COUNTRY ECONOMIC REVIEW 2017

ANGUILLA

Dollars ($) throughout refer to Eastern Caribbean dollars (XCD) unless otherwise stated
USD 1.00 = 2.70 XCD

OVERVIEW

The Anguilla economy contracted in 2017. After a fairly robust performance during the first half of the year, the economy was battered by a catastrophic, Category 5 hurricane in September. Hurricane Irma resulted in severe infrastructural damage and one confirmed fatality. In the storm's aftermath, the overwhelming majority of income, employment, and foreign exchange activities decelerated, dampening overall economic activity. The tourism sector, the main driver of growth, declined as damaged hotels closed. Electricity and water production contracted, as did most of the other major economic sectors, with the exception of construction. An impact assessment[1] puts the total damage and losses, as a result of the hurricane, at $880 mn, 97% of the 2016 Gross Domestic Product (GDP). The Government of Anguilla (GOA) was able to finance its budget, aided by financial buffers including catastrophic insurance proceeds, grant-in-aid budget support, and GOA's own liquid reserves. With limited borrowing and net debt amortisation, debt stock levels fell. Growth is projected to recover in 2018, driven by hotel and public sector-financed reconstruction projects. Tourism, the main economic pillar, is expected to remain in decline as hotel properties undergo repair. Fiscal challenges will heighten resulting from projected revenue losses and an expanding public debt burden. Aid from the Government of the United Kingdom (GOUK) should help ease expenditure pressures to reconstruct and rebuild. However, additional resources will be needed to shore up finances, close financing gaps, and restore fiscal buffers.

1. REAL SECTOR

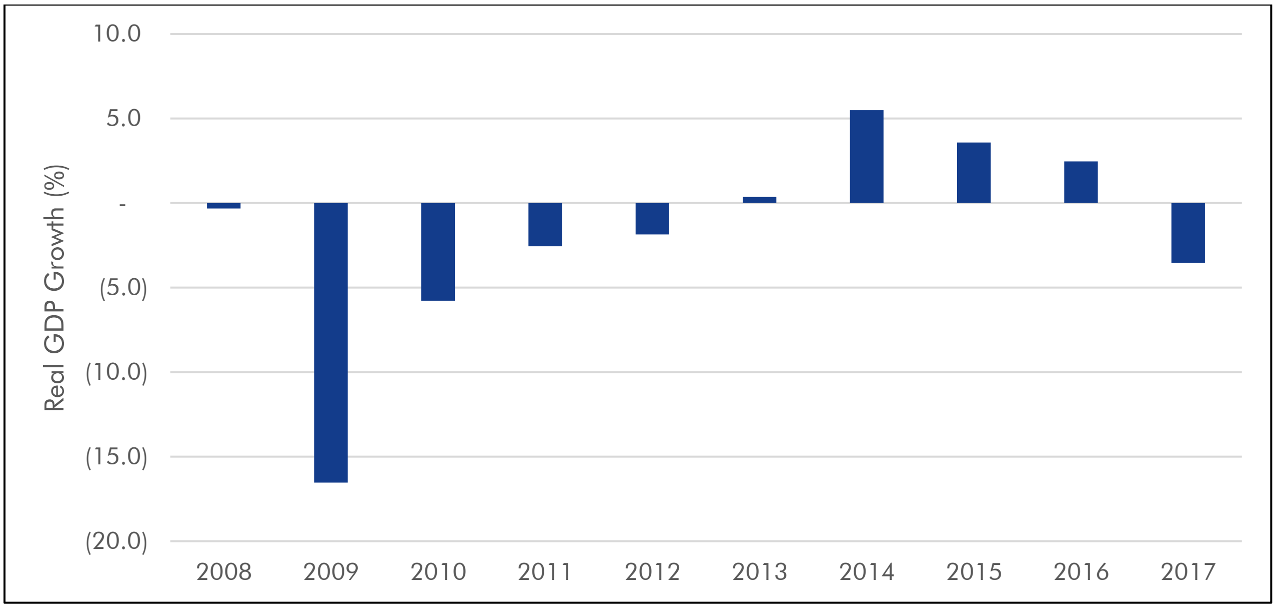
1.01 The Anguilla economy is projected to contract by 3.5% in 2017 (Figure 1), after three consecutive years of growth from 2014 to 2016. This decline marked a return to negative growth, a position that prevailed for much of the past decade (2008 to 2017) due to the adverse impacts of major economic shocks. Economic decline resulted from severe damage and dislocation caused by the effects of a major hurricane, one of four to have impacted in the past decade. Hurricane Irma caused total damage and losses of $880 mn, with the productive sectors suffering 54.8% of the total damage, followed by social sectors, 28.2%, and infrastructure, 17%. The heavy losses sustained crippled economic activity during the last quarter of the year, and virtually unwound strong gains attained prior to the hurricane.

1.02 Economic decline was led by a sharp fall-off in tourism activity[2], the mainstay of the economy. The sector's real value added is projected to contract by 10.4% in 2017. Stayover arrivals of 150,678 contracted by 14.4% relative to the number of visitors in 2016, sharply reversing the

[1] Economic Commission for Latin America and the Caribbean.
[2] Tourism, proxied by Hotels and Restaurants, accounts for approximately 22% of GDP, with a significantly larger indirect economic contribution estimated at 57% of GDP.

growth momentum recorded prior to the hurricane. By the end of August 2017, stayover arrivals had increased by 7.1% to peak at 63,406 visitors, the highest recorded level of arrivals for the eight month period. However, in the wake of the storm, limited access[3] into Anguilla due to seaport and airport damage and the closure of over 60% of the room stock, led to a reversal of this trend. Anguilla attracts mainly American tourists who constituted around 64% of arrivals to October. Arrivals from the Caribbean, the second largest source market (7% of total) also declined. The number of excursionists or day-trippers declined, reflecting the destruction in Sint Maarten / St. Martin, the main gateway into Anguilla.

FIGURE 1: REAL GDP GROWTH 2008-2017



Source: Government of Anguilla

1.03 The sudden decline in tourist arrivals after Hurricane Irma had adverse knock-on effects in other sectors, including wholesale and retail trade, transport, storage and communication, and business activities, all of which contracted. Similarly, destruction to the electricity transmission and distribution infrastructure through excessive winds and water damage, induced dampening effects on households, Government entities and businesses. In the storm's aftermath, construction increased by 9%, driven primarily by hotel repair and public investment in port infrastructure.

Social Sector

1.04 Hurricane Irma deepened socioeconomic challenges following on from the decade-long fallout from the financial crisis. Although the residential housing stock mostly withstood the

[3] The island's sole passenger ferry terminal at Blowing Point was completely destroyed, and the Princess Juliana Airport on Dutch St. Maarten which serves as Anguilla's main air access point, was devastated.

excessive winds with minimal damage, disposable incomes were lost as unemployment spiked. GOA anticipates that with the closure of major hotels, close to 2,000 hotel workers (nearly 14% of the population) have been displaced, most being female employees. Some hotels workers were retained on a temporary basis, to assist with the cleaning and clearing of hotel properties. New employment in construction is, however, anticipated as reconstruction work gains momentum.

1.05 The average 12-month inflation rate to the end of June was positive at 1.6%. After several years of price deflation, higher inflationary pressures were evident during the year, primarily associated with higher food, transportation, clothing, medical and communication costs.

2. CENTRAL GOVERNMENT OPERATIONS AND DEBT

2.01 Fiscal operations in 2017 resulted in a modest overall surplus of $7.1 mn (0.8% of GDP), and a recurrent surplus of $5.9 mn (0.7% of GDP). Notwithstanding a falloff in recurrent revenues (by 23.9%) during the last four months of the year, GOA collected more revenue in 2017 ($199.9 mn[4]) compared with 2016 ($188.7 mn), although less than budget ($214.8 mn).

2.02 Tax receipts were higher by 5% on account of a more than doubling in stamp duty (to $16 mn) associated primarily with the sale of a large hotel property, Cap Juluca, in May and higher inflows from tourism-related taxes (21% to $23.3 mn). Also, the yield from property tax increased by 23.3%, to a total of $7.2 mn on account of the introduction of market-based assessments, and improved enforcement and compliance measures. However, import duties and other taxes on trade declined by 10.2%, in line with lower import volumes, reduced fuel imports (with a reduction in electricity and gas consumption from lower car rentals after Hurricane Irma), and duty exemptions provided post-Irma. Non-tax revenue and taxes on income also declined by 8.2% and 2%, respectively. Revenues were supplemented by significant capital grants, grant aid primarily from the European Development Fund and GOUK, and insurance inflows from CCRIF SPC (formerly the Caribbean Catastrophe Risk Insurance Facility). With these, total revenues and grants totaled $223 mn.

2.03 Recurrent expenditure increased by 4.1% to $195.4 mn compared with the previous year's spending, but ended lower than budget ($211.9 mn). Higher spending was driven by a 37% increase ($4.4 mn) in interest payments that rose to $16.4 mn, and an almost doubling in utility costs to $7.7 mn. Spending on transfers and subsidies increased due to a 30% higher outlay ($7.8 mn) for public assistance after the hurricane. Subsidies – which account for 23% of recurrent spending – for health service, the tourism board and the community college, remained steady. With continuing restraints on hiring and wage increases, GOA's wage bill declined by 1.6% to $83.2 mn. As a share of GDP, the wage bill remained relatively steady at 9% of GDP, but shrank as a share of recurrent expenditure from 45% in 2016 to 42.6% in 2017.

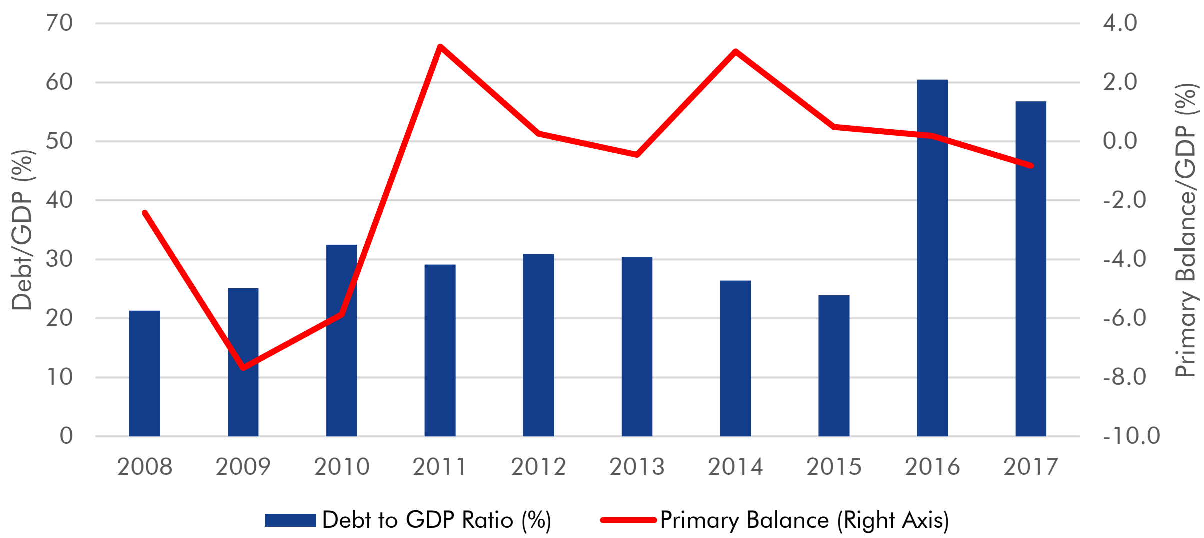
[4] This amounted to 21% of GDP.

2.04 Capital spending at $20.5 mn (2.3% of GDP), rose to its highest level in the past decade, doubling the $11.4 mn spent in 2016, underpinned by ongoing construction of the new fire hall facility at the international airport, and clearing and repairs in the wake of Hurricane Irma. Since 2009, spending on capital investment has been low. Financial constraints and a focus on narrowing imbalances and meeting mandated fiscal targets, have required that GOA maintain a low level of capital investment. To close its financing gap, Government exhausted liquid reserves ($14.4 mn), and increased short-term financing in 2017. Overdraft balances rose by $7.2 mn to reach its ceiling of $20 mn during the year. By the end of December, the overdraft balance was reduced to $10.7 mn.

2.05 The public debt stock declined during 2017 by 6.3% to $517.1 mn, 56.8% of GDP (Figure 2). The shares of domestic and external debt accounted for 62.6% and 37.4%, respectively. Central Government debt accounted for the major share (98%) of the total disbursed outstanding debt. In 2016, the debt stock rose sharply from $212.7 mn to $551.8 mn (60.5% of GDP), when Government incurred debt to fund the resolution of two insolvent banks and to stabilise the financial sector. This borrowing increased the stock of debt above thresholds[5] established by the 2013 Fiscal Responsibility Act. Consequently, debt service payments rose from $16.9 mn to $38.8 mn in 2017. As a share of GDP, this obligation increased from 3.4% to 4.3%. At the end of 2017, the public debt stock and debt service to revenue remained elevated at 264% and 20.6%, respectively.

[5] Anguilla's fiscal responsibility legislation relies on three benchmarks for public debt guidance: (a) net risk-adjusted debt-to-current revenue below 80%; (b) risk-adjusted debt service-to-current revenue less than 10%; and (c) liquid assets (reserves)-to-current expenditure greater than 25% (or 90 days).

FIGURE 2: DEBT/GDP AND PRIMARY BALANCE



Source: Government of Anguilla

3. EXTERNAL SECTOR

3.01 Indications are that import volumes declined during the months ahead of the hurricane, contributing to a narrowing in the trade deficit. The merchandise trade deficit was reduced to $398.2 mn[6] in the first nine months of 2017, from $403.3 mn recorded in the corresponding period of 2016. Import payment declined by $11.2 mn, while export receipts are estimated to have contracted by $6.1 mn. Gross travel receipts increased by 2.7% to $278.9 mn, consistent with gains in the number of visitor arrivals to the end of September.

4. FINANCIAL SECTOR

4.01 Broad money supply, M2, expanded by 1.5% at the end of September compared with a decline of 5.2% in the corresponding period of 2016. This reflected an expansion in both private sector deposits and currency in circulation, consequent on the expansion in economic activity, and a preference to hold liquid assets in the immediate aftermath of the hurricane. Foreign currency deposits dipped slightly.

4.02 Domestic credit (net) fell marginally by $2.6 mn to $529.4 mn. This contraction was largely due to a substantial increase of 26%, or $20.0 mn, in the net deposit position of GOA which rose following the receipt of large grants and insurance flows after the hurricane. In contrast, loans to the private sector expanded by $30.7 mn. The net foreign assets of the banking system expanded,

[6] Provisional.

with growth in both the imputed share of the Central Bank's reserves and the commercial bank's net asset position.

4.03 The domestic banking system remained stable, supported by the ongoing recovery of the newly created National Commercial Bank of Anguilla[7], the largest commercial bank. Risks and fragilities heightened, however, on account of the hurricane's impact which affected several facets of banking operations. The large number of labour force participants displaced following the closure of many private businesses, fed through to a rise in the banking system's ratio of non-performing loans (NPLs) to gross loans. NPLs rose from 6.5% at the end of December 2016, to 19.3% at the end of September 2017, higher than the recommended prudential benchmark of 5%. Regulatory capital strengthened slightly and remained above the minimum 8% requirement. Strengthening the profitability of the banking sector remained a challenge, evidenced by a decline in the return on average assets ratio which fell from 1% in 2016 to 0.8% at the end of September. Liquidity in the banking system increased, reflecting increasing deposits. Loans and advances to total deposits fell post-Irma from 56% in 2016 to 49.3% in September, well below the prudential benchmark of 75-85%, reflecting the economic uncertainties and reduced effective demand.

4.04 GOA launched a National Risk Assessment exercise during 2017 as part of efforts to strengthen the regulation of the financial services sector, and comply with international obligations and standards on anti-money laundering. Anguilla is scheduled to undergo an on-site review in 2020 as part of the Fourth Round of Mutual Evaluation led by the Caribbean Financial Action Task Force.

5. OUTLOOK

5.01 Output recovery is expected to be robust, increasing by 7% in 2018. There is significant public capital investment to rebuild and repair demolished public buildings, including schools and the ferry port terminal. GOUK has pledged 60 mn Pounds of grant aid, which will significantly accelerate the pace of rebuilding in 2018 and bump up construction sector growth. Construction activity is expected to be a multi-year process and will continue into 2019 before tapering in 2020. Meanwhile, delays in the reopening of hotels and the main access gateways into Anguilla, will result in another year of tourism decline. A fast recovery is, however, anticipated for the 2019 tourism season premised on external demand remaining buoyant, aggressive marketing by local hotels, improved airlift capacity, and a return to normalcy at the port and airports. Beyond 2019, a full recovery in stayover arrivals is expected to sustain overall economic growth once reconstruction winds down.

5.02 Some recovery is expected in employment during 2018 as a result of the construction boom, although some measure of structural unemployment will likely remain. For the financial sector, economic uncertainties, persisting unemployment (and loss of household incomes), and continuing

[7] Established as a bridge bank in 2016 from the resolution of two insolvent banks.

weakness in real estate markets will continue to dampen loan demand, increase NPLs, and adversely affect earnings and profitability positions. Inflation is expected to remain moderate.

5.03 GOA will face a budget shortfall and cash flow limitations in 2018, notwithstanding higher capital grant inflows and strong economic growth, as its ability to earn revenue will remain compromised by a weak tourism sector. To help ease this constraint, GOA plans to raise additional revenue from selling shares in the Anguilla Electricity Company Ltd, and access loans to help close the financing gap. The related increase in debt servicing costs will put further strain on Government finances and likely remain a weight on Government budgets.

5.04 GOA has been collaborating with the Caribbean Regional Technical Assistance Centre to improve tax administration, and plans to enhance its Medium-term Fiscal Plan to help place fiscal and debt operations on a more sustainable footing. Beyond 2018, GOA's debt strategy is expected to focus on debt repayment in order to return to a downward trajectory, with improvements to sustainability over time. This remains subject to significant risks, including further shocks to the fiscal balance and GDP growth. Proceeds from bank resolution recoveries are expected to help reduce public debt.

SELECTED INDICATORS

	2013	2014	2015	2016	2017
Real GDP Growth (%)	0.4	5.5	3.6	2.5	(3.5)
Average Inflation (%)	0.2	(0.3)	(0.9)	(0.5)	1.3
Primary Balance (% of GDP)	(0.4)	3.1	0.5	0.2	(0.8)
Public Sector Debt (% of GDP)	30.4	26.4	23.9	60.5	56.8

Source: GOA.