COUNTRY ECONOMIC REVIEW 2018

BRITISH VIRGIN ISLANDS

OVERVIEW

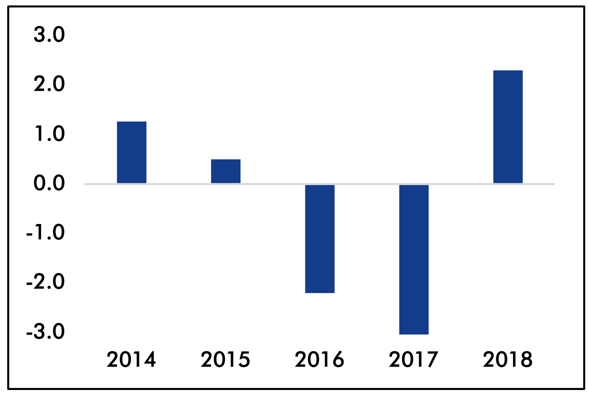
Economic growth in the British Virgin Islands (BVI) rebounded in 2018. Following damage inflicted by Hurricanes Irma and Maria in 2017, there was increased construction activity related to recovery. Tourism, activity also increased, although not to pre-hurricane levels. Growth in company incorporations remained robust, contributing to improved financial services' performance.

Public sector finances improved; but increased spending will be necessary to complete the post-hurricane recovery. Financing the Recovery and Development Plan (RDP) is expected to place additional pressures on fiscal and debt sustainability. . Despite progress made in finalising the RDP and the establishment of the Recovery and Development Agency (RDA) in 2018, capacity constraints have delayed the start of the projects . A fully operational RDA, supported by an appropriate financing and debt strategy, which takes into account a potential guarantee from the United Kingdom Government (UKG), could help advance the reconstruction efforts[1].

KEY DEVELOPMENTS IN 2018

It is estimated that gross domestic product (GDP) grew by 2.3% in 2018. (See Chart 1). Following the two hurricanes in 2017, private rehabilitation and reconstruction efforts drove activity in the construction sector. Tourism continued to recover, but in spite of the reopening of a number of properties and the return of some major cruise lines, stay-over and cruise arrivals remained below the pre-2017 hurricane levels[2]. In addition, there was growth in the financial services industry. At the end of June, the number of active companies registered in BVI had reached 403,004, representing a 16.0% year-on-year increase in new incorporations. An update of the Limited Partnership Legislation also contributed to higher limited partnership company registrations.

Chart 1: Real GDP Growth



Source: MOF, BVI, CDB staff estimates.

Inflation ticked up to 2.1% in 2018, above the historical five-year average of 1.3%. General price increases were observed in housing and utilities, communications, food and transportation. This partly reflected higher demand related to reconstruction activity.

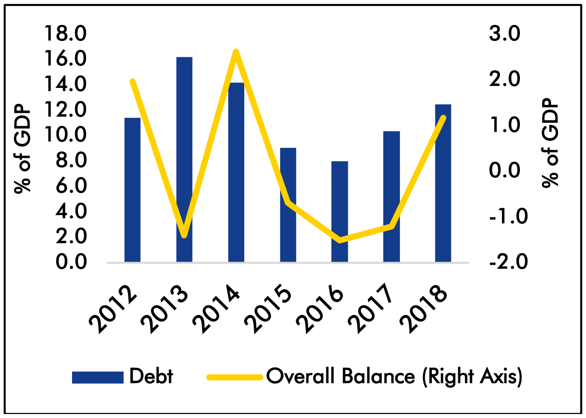
The fiscal position improved in 2018. (See Chart 2). It is estimated that the Government of the Virgin Islands (GOBVI) achieved an overall surplus of 1.2% of GDP. Total revenue, buoyed by receipts from the offshore financial sector, grew by 27% compared with 2017. Revenue performance also reflected

[1] BVI has access to total of US$400 mn in loan guarantees from UKG. However, the territory has not yet borrowed against these guarantees.

[2] Stayover arrivals fell by 55.3% between January and October 2018; Cruise arrivals dropped by 84.5% over the same period.

changes to a number of taxes and fees[3]. Total expenditure was higher than in 2017, reflecting higher capital expenditure, and transfers and subsidies. Perennial implementation challenges continued to hinder execution of the capital programme, which remained below budgeted levels.

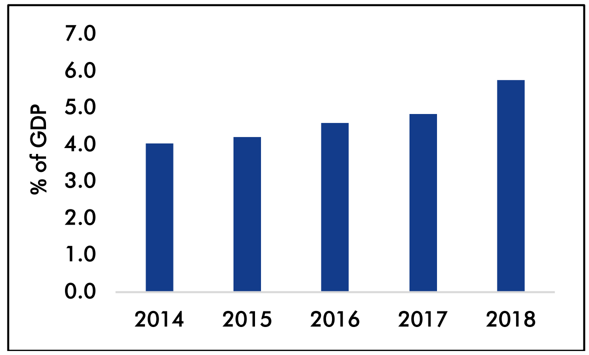
Chart 2: Fiscal and Debt Performance



Source: MOF, BVI.

At the end of 2018, the Reserve Fund balance reached US$70 million (mn), (see Chart 3). The fiscal surplus enabled GOBVI to contribute US$13.1 mn to the Fund. The Reserve Fund acts as a fiscal buffer which can be used in the event of an external shock.

Chart 3: Reserve Fund Balances



Source: MOF, BVI.

Central Government (CG) debt[4] rose to 12.5% of GDP at the end of 2018. Increased development finance[5] and revenue gains during the year were utilised to pay off more expensive debt. Debt servicing costs reflected the payment of a commercial credit line. As GOBVI contracts additional debt for the reconstruction, debt-servicing costs are likely to rise.

Financial sector performance remained strong during the first half of 2018. Deposits remained above loans and advances. Total deposits grew by 16.7% year-on-year at the end of June, reflective of increased insurance payments emanating from the 2017 hurricanes. Over the same period, loans and advances fell due in part to tightening of credit standards and lower demand. Bank profitability indicators remain positive despite the ratio of non-performing loans to total loans rising to 8.1% from 4.4% at the end of June 2017.

Challenges in the financial services sector remain acute as regulatory pressures related to de-risking practices continue. The most imminent threat emanates from the European

[3] In 2017, GOBVI introduced a number of new tax and fee measures, including an increase in hotel accommodation tax, work permit fees, cruising permits, and the introduction of an environmental/tourism levy. In January 2018, financial service fees were also increased.

[4] CG debt does not include Parastatals' Risk Weighted debt.

[5] GOBVI accessed a Policy-based Loan (US$50 mn) and an Immediate Response Loan (US$2.25 mn) from CDB in 2018.

Union's (EU) attempts to list the Territory as a Non-cooperative Jurisdiction for Tax Purposes, and the UK's Sanctions and Anti-Money Laundering Act. The European Union also requires evidence of economic substance, and more specifically for UK Overseas Territories, the publication of beneficial ownership registers. In response to the requirements of the EU Code of Conduct Group, BVI has enacted new legislation setting out an economic substance test for tax-resident entities effective from January 2019.

OUTLOOK

The outlook for BVI is optimistic. CDB projects that GDP will grow by 2.2% in 2019. Private and public sector construction activity will lead growth. The RDP will guide public sector reconstruction. Continued rehabilitation and reconstruction in the private sector, particularly the hotels and accommodation sector, will help boost tourism. The return of some major cruise lines during the last quarter of 2018, will also contribute to tourism growth. The financial services sector performance is also expected to remain strong.

The overall fiscal and debt position is likely to weaken in 2019. GOBVI will contract new borrowing for implementation of the RDP. It is anticipated that the UKG guarantee will be accessed during 2019. The medium term fiscal strategy that takes this guarantee into account will be important for debt sustainability.

Downside risks are related to the regulatory requirements that are being imposed on the financial services sector. Capacity constraints, particularly labour, will likely continue to adversely affect the pace of reconstruction. Additional risks from the external environment, including a global economic slowdown and extreme weather events in 2019, would place additional pressures on the recovery.

BVI's RDP, while focusing broadly on reconstruction, is also aligned with the main pillars of the Medium-Term Development Strategy (MTDS). Embodied in both the RDP and MTDS is the need to build resilience into all projects and activities. While the RDP focuses primarily on reconstruction, GOBVI should also prioritise long term development needs in human and social development, improving the doing business environment and environment and climate change issues.

DATA

The table below summarises the key economic and social indicators underpinning this Country Brief. These data are taken from a number of sources, and are the latest available at time of publication. Some are subject to revision.

Selected Indicators

	2014	2015	2016	2017	2018[e]
Real GDP Growth (%)	1.7	0.8	7.1	(3.7)	2.3
Average Inflation (%)	1.9	0.9	1.1	1.2	2.1
Unemployment (%)	2.8	2.8	2.8	2.8	n.a.
Primary Balance (% of GDP)	2.9	(0.3)	(1.2)	(0.8)	1.7
CG Debt (% of GDP)	14.2	9.1	8.0	10.4	12.5

Sources: MOF, BVI.

Notes: e – estimate; n.a. – not available.