debt (Unguaranteed)	$158.0 million 5% GDP	Interest Rate Risk, Risk to domestic prices for services provided
	-	-	-	o/w Debt in arrears	$10.5 million 0.4% of GDP	Interest Rate Risk, Risk to domestic prices for services provided by relevant SOEs
	-	-	-	o/w Debt Service due in 2022	$17.3 million 0.5% of GDP	Interest Rate Risk, Risk to domestic prices for

[1] Latest published actuarial report.

						services provided by relevant SOEs
	-	-	-	Increased employee remuneration as a result of Salary negotiations	TBD	Sustainability Risk
	-	-	-	Unfunded SOE Pension Scheme	TBD	Sustainability Risk

Source: Ministry of Finance

Contingent liabilities with respect to SOEs remain low. However, given the turbulence of the current economic environment on account of the COVID-19 pandemic, these liabilities may still present a moderate degree of fiscal risk as the debt stock (domestic and external), which comprises non-guaranteed debt, could require Government's intervention should a SOE be unable to meet its financial obligations when they become due.

To date, SOEs non-guaranteed debt amounts to $158.0 million. Most non-guaranteed debt 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 disasters is an inherent risk. Climate change is a predominant driver of more intense and frequent natural disasters that can affect all sectors especially tourism, agriculture, and construction. A joint World Bank-IMF Low Income Country Debt Sustainability Analysis published in July 2018 calibrates the effect of natural disasters from the estimated growth effects of the 2017 hurricane Maria in the Commonwealth of Dominica *(the total damage from Maria in terms of country GDP is like those of hurricane Ivan for Grenada in 2004)* - to have a fiscal response that results in increased expenditure of about 5.0 percent to cover reconstruction costs. Coupled with the protractive pandemic, climate-related shocks present a significant challenge to the recovery. Government continues to build resilience to climate change as demonstrated in its strategic adaptation and mitigation priorities to be accomplished over the medium term. Relatedly, once the disruptive effects of the pandemic abates, Government will resume building fiscal buffers to mitigate climated-related shocks should these materialise.

Other Potential Sources of Risks:

Financial Sector

Despite financial pressures due to the COVID-19 pandemic, the financial sector is characterised by high liquidity and so far, risks to financial stability have been contained. The loan moratoria extension granted by commercial banks in October of 2020, expired in September 2021 and indications suggest that the overall impact of this on banks' balance sheet is minimal. Though some financial vulnerability may exist particularly but not exclusively because of affected firms and businesses within the tourism sector, banks and non-bank financial institutions have remained adequately capitalised. However, enhanced financial sector surveillance and continued efforts to safeguard financial stability would be required as uncertainties surrounding the pandemic shock persist and spread to other major sectors of the economy.

Public-Private Partnerships

Concerning Public-Private Partnerships (PPPs), there was still only one such existing arrangement in place in 2021, which is a 15-year agreement with Digicel. The PPP agreement is part of the

Caribbean Regional Communication Programme, 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 3 provides a Risk Summary.

Table 3: Risk Assessment Summary

Risk Description	Source of Risk	Risk Rating	Measures to Manage/Mitigate Risks
Macroeconomic	• Contraction of the global economy . • Longer-lasting COVID-19 pandemic shock. • The resurgence of geopolitical uncertainties.		Continue to implement 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 longer than anticipated. Update and improve protocols at various entry ports regularly to ameliorate the further spread and exposure of the virus. Over the medium term, continue to implement structural reforms to diversify the economy to boost economic resilience.
Budget Implementation	Lower-than-expected external inflows and Grants.		Prioritise 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 the 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 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 (approved by the World Bank in 2019) for which the drawdown trigger is an unforeseen natural event; and insurance (CCRIF).

Key	
	High Risk
	Medium Risk