COUNTRY ECONOMIC REVIEW 2019

VIRGIN ISLANDS

OVERVIEW

Recovery of the Virgin Islands' economy continued apace with an estimated growth rate of 2.1%. Activity was driven by the construction sector, as rehabilitation and reconstruction efforts were sustained. Available data indicate that tourism was also a major contributor to the expansion of aggregate output and employment.

Building resilience, diversifying the economy and immigration reform are key development imperatives for the country. The Government is committed to designing and building resilient infrastructure to mitigate the effects of climate change. A key part of the resilience objective is to diversify the economy through investments in other sectors. In June 2019, the Government amended its immigration laws to remove loopholes and rationalise the residency, work permit and 'belongership' process. The resulting increase in those who hold belonger status is expected to have a positive impact on the economy.

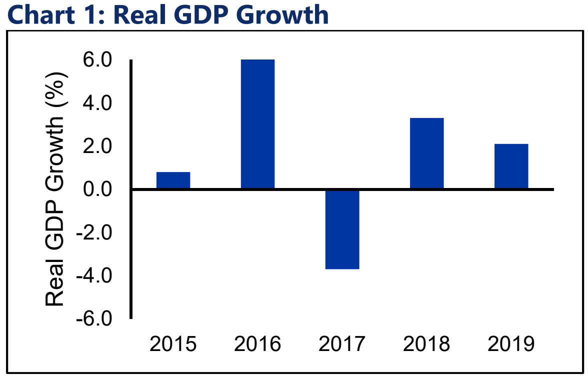
KEY DEVELOPMENTS IN 2019

Economic growth was estimated at 2.1% in 2019, compared with 3.3% in 2018 (see Chart 1). The increase in aggregate output was supported by ongoing private sector reconstruction activity and high and sustained levels of public expenditure on recovery projects in the aftermath of the 2017 hurricane season. These projects included the rehabilitation of the Central Administrative Building, scheduled for completion in the first quarter of 2020.

Meanwhile, financial services suffered major setbacks. Up to September, new company incorporations had declined by 27.9% and revenue from the Registry of Corporate Affairs had fallen by 8.7%. The reduction in new company incorporations was due in part to new economic substance legislation, which requires companies to establish a physical presence in the Virgin Islands. Uncertainty about the new requirements for establishing country presence affected new company incorporations, as did more general regulatory uncertainty.

These adverse shocks to financial services were offset by buoyancy in the tourism sector. Stayover and cruise arrivals from January to August increased by 76.6% and 865.2%, respectively, relative to the same period in 2018. This recovery reflected the reopening of a number of properties, and a return of several major cruise lines to the Virgin Islands.

Chart 1: Real GDP Growth



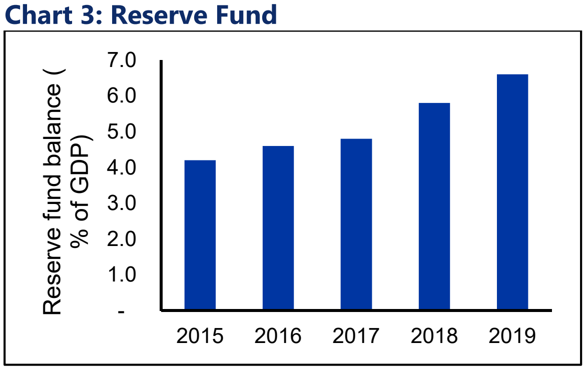
Source: Ministry of Finance (MOF).

Average inflation is estimated at 1.7%, down from 2.1% in 2018, and closer to the five-year average of 1.3%.

The Government's fiscal surplus after deposits to the Reserve Fund was estimated at 0.04% of gross domestic product (GDP). Notwithstanding revenue declines from the financial services industry, tax revenue was boosted by increases in receipts from hotel accommodation tax, cruising permits, the environmental levy, income tax and taxes on international trade. Total revenue was estimated at US$350.3 million (mn). Recurrent expenditure of US$319.9 mn, relative to the planned expenditure of US$331.3 mn, reflected fiscal restraint as well as budget execution challenges. The Government contributed US$29.9 mn to the Reserve Fund.

The Reserve Fund was estimated at US$87.8 mn at the end of 2019 (see Chart 2). A fiscal surplus and regulatory requirements led to the Government making a substantial contribution to the Reserve Fund. The Fund acts as a fiscal buffer, which can be used in the event of an external shock.

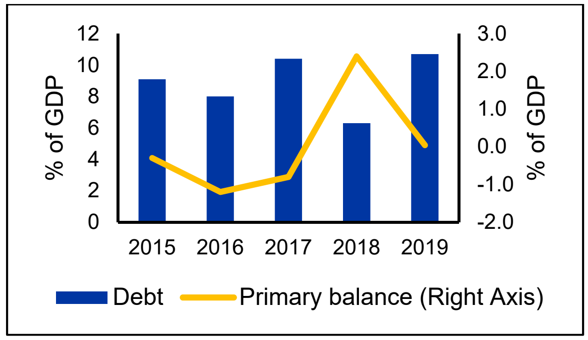
Chart 3: Reserve Fund



Source: MOF.

Central Government debt[1] rose from an estimated US$80.9 mn (6.3% of GDP) in 2018 to US$143.1 (10.7% of GDP) in 2019 (see Chart 3). Debt repayment obligations will increase in 2020 because of expiring grace periods on a policy-based loan and an immediate response loan from the Caribbean Development Bank (CDB). The proposed United Kingdom (UK) loan guarantee to the Virgin Islands is currently delayed because it is not fully compatible with existing budget rules. Once the guarantee is in place, debt service costs will fall, but there could be upward pressure on the debt ratio, if additional debt is acquired.

Chart 2: Fiscal and Debt Performance



Source: MOF.

Financial sector performance remained strong, but signs of growing market risk are evident. Total assets of the banking sector stood at US$2.3 billion (bn) at the end of the third quarter, down 5.1% from the same quarter in 2018. Over the same period, deposits fell by 7.9% to US$1.97 bn. The decrease in deposits was due to fluctuations within interest bearing accounts and increased spending. Over the same period, loans and advances increased by 9.2% to US$1.37 bn, while investments grew by 133.7% to US$12.8 bn. Net Interest income and net income for the banking sector rose by 4.7% and 16.2%, respectively, in the third quarter of 2019 when compared with the same period in 2018. Despite favourable profitability indicators, there are signs of growing market risk. The ratio of non-performing loans to total loans rose to

[1]Central Government debt does not include parastatals' risk weighted debt.

7.9% from 7% at the end of the third quarter in 2019.

OUTLOOK

The outlook for the Virgin Islands has become clouded by the outbreak of COVID-19, which has significantly affected developed and developing economies. In early 2020 the tourism sector has seen mass cancellations. Rehabilitation and reconstruction in the private sector, particularly hotels and accommodation, was supposed to help sustain the momentum in tourism. However, there is little activity going on. Normally the Government clarifying the regulatory uncertainty surrounding the economic substance legislation should lead to a rebound in new company incorporations, but these are highly unusual circumstances. Government finances have come under increasing pressure.

Given the uncertainty as to how long this situation will persist, it is very difficult to forecast how the economy will perform in 2020 and beyond. This will be addressed in an updated Economic Brief later this year.

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. The 2019 data are CDB estimates.

Selected Indicators

	2015	2016	2017	2018	2019^{e}
Real GDP Growth (%)	0.8	7.1	(3.7)	3.3	2.1
Average Inflation (%)	0.9	1.1	1.2	2.1	1.7
Unemployment (%)	2.8	2.8	2.8	n.a.	n.a.
Primary Balance (% of GDP)	(0.3)	(1.2)	(0.8)	2.4	0.0
Central Government Debt (% of GDP)	9.1	8.0	10.4	6.3	10.7

Sources: MOF, Economist Intelligence Unit.

Notes: e – estimate (as at January 31, 2020); n.a. – not available.

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