CAYMAN ISLANDS

COUNTRY ECONOMIC REVIEW 2020

Cayman Islands dollar (CI$); United States dollar (US$). **US$1 = CI$0.83**

OVERVIEW

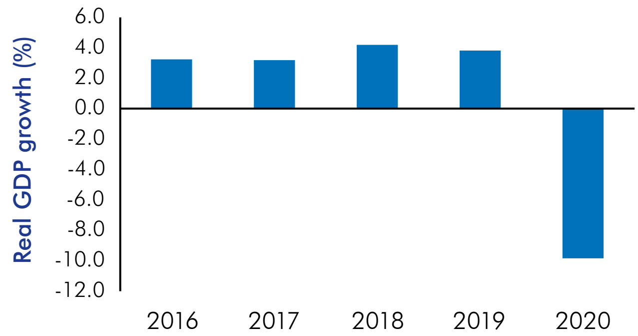
In 2020 the Cayman Islands economy contracted by more than 7%. From March, the Government kept borders closed for travellers[1] and imposed restrictions on non-essential activities to contain the spread of COVID-19. Consequently, most sectors of the economy experienced double-digit declines.

2020 represented a rupture for government finances as the overall fiscal balance swung to a deficit for the first time since 2012. All major revenue categories recorded significant decreases and current expenditure increased amid rising health-related and social spending.

KEY DEVELOPMENTS IN 2020

The economy contracted in 2020 following robust growth in the previous year. The Caribbean Development Bank (CDB) estimates that the contraction amounted to 7.3%, after 3.8% growth in 2019 (see Chart 1). The contraction was driven by a COVID-19-related drop in tourism as the number of stayover arrivals decreased by 72.1% to 140,400, mainly due to prolonged border closure. For the same reason, cruise ship passenger arrivals declined by 70.8%, and total visitor expenditure fell by 71.8%. A lockdown from mid-March to May limited the epidemiological fallout from the crisis and allowed for reopening the domestic economy. Cayman closed 2020 with only 338 confirmed cases of COVID-19 and two related deaths. Reduced tourism activity and restrictions on the mobility of the local population were major contributors to the contraction in the value added of hotels and restaurants, estimated to have declined by 35.9%, and to the lower activity in the transport and storage, and the real estate sectors. Wholesale and retail trade, the financial services sector and professional, scientific, and technical activities proved resilient as they declined by 3% or less.

Chart 1: Real gross domestic product growth



Sources: *Economics and Statistics Office (ESO), CDB staff estimates.*

The unemployment rate increased to 5.2% from 3.5% in 2019 due to the health-related closure of the economy. The Government supported laid-off workers – mostly from the tourism industry – with a monthly CI$1,000 stipend; provided assistance to meet health insurance payments; and introduced a programme to retrain displaced workers while supporting more than 5,000 people through the Needs Assessment Unit.

Consumer prices increased by 1% following a 5.9% increase in 2019. Prices in the recreational and in the hotels and restaurants sectors eased among weak demand, and transport prices also fell due to

1 Entry to the islands is still restricted to Caymanians, residents, workers, students, and a limited number of property owners.

lower oil prices. Stronger demand due to people working from home led to inflationary pressures and price increases in the communications sector while price increases for food and non-alcoholic beverages also reflected imported inflation.

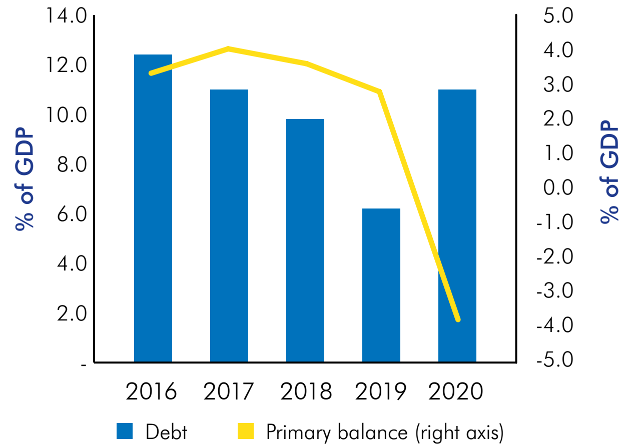
The overall fiscal position materially deteriorated in 2020 (see Chart 2). Preliminary full-year fiscal data for the Government suggest that the decline in tourism and in the broader economy led mainly to a spike in expenditure due to social programmes although revenue also declined. The Government estimates a current deficit of CI$40 million (mn), which would bring the overall deficit to CI$141 mn (3.4% of gross domestic product [GDP]).

Total revenue declined by an estimated 8.4%. The strongest contraction was recorded in non-tax revenue, mainly sales of goods and services, which dropped 14%. Taxes on domestic goods and services – including financial services and other licenses – declined by 9%, and taxes on international trade decreased by 5%. The Government waived taxes and business license fees and help for farmers, seamen, veterans, artists, and persons with disabilities.

The Government's adoption of broad-based support measures to alleviate the impact of COVID-19 pushed up expenditures. In addition to providing income support for displaced workers, a CI$10 mn grant programme and a CI$5-mn low-interest loan programme were put in place for micro and small-sized businesses, and a CI$200-mn, partial credit guarantee loan scheme for medium and large-sized enterprises. These measures to stimulate the economy were reflected by a 22.6% increase in total expenditure, with transfers expanding by 75% and subsidies by 15%.

Cayman failed to fully comply with its Fiscal Framework for Responsibility (FFR). The cash reserve dropped below the minimum requirement of 90 days as the Government drew down on these funds to close its deficit. The Government also failed to achieve a fiscal current account surplus[2]. The public debt-to-GDP ratio is estimated to have risen to 9.9% in 2020 from 6.2% in 2019.

Chart 2: Fiscal and debt performance



***Sources:** Ministry of Finance, ESO, CDB staff estimates.*

Financial sector activity was stable, but the COVID-19 payment moratoria is expected to have weighed on banks' key performance indicators. By September 2020, the number of banks and trust companies had declined, but the number of mutual funds and insurance companies had gone up. As of September 2020, total domestic credit rose by 8.2%, driven by very strong growth in public sector borrowing and in lending to businesses and households. Loans to real estate agents, rental and leasing companies, and to households for domestic properties were the main drivers of credit growth. The country was removed from the European Union's list of non-cooperative jurisdictions in tax matters after it adopted new reforms to improve its tax policy framework.

Due to a high degree of dollarisation, the Cayman Island Monetary Authority (CIMA) holds negligible amounts of international reserves. Between June 2019 and June 2020

2 Further indicators included in the FFR: annual debt service should be no more than 10% of the Government's revenue; net worth should be positive; net debt should be no more than 80% of Government's revenue; and financial risks should be managed prudently, which includes insurance cover and hurricane preparedness strategy.

CIMA's net foreign assets (NFAs) increased by 25.7% to CI$171.4 mn while commercial banks' NFAs grew by 1.2% to CI$5,484.9 mn. Total NFAs rose to CI$5,653.3 mn, or 127.9% of GDP.

The external current account balance worsened due to disruptions to travel and transport. This is despite the visible trade balance with the United States of America (USA), the largest trading partner, improving on account of smaller imports. Travel receipts are estimated to have declined by CI$556 mn while the trade balance improved by CI$272 mn between January and September 2020, with lower imports outweighing a decline in exports. CDB estimates that the current account deficit has widened to 22.2% of GDP from 9.8% in 2019.

OUTLOOK

CDB projects economic recovery of 4.5% in 2021. Tourism activity is expected to rebound given better prospects to combat the pandemic in 2021, and support from the authorities' three-year strategic tourism recovery plan that targets the return to pre-pandemic levels of 500,000 stayover arrivals by 2023. However, past global shocks to tourism suggest that a return to 2019 levels of arrivals might take much longer. The speed of recovery in tourism is also contingent on the strength of the economic rebound in the main source markets, especially the USA, which accounts for more than 80% of visitors. At the end of 2020, the Government introduced the Global Citizens Programme to attract rich individuals for a two-year stay and partially make up for low tourist numbers, as a full border opening initially planned for March 2021 has been pushed back.

Fiscal policy is expected to remain expansive in 2021 to mitigate the ongoing shock. The Government is expected to keep transfers and subsidies at elevated levels. The monthly stipend for laid-off tourism workers was increased to CI$1,500 for the period January through June. This will boost the domestic economy. Capital investment is likely to remain within historical ranges (1.4% of GDP between 2015 and 2019) as fiscal policy is constrained by FFR. The primary balance should return to a small surplus by 2023, and the deb-to-GDP ratio is expected to start to decline. The Government has secured a US$400-mn, 18-month, precautionary line of credit from a consortium of local banks in September 2020. This, along with public cash reserve holding of CI$449 mn, should support expenditures in 2021 and help cushion a possible protracted impact of the pandemic.

DATA

The table below summarises the key economic and social indicators underpinning this country brief. These data are taken from several sources and are the latest available at time of publication. Some are subject to revision. 2020 data are estimates.

Selected indicators

	2016	2017	2018	2019	2020e
Real GDP growth (%)	3.2	3.2	4.2	3.8	-7.3
Average inflation (%)	-0.7	2.0	3.3	5.9	1.0
Unemployment (%)	4.2	4.9	2.8	3.5	5.2
Primary balance (% of GDP)	3.2	4.1	3.6	2.7	-3.0
Public Sector debt (% of GDP)	12.4	11.0	9.8	6.2	9.9

***Sources:** ESO, CDB staff estimates.*

Note: e – estimate (as at March 31, 2021).