VIRGIN ISLANDS

COUNTRY ECONOMIC REVIEW 2020

United States dollar (US$).

OVERVIEW

The economy in the Virgin Islands contracted in 2020, after seven consecutive years of growth. With border closures and strict lockdown measures taken to contain the spread of COVID-19, activity in most sectors were negatively impacted contributing to a rise in unemployment. Fiscal balances deteriorated and debt levels ticked up, but public finances remained compliant with key borrowing and fiscal ratios under the Virgin Island's Protocols for Effective Financial Management (PEFM)[1]. The banking sector remained well capitalised. The external current account deficit widened, imports dropped, and export income fell. The medium-term outlook is positive but remains uncertain with several downside risks.

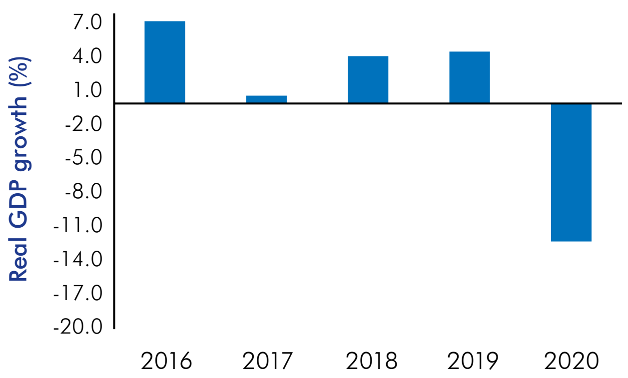
KEY DEVELOPMENTS IN 2020

Real gross domestic product (GDP) fell by an estimated 12.2% in 2020. This comes after years of consecutive years of growth (see Chart 1). The collapse in the tourism sector and a fall-off in the financial services sector were the main contributors to the decline in output.

Key sectors were impacted by COVID-19-related closures and restrictions. Country borders were closed for nine months from March when the first confirmed COVID-19 case was detected, resulting in the shutdown of several tourism establishments. Restrictions were gradually eased between June and mid-August, as the infection remained contained to under 10 cases for much of this period but were reimposed in September amid a surge in new cases. By December, confirmed cases had risen to 86. Stay-over and cruise arrivals contracted by 72.7% and 61.8%, respectively. Activity was also suppressed in the construction sector, which had already slowed in 2019. Other sectors, such as transportation, wholesale and retail, and real estate, are also expected to have been impacted by COVID-19-related closures and restrictions.

The financial sector continued to underperform. In 2020, new company incorporations declined by 14.5%. The total number of active companies (343,747) was 11.3% lower than the number recorded in 2019. The decline in the financial sector was attributed to a combination of factors, including impacts of continuing tightening of the regulatory framework, de-risking practices by banks, and the economic slowdown in key source markets.

Chart 1: Real gross domestic product growth



Sources: *Ministry of Finance (MOF), Caribbean Development Bank (CDB) projections.*

Average inflation is estimated at 0.7% for 2020. Lower demand arising from the lockdowns contributed to lower inflation. Survey data collected by the

1 The key ratios include borrowing ratios of net debt, debt servicing, and liquid assets.

Department of Labour between May and September indicate that 13.0% were unemployed.

Fiscal balances worsened in 2020 as revenues shrank. A primary deficit of 6.7% of GDP was estimated, compared with a deficit of 0.6% in 2019. The overall deficit also widened to 7.2% of GDP from 1.2%. Total revenue fell by 5.8%, with notable declines from Financial Services Commission (FSC) revenue, taxes on international trade, and taxes on income and profits. FSC revenue dropped by 15.0%, due, in part, to the continued impact of the economic substance legislation. Declines in the other revenue streams were also associated with the effects of the pandemic and the various containment measures taken.

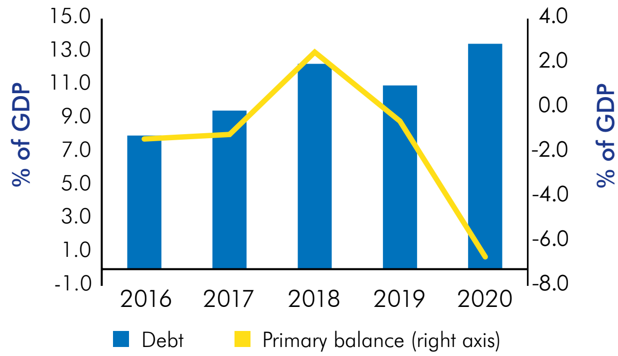
At the same time, total expenditure rose by 11.6%, reflecting higher spending on account of COVID-19. In particular, the economic stimulus package of US$63.4 million (mn) [6.0% of GDP], provided unemployment benefits support, business grants, and continued reconstruction spending. The Social Security Board provided a grant of US$40.1 mn to the Government in support of its stimulus package.

Fiscal buffers helped to cushion the fiscal fall-out. The Government's Reserve Fund, held to help the Government respond to external shocks, provided $7.2 mn to finance the budget. As at December, the Reserve Fund was estimated at US$65.3 mn.

Public debt[2] moved up in 2020. Debt rose to 13.5% of GDP to an estimated $149.1 mn, from US$143.6 mn in 2019 (see Chart 2). In 2020, CDB held the highest share of the public debt (56.7%). The commencement of principal repayments in July on the outstanding debt to CDB increased debt service payments to US$15.9 mn, 5.8% of recurrent revenue.

2 Public debt does not include parastatals' risk-weighted debt.

Chart 2: Fiscal and debt performance



Source: *MOF.*

Financial sector performance remained strong, but signs of weakening were evident. Total assets of the banking sector stood at US$2.3 billion (bn) at the end of the third quarter of 2020, down by 2.9%, compared with the same period in 2019. Deposits grew by 1.4% to US$2.0 bn. At the end of the third quarter of 2020, loans and advances declined by 4.5% to US$1.3 bn, and investments also fell. Net interest income and net income for the banking sector contracted by 17.2% and 54.7%, respectively, in the third quarter of 2020 when compared with the same period in 2019. The ratio of non-performing loans to total loans rose to 8.7% at the end of September 2020, from 7.9% at the end of the third quarter in 2019.

OUTLOOK

The outlook for the Virgin Islands is tentatively positive. Economic growth of 0.4% is projected for 2021. Borders reopened to visitors on December 1. The recovery will be led primarily by tourism, although neither tourism nor ancillary services are expected to return to pre-COVID levels in the short term. The rate of vaccination will also determine the pace of recovery and the extent to which business activity continues. Construction activity will continue, albeit at a slower pace, as post-hurricane private construction wanes. The financial services sector remains in a strong position but is vulnerable to the enactment of economic substance legislation and the imminent publicly accessible register of beneficial ownership. The legislation aims is to increase corporate transparency and deter corruption and money laundering. However, there are concerns that corporations will move to other jurisdictions that do not have a public beneficial ownership register, and the cost of implementation may be prohibitive.

The medium-term fiscal and debt strategies will have to be carefully managed. Fiscal deficits are anticipated to continue over the next two years with an increase in debt levels. The Government is expected to implement several measures, which will address the requirements under PEFM.

Downside risks are elevated. A prolonged pandemic will further undermine economic activity and the ability of the Government to respond. Other key areas of concern are centred around developments in the offshore financial sector and the imposition of any additional regulatory burdens, as well as the knock-on effects of Brexit. The Virgin Islands remain vulnerable to extreme weather events.

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. The 2020 data are CDB estimates and subject to change.

Selected indicators

	2016	2017	2018	2019	2020e
Real GDP growth (%)	7.3	0.7	4.2	4.6	-12.2
Average inflation (%)	1.1	1.2	2.1	1.4	0.7
Unemployment (%)	2.8	2.8	n.a.	n.a.	n.a.
Primary balance (% of GDP)	-1.4	-1.2	2.5	-0.6	-6.7
Public sector debt (% of GDP)	8.0	9.5	12.3	11.0	13.5

***Sources:** MOF, Economist Intelligence Unit.*

Note: e – estimate (as at March 31, 2021); n.a. – not available.Selected indicators

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