

III MACROECONOMIC EFFECTS

This chapter comprises four sections. The first section presents an estimation of the summary of damages (direct and indirect) and an evaluation and interpretation of the results. The second section describes the macroeconomic trends in the previous year (i.e., the year prior to the disaster). The third section analyses the short run (2004) and medium run (2005-2007) expected performance of the economy without the disaster. The final section provides a macroeconomic assessment of the disaster. The second, third and fourth sections survey the overall economic trends of the economy, fiscal policy, the external sector and the financial system to the extent that is permitted by the availability of data. The last section also gives a detailed analysis of the expected performance of the main economic sectors. In addition the fourth section considers the effect of the disaster on the evolution of prices and the level of employment.

All estimations were carried out on the basis of official data and also on information provided by private sector organisations. They are presented in Eastern Caribbean Dollars.

The effect of the damages are significant. They amount to twice the current value of GDP. By far the most important component of overall damages, losses or costs is the direct damage. In relative terms the overriding damage is concentrated in the housing sector. As well the damage has important implications at the social level since it has affected those sectors that are labour intensive, in particular agriculture and tourism.. The effects of the Hurricane are bound to curtail the level of employment.

In the year in which the disaster occurred (2004) overall GDP is project to contract by – 1.4. While the tourism sector will most likely register a severe downturn, agriculture is expected to contract by –1%. The above average output of the sector (especially of traditional crops) in the first half of 2004 will partly offset the halt in its ouput in the last three months of the year. The sector will register the full effects of the Hurricane in 2005 (-39%). The manufacturing sector that had registered negative growth rates in past three years and is projected to maintain this trend in 2004. Contrarily the construction sector will expand due to the reconstruction and recovery efforts in the housing and tourism sectors.

Notwithstanding the devastating effects of the disaster there are safety valves which if appropriately identified and managed can act as buffer stocks to the general economic downturn. The development of short term crops in agriculture, the effect on the construction sector on related economic activities, and the cruiseship and yachting industry are but a few examples.

One of the most important challenges that policy makers will face is to match those safety valves with the pressing needs of the population and with the concomitant increase in the supply of labor provoked by the effects of the Hurricane on the productive sectors and in particular on labor intensive activities.

1. Summary of damages

The total damage of Hurricane Ivan is estimated to be 2,4 billion EC\$, that is more than twice the current value of GDP. The bulk is concentrated in direct damages. These account for 89% of the damage, 201% of GDP. For its part indirect damage accounts for 11% of the damage (26% of GDP). (See Table 37).

The results highlight the fact that, as described in this report, most of the damage was concentrated in infrastructure and in particular in housing, as 89% of the housing stock registered some or other type of damage caused by the Hurricane.

Sector	Direct damage	Indirect damage	Total
Agriculture	54	46	100
Manufacturing	18	4	22
Wholesale and retail trade	...	11	11
Tourism	305	101.2	406.2
Electricity	70	21	91
Water/sewage	7	1	8
Telecommunications and broadcasting	76.5	62.4	138.9
Cable	8	5	13
Education	195	1	196
Transport	10.3	1.2	11.5
Housing	1,372	9	1381
Health	11	0	11
Total	2,127	263	2389.6

Table 37 Summary of direct and indirect damages Millions of Eastern Caribbean Dollars

In accordance with this finding, when seen in relation to nominal GDP, the damage to housing alone is equivalent to 1.4 times the money value of GDP (that is the value of the flow of goods and services produced by Grenada in a year) (See table 38 below).

The agricultural sector recorded a level of damage (10% of GDP) equivalent roughly to its contribution to GDP. In the case of agriculture direct damage was close in magnitude to that of indirect damage. This reflects mainly the fact that the damage not only wiped out traditional crops but also that as a result the source of income of traditional farmers was been destroyed and will not be easily substituted.

In the case of tourism direct damage (41% of GDP) reflects not only the damage to tourist accommodations but also to yachts. The tourism's sector flow of income will be severely affected in the last three months of the year but gradually the sector will witness some recovery. The sector is expected to be close to fully operational at the end of 2005.

Sector	Direct damage	Indirect damage	Total
Agriculture	0.05	0.05	0.10
Manufacturing	0.02	0.00	0.02
Wholesale and retail trade		0.01	0.01
Tourism	0.31	0.10	0.41
Electricity	0.07	0.02	0.09
Water/sewage	0.01	0.00	0.01
Telecommunications and broadcasting	0.08	0.06	0.14
Cable	0.01	0.01	0.01
Education	0.20	0.00	0.20
Transport	0.01	0.00	0.01
Housing	1.37	0.01	1.38
Health	0.01	0.00	0.01
Total	2.13	0.26	2.39

Table 38 Summary of direct and indirect damages In relation to of GDP

Damages to electricity, as a result of the impact of the wind on electrical posts and on building structures and the concomitant damages to telecommunications are also significant (9% and 14% of GDP).

Finally the quantification of the loss to the education (20% of GDP) underscores the severe social consequences of the disaster. Indeed, while the economic effects is pressing need to be solved in the short run, the social consequences of Hurricane Ivan, in the long run may mostly concentrated in the social sectors of the economy.

2. The pre-disaster situation

2.1 General trends

Since 1980, Grenada has undergone two phases of economic growth (See Figure 9). The first one lasted from 1980 until 1987. The second one began in 1993 and was interrupted by the effects of the September 11th events. Following two years of negative growth (-4.3% and -0.4% in 2002 and 2003 respectively) the economy clearly recovered in 2003 and expanded at a rate of 5.7% (the highest among the OECS and also among CARICOM economies) (See table 48)

In 2003 growth was mainly propelled by the construction sector and the tourism industry. In that year construction registered the highest rate of growth in at least a decade (29%) and its contribution to GDP reached 9.8%. Construction activity responded mainly to the initiative of the private sector and public capital expenditures.

The robust performance of the tourism industry (6% and 14% in 2002 and 2003 respectively) indicated that the sector was poised for a definitive recovery following the effects of the September 11th events. In 2003, the total number of visitors and tourism expenditure grew 9% and 23% respectively.

For their part the agricultural and manufacturing sectors registered contractions (-2.4% and -2.8%). The behavior of the agricultural sector reflected the reduction in the output of traditional crops (nutmeg, banana and cocoa). The evolution of the manufacturing sector responded to declines in the production of animal feed, technical difficulties in obtaining raw materials for the manufacture of rum, and shifts in the production of flour to other sources.

The increase in aggregate output and in particular the dynamism of the construction sector translated into a higher import demand for goods. This led, in conjunction with the contraction in the production of traditional export crops, to a widening of the merchandise trade deficit (35% and 43% of GDP in 2002 and 2003). The result in the merchandise balance was reinforced by profit repatriation outflows (35% of GDP in 2003), and was partially offset by the surplus in the services sector (11% and 14% of GDP for 2002 and 2003). The overall result was a widening of the current account deficit from -29% of GDP in 2002 to 35% the following year.

At the same time the greater demand for imports expanded tax revenues which jointly with expenditure restraint improved the fiscal position of the authorities.

2.2 Fiscal policy

In 2003 the overall fiscal deficit declined in relation to the previous year (-19% to -4.9% and -21% to -10% with and without grants respectively). This resulted from an increase in current revenues coupled with a decline in capital expenditures.

Current revenue increased significantly by \$31.0m or 10.6% in 2003 when compared with the outturn in 2002. This increase was mainly attributed to higher revenue from taxes particularly from taxes on international trade. This was driven by robust growth in imports particularly construction materials, motor vehicles, telecommunication accessories and consumer goods. As a result the government recorded a current account surplus of \$38.4m, 3.3 per cent of GDP compared with \$9.3m or 0.9 per cent of GDP in 2002.

Recurrent expenditure increased slightly by \$1.9m or 0.7%. Contributing to this slow increase in recurrent expenditure was a moderate growth in salaries and allowances, which reflected a 2.5% increase in salary payments for the year 2002 and interest payments. Capital expenditure declined by 89.0m (36.4%) to \$155.4m and was financed mainly by external loans.

Central Government debt, excluding guaranteed debt, moved from \$909.9 million EC\$ (84.6% of GDP) in 2002 to \$984.0 million EC\$ (83.3% of GDP) in 2003. The domestic debt stock represented 22.9% of the total.

After recording significant growth in 2002 with the contraction of the US \$100.0m bond, at the end of 2003 central government's external debt grew by 6.9 per cent to \$731.7m. External debt service to current revenue also represented 21.8% in 2003 and is estimated to remain at that level during 2004.

2.3 The balance of payments

During 2003 the overall balance of payments position of Grenada was estimated to have deteriorated as a deficit of \$34.6 million EC\$ was recorded in contrast to a surplus of \$84.3 EC\$ in 2002. This outcome reflected primarily activity on the current account as the deficit widened by 17.9% to \$400.9m (33.9% of GDP) due to the increase of the merchandise trade deficit by 33.5% to \$511.2m. The expansion in the merchandise trade deficit over 2003 was influenced by a higher import bill primarily for construction and tourism related purposes.

Net inflows on the services account were estimated to have grown by 36.2% to \$165.1 million EC\$ in 2003. These developments were largely attributable to an increase in inflow on the travel account and reduced outflows on the other business services account. On the income account the deficit grew by 3.6% to \$152.4 million EC\$ in 2003 due primarily to interest payments.

On the capital and financial account, the surplus improved from \$278.9 million EC\$ in 2002 to \$284.9 million EC\$ in 2003 due to a fall in other liabilities payments. The surplus on the financial account declined due to a fall in the inflow of official bond proceeds.

2.4 Developments in the financial system

Consistent with the growth in the economy, total monetary liabilities of the banking system increased by 8.0% to \$1,260.4 million EC\$ during 2003 compared with growth 7.1% in 2002. The growth in M2 reflected expansions in both the narrow money supply (M1) (13.7 per cent) and quasi money (6.7 per cent). The increase in M1 was influenced by a 14.3% expansion in private sector demand deposits. Of quasi money private sector savings deposits rose by 9.6% while private sector foreign currency deposit increased by 20.8 per cent.

Over 2003 domestic credit grew by 5.4% to \$978.5 million EC\$. Net credit to the central government from the banking system increased by 78.2% (\$55.5m) to \$126.6 million EC\$. This is in contrast to the development in 2002 when net credit fell by 25.0 per cent,

reflecting increased deposits associated with proceeds from a bond floated on the international capital market. Commercial bank credit to the central government rose by 24.5 per cent to \$144.0 million EC\$, well above the 9.7 per cent rate of growth in 2002. This performance was partly attributed to an increase in commercial bank holdings of treasury bills and debentures and the granting of additional loans and advances. The central government's deposits in the banking system fell by 35.5 per cent to \$32.3 million EC\$, following strong growth in 2002. Lending to the private sector grew by 3.1% to \$923.7 million EC\$.

During 2003 the net foreign assets of the banking system rose by 23.9% (\$78.2 million EC\$), consistent with the growth in monetary liabilities and the slower growth in domestic credit. The net foreign assets of the commercial banks doubled to \$181.3 million EC\$. Grenada's imputed share of the reserves held by the Central Bank was down by 53% to \$224.7 million EC\$, indicative of the overall deficit on the balance of payments account. Liquidity within the commercial banking system remained high during 2003.

As the economy continues to expand, the total monetary liabilities of the banking system are estimated to increase by 6.5% to \$1,342.2 million EC\$ in 2004. Domestic credit is expected to grow by 8.5% reflecting growth in credit to both the central government and the private sector. The net foreign assets of the banking are expected to increase by 2.3% to \$415.1 million EC\$ in 2004. In line with an average import cover of 4.3 months, Grenada's imputed share of the ECCB reserves are estimated at \$233.8 million EC\$ at the end of 2004.

3. The short and medium run expected performance of the economy without the disaster 2004-2007

3.1 Overall trends

Based on projections prior to the impact of hurricane Ivan, the economy was estimated to grow by 4.7% in 2004 (See table 48). This growth was expected to be fuelled mainly by developments in agriculture, tourism, and banking and insurance. Agriculture was estimated to grow by 3.6% resulting from an improved performance of the traditional crops as well as the continued increase in the non-traditional crops. The hotel and restaurant sector was projected to increase by 8.0%. For the first half of 2004 value added in this sector would have benefited from a 9% growth in stayover arrivals. This growth is expected to have spill over effects in the more service-oriented sectors particularly in communications, transportation and banks and insurance. Among the other sectors, construction was expected to grow by 5.0%.

The preliminary outturn of central government fiscal operations for 2004 showed a current account surplus of \$17.5 million EC\$, which represents 1.4% of GDP and an

overall deficit of \$60.6million EC\$, equivalent to 4.5% of GDP. Current revenue was expected to grow by \$31.8 million EC\$ as a result of the expansion in economic activity. Both capital and recurrent expenditure was projected to increase, resulting in a lower current account balance relative to the outturn in 2003. The growth in capital expenditure will be based on ongoing implementation of the PSIP while recurrent expenditure will increase in part due to higher outlays on personal emoluments.

Over 2004, prior to the occurrence of the disaster, the current account deficit of the balance of payments was estimated to contract albeit marginally by 1.5% to \$395.0 million EC\$. This performance was based upon a narrowing in the merchandise trade deficit as imports were projected to contract as the construction boom slows. As a result of the weak performance of the agriculture and manufacturing sectors on the international market, merchandise exports were estimated to contract by 3.4% to \$102.1 million EC\$ in 2004. On the capital and financial account the surplus is estimated to contract by 9.7% to \$358.8 million EC\$ due to a further reduction in official receipts.

As the economy continued to expand, the total monetary liabilities of the banking system were estimated to increase by 6.5% to \$1,342.2 million EC\$ in 2004. Domestic credit was expected to grow by 8.5% reflecting growth in credit to both the central government and the private sector. The net foreign assets of the banking system were expected to increase by 2.3% to \$415.1 million EC\$ in 2004. In line with an average import cover of 4.3 months, Grenada's imputed share of the ECCB reserves was estimated at \$233.8 million EC\$ at the end of 2004.

Over the medium term (2005 to 2007) prior to the event, the economy was projected to grow at an overall average rate of 5.0%. In 2005 the economy was expected to grow at approximately 5.0% due to growth in agriculture, construction and tourism. The agricultural sector was expected to grow by 12.0%, due to the anticipated peak year for the nutmeg industry, as well as the continued improvement of the non-traditional crops. Construction was projected to grow by 7.0%, due to the preparations to host some of the 2007 World Cup cricket matches. In the hotel and restaurant sector, growth of 6.0% was expected for 2005, due to improved performance of stayover visitor arrivals.

The economy was expected to continue to grow in 2006 by 4.8%, as the construction sector (10.0%) and tourism industry (6.0%) continued to maintain their levels of growth, due to the preparation of the staging to the World Cup and the high increase in tourist arrivals.

A higher level of growth of 5.2% was anticipated in 2007, influenced mainly by the development in the hotel and restaurant sector (12.0%) and other tourism related sectors due to activities associated with hosting the World Cup in 2007. Construction was expected to grow by approximately 6.0%.

3.2 Fiscal Accounts

The preliminary outlook for 2004, without the disaster, showed a current account surplus of \$29 million EC\$, representing 1.3% of GDP and an overall deficit of \$131.8 million EC\$, equivalent to -4.5% of GDP (-9.3% without grants). Current revenue was expected to grow by \$90 million EC\$ as a result of the expansion in economic activity. Both capital and recurrent expenditure were expected to increase resulting in a lower current account balance relative to the outcome in 2003. The growth in capital expenditure was seen to be developing in line with ongoing implementation of the PSIP while recurrent expenditure will increase in part due to higher outlays on personal emoluments.

Over the medium term 2005 to 2007, the surplus on the current account is projected to move from \$22.6m (1.7% of GDP) in 2005 to \$38.5m (2.5% of GDP) in 2007. The improvement in central government's current account position over the medium term will be as a result of the growth in revenue outpacing that of current expenditure. Of the recurrent revenue items, taxes on international trade which represents approximately 50.0% is forecasted to increase on average by 6.5% from \$189.2m in 2005 to \$214.6m in 2007. In line with the forecasted growth in economic activity taxes on domestic goods and services is expected to increase on average by 8.1 per cent to \$64.3m (4.1 per cent of GDP) in 2007.

During the period 2005 to 2007 recurrent expenditure was forecasted to increase on average by 5.1 per cent to \$392.8m in 2007. Personal emoluments, the major component of recurrent expenditure was forecasted to grow on average by 5.5 per cent to \$177.5 million EC\$ in 2007. The growth in personal emoluments would have resulted from incremental salary increases to public officers and the implementation of specific wage increase agreements.

The overall fiscal operations of the central government are forecasted to fluctuate over the medium term. The overall deficit was expected to move from \$111.0 million EC\$ (8.3 per cent of GDP) in 2005 (-10.2% without grants) to \$117.4 million EC\$ (7.5 per cent of GDP and 9.5% without grants) in 2007.

Total central government's debt was forecasted to increase by 5.4% in 2004 and over the medium run by 8.8% on average reaching 1,020.2 million EC\$ in 2007. Over 2004 it was also expected that central government external debt grow by 16.2 per cent to \$850.3m.

3.3. External Accounts

Over 2004 the current account deficit was estimated to contract albeit marginally by 1.5% to \$395.0m. This result was influenced by a narrowing in the merchandise trade deficit as imports were projected to contract responding, in turn, to the slowdown in construction activities. As a result of the weak performance of the agriculture and manufacturing

sectors on the international market, merchandise exports were estimated to contract by 3.4% to \$102.1 million EC\$ in 2004. On the capital and financial account the surplus was estimated to contract by 9.7% to \$358.8 million EC\$ due to a further reduction in official receipts.

Over the medium term 2005 to 2007, the current account deficit is forecasted to increase on average by 5.5% to \$434 million EC\$ in 2007. The growth in the deficit was seen to respond to the expected higher import bill associated with the importation of items to facilitate the country's hosting some world cup cricket games in 2007. From 2005 to 2007 merchandise exports were forecasted to grow on average by 5.9% to \$118.7 million EC\$ due in part to some recovery in demand on the international market for the output of traditional crops and manufactured items.

Net inflows on the services account are projected to increase to \$276.6 million EC\$ in 2007. These developments were be associated with strong growth in all categories of visitor arrivals. On the income account, the deficit was expected to widen to \$205.0 million EC\$ in 2007 attributable to interest payments as the debt expands. Net current transfers were expected to grow moderately over the period 2004 to 2007 in line with the growth in industrialized countries.

The surplus on the capital and financial account was expected to grow over the medium term influenced by activity on the financial account. Net inflows on the capital account were expected to increase from \$99.0 million EC\$ in 2005 to \$107.2 million EC\$ in 2007 as a result of a steady increase in capital transfers. On the financial account direct investments were estimated to increases related to construction activities such as a marina on the sister island of Carriacou and the Levera project.

3.4 Monetary Accounts

In line with the expected expansion of the economy, the total monetary liabilities of the banking system were estimated to increase by 6.5% to \$1,342.2 million EC\$ in 2004. Domestic credit was expected to grow by 8.5% reflecting growth in credit to both the central government and the private sector. The net foreign assets of the banking were projected to increase by 2.3% to \$415.1 million EC\$ in 2004. In accordance with an average import cover of 4.3 months, Grenada's imputed share of the ECCB reserves were estimated at \$233.8 million EC\$ at the end of 2004.

Over the medium term 2005 to 2007 monetary liabilities were expected to grow on average by 7.6% to \$1,672.0 million EC\$ in 2007. Domestic credit was expected to increase over the medium term, as the central government utilised the domestic banking system to finance a portion of its overall deficit.

With the anticipated growth in economic activity the expected reliance on the banking system by the private sector would also have contributed to an increase in domestic

credit. The net foreign assets of the banking system are forecasted to increase over the medium term on average by 3.7% to \$459.7 million EC\$ in 2007. Based on an average import cover of 4.3 months, Grenada imputed share of the ECCB reserves was forecasted to increase to \$278.4 million EC\$ by 2007. As well commercial banking liquidity was forecasted to remain high over the medium term.

3.5 Assumptions

The major assumptions underlying the growth projections without the disaster are as follows.

Domestic Exports

Nominal contraction estimated for 2004.

For the period 2005 to 2007 growth based on resumption of three-year cycle for nutmeg and nutmeg oil from 2005.

Domestic Imports

Fall off expected in 2004. Over the medium term imports moved in line with the anticipated requirements of the tourism industry and construction sector.

Travel – Visitor Expenditure

10.1 per cent increase in travel credit expected in 2004 followed by some further increases over the medium term. Based on discussions with Grenada Tourist Board

Portfolio Investment – Other Profits and Dividends

Debit in 2004 and over the medium term refers to bi-annual interest payments on US\$100m bond and other official bond payments.

Direct Investment – Other

In 2003 funds related to investment statistics captured by the GIDC (\$68.7m), St Georges University (\$20.0m) and other investments. Over the medium term financial inflows will be related to the Levera project and several marina projects around the island.

Other Public Sector Long term Loans

Includes proceeds of two bond issues in 2003 - US\$100m (Bears Sterns) and US\$10m (Unit Trust Corp in T'dad)-only US\$3m disbursed in Nov 2002. Over the medium term external proceeds necessary to assist with the funding of the fiscal deficit.

Financing

In 2003 a significant portion of change in Government Foreign Assets represents US\$7.0m disbursed from UTC Trinidad. Over 2003 Grenada also drew down \$12.5m of its imputed reserves at the Central Bank to finance the deficit on its balance of payments.

Over the medium term financing for the balance of payments represented the change in imputed reserves at an average import cover of 4.3 months.

GDP by Sector

Agriculture

Agricultural production is projected to increase from 2005 based on likely developments in the nutmeg, cocoa and banana industries. Nutmeg production should benefit from secondary and tertiary processing; banana production should benefit from the organic project; and cocoa output from a revitalisation programme.

Fishing

New fish market to be opened in Grenville in 2003.

Manufacturing

Activity in the manufacturing sector is expected to improve in 2005 with the establishment of an agro-processing plant.

Electricity and Water

Based on trend.

Construction

Includes construction work on the Levera project, second phase of the cruise terminal, marine development and other construction activity in preparation for the 2007 cricket world cup.

Hotels and Restaurants (Tourism)

In 2005 and beyond sector is expected to improve further based on factors such as increased marketing and additional airlift.

Air Transport

Based on performance in hotels and restaurants

Road Transport

Based on performance of hotels and restaurants and construction.

Sea Transport

Based on cargo landed and loaded of expected projects.

Communications

Some sectoral growth is anticipated from 2005 and beyond with the establishment of two additional communication providers. Nominal growth is also projected thereafter with recovery in the tourism industry.

Government Services

Based on natural increase in employment of government sector and future increments.

Other Services

Growth projected.

Consumer Price Index is expected to increase by 2.5 per cent in 2005 and over the rest of the medium term.

3.6 The Fiscal accounts

The domestic economy is expected to grow in 2005 by 5.0 per cent. Real growth of 4.9 per cent and 5.1 per cent is projected over 2006 and 2007 respectively.

Inflation, which has averaged around 1.0 percent over the last couple of years, is expected to average 2.5 per cent over the medium term.

Monetary Liabilities are projected to grow steadily during the period 2005 – 2007. The anticipated growth in monetary liabilities is expected to result in large part from the projected increase in domestic credit to the Government and the Private Sector.

Imports of goods and services are projected to grow on average at around 6.0 percent during the period 2005 –2007.

Revenue projections under the baseline scenario are based on the assumption that there are no further changes in the tax system during the period 2005 –2007. The systematic relationship between the major tax categories and their respective bases is assumed to be unitary. Expected developments in the proxy bases (Nominal GDP, Imports and Private Consumption) are used to forecast fiscal revenues.

A very conservative approach was taken with respect to recurrent expenditure projections. With the exception of interest payments, the growth in the other categories

was based on: (I) expected inflation rate, (ii) the growth in nominal GDP, and; the annual average growth rate of the particular category. Interest payments were estimated using the projected increase in the stock of external and domestic debt and the average implied interest rate for the respective category.

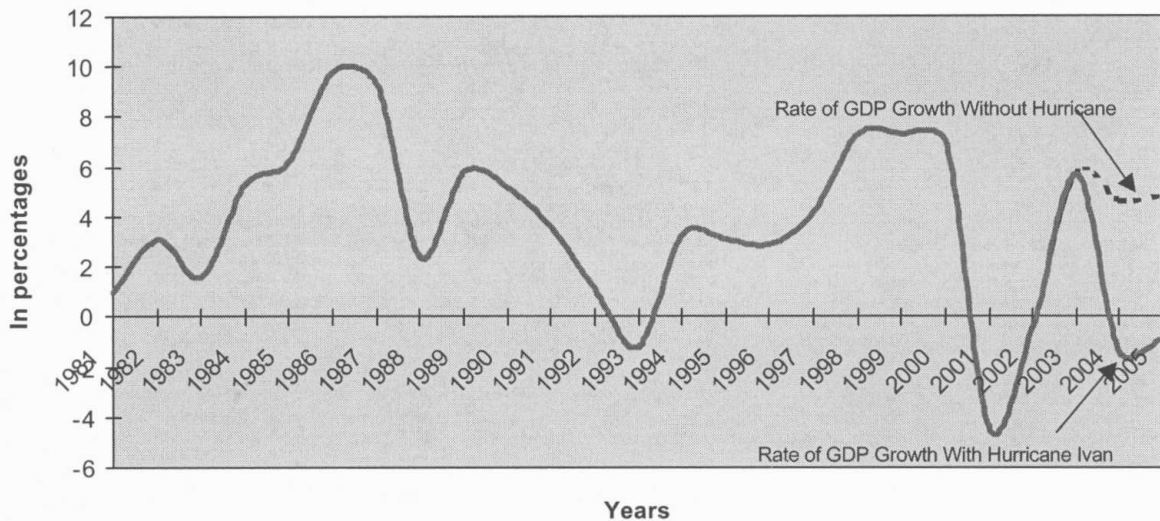
Capital expenditure was projected at 9.5 percent of GDP over the period. Our assumption is that by cutting capital expenditure too thin, there is the risk of unfavourably affecting projects and programmes needed to spur economic growth.

4. The post disaster macroeconomic assessment

4.1. GDP growth

As a result of the Hurricane GDP growth is expected to contract in 2004 by -1.4% The contraction in GDP growth will respond mainly to the underperformance of most sectors and in particular due to the devastation caused by the disaster in the agricultural sector and in the tourism industry.

Figure: 9
Grenada
GDP growth with an without Hurricane Ivan
1981 - 2005



The agricultural sector (-0.8% taking into account the effects of the disaster) will reflect the full stop in the production of the traditional crops (bananas, cocoa and in particular nutmeg) after the hurricane. Notwithstanding the effects of the overall halt in the production of nutmeg (which represents 35% of the volume output of total crops) in the last quarter of the year growth in agricultural output will be partly or more than fully compensated by the significant growth in nutmeg in the first half of the year (34%). As a result the rate of growth in the volume of nutmeg production will rise in 2004 by 19%. However due the drop in the international price of nutmeg (between January and August, the international unit price of nutmeg declined by 36%) the value sales are projected to decrease by -24%.

A similar outcome can be expected in the case of cocoa. The volume output is forecasted to increase by 17%. The value of production will also rise as the unit prices for the first eight months of the year were higher than those recorded for the same period in the previous year (1.79\$ and 1.94\$ for 2003 and 2004 respectively).

Contrarily maize will register an overall decline in volume and value of -22% and -7% respectively. It should also be taken into account that the production of this crop declined by -29.3% in the first half of the year

The effects of the hurricane on agricultural production will be fully felt in 2005. Cocoa and nutmeg production will cease altogether and banana output will recover only partially after the first nine months of 2005. Non-traditional crops will decline in 2005 but will register marginal growth in subsequent years.

Tourism is projected to contract by 25% reflecting the damage to the hotel plant and the damages of approximately 90 percent of hotel rooms. As a consequence growth in stay over visitors for the last three months of the year is expected to be minimal. This will translate into a significant loss of income during the said period (and also in 2005), which is the basis for the determination of value added in that sector.

For its part the manufacturing sector is projected to contract by 10%, as most of the enterprises suffered damages to buildings and stocks. In particular, some industries were adversely affected by the complete depletion of stocks in the aftermath of the Hurricane.

The wholesale and retail sector was also adversely affected by the destructive trading activity that took place following the Hurricane and the loss of stocks immediately after the Hurricane. Consequently the sector is not projected to record growth in 2004.

The construction sector is poised to register positive growth in 2004, which is estimated at this time at 15%. This reflects the rehabilitation and recovery efforts following the Hurricane. In the public sector, construction activity will be focused on developing the

social infrastructure and restoring public buildings. This will be financed with grants and loans. Activity in the private sector, dominated by home reconstruction will be financed, only partially, from insurance inflows and migrant transfers.

4.2. Fiscal policy

For 2004, the secondary fiscal effects will include a widening of the fiscal gap. The fiscal deficit, taking into account the effects of the disaster, is projected to increase to -145 EC\$ million dollars (-60.6 EC\$ million in 2003) including grants. This represents 12 per cent of GDP taking into account grants (-18.7% without grants).

The fiscal performance will reflect a decline in revenue due mainly to the contraction in GDP, which will affect negatively the revenues from tax collection. Tax revenues are expected to decline from 303.5 to 246.3 million EC\$ (-19%).

At the same time the decline in GDP will have a negative impact on revenues corresponding to international trade and transactions. This category will witness a decline from 182.2 to 144.7 million EC\$ (-21%). Nonetheless, the economy is bound to witness an increase in import growth reflecting activities related to emergency efforts, which are not subject to taxes and duties.

On the expenditure side, total expenditures will increase (474 and 508 million EC\$ without and with taking into account the effects of the disaster). This result will be influenced by developments on both the capital and current account (318 and 335 million EC\$ without and with the disaster).

The behavior of current expenditures will reflect efforts at containing its growth in the last quarter of the year. This reflects in part the fact that contractors are providing free services to the government for the undertaking of clean-up operations following the natural disaster. The government's involvement comprises the provision of fuel and oil. At the same time the government is planning to reduce its transfers and part of its demand for goods and services. Wages and salaries will not be significantly affected, as they are mainly non-discretionary expenditures.

Capital expenditures are expected to rise from 135 to 173 million EC\$ mainly as a result of rehabilitation of schools, government buildings in need of urgent attention and improvements to the road network.

The fiscal deficit will be financed by a larger inflow of grants (57 and 81 million EC\$ in the pre and post disaster scenarios) and the contract of additional loans. The inflow of grants is mainly bilateral and responds to disaster relief. The additional loans are geared to support capital expenditures.

Over the medium term, the fiscal deficit of the central government will be gradually reduced. The revenue base will be recovering while efforts will be made to control the

level of expenditures, particularly on goods and services. However, as a result of the previous year's fiscal performance interest payments on the debt will rise unless a moratorium on the public debt is granted as a result of the devastation of the disaster. Other categories of current expenditure will continue of pre-disaster projected growth path.

Capital expenditures will register an increase over the medium-term as result of payments associated with the disaster reconstruction and rehabilitation efforts.

4.3. Balance of payments

Following the disaster the deficit of the current account will increase from 372 (pre-disaster scenario) to 450 million EC\$ (post disaster scenario). This will be due on the one hand to the higher level of merchandise imports as a result of emergency, recovery and reconstruction activities. On the other hand, merchandise exports are expected to decline by 20 percent to \$61 million EC\$.

Also the services balance will witness a reduction in its surplus due to both supply constraints and demand factors. The supply constraints result from the damage sustained to hotel plants, marina bays, and tourist infrastructure. The demand constraints arise from the suspension of visitor arrivals, mainly stay-over, due to the overall effects of the disaster. The net service movement is expected to move from 176 (pre-disaster scenario) to 101 million (post disaster scenario).

The current account will benefit from money flows of unilateral transfers, and grants. More specifically, it is expected that current transfers to the government will increase from 18 to 53 million (pre and post disaster scenarios respectively). Workers remittances will more than double as family members living abroad provide assistance to their relatives.

The capital and financial account will strengthen associated with the increase in capital grants to the government and higher inflows associated with insurance. Capital grants are estimated to rise roughly by 50%. Insurance flows are projected to reach at the time of this report to 75 million EC\$.

In 2005, the current account deficit will widen as the tourism sector continues to struggle with the effects of hurricane Ivan and production of the traditional crops contracts sharply. Nonetheless the economy will continue to benefit from financial flows mainly grants and insurance inflows.

4.4 Prices and employment

Prices are expected to increase in the short run and moderate thereafter. A very recent field survey conducted indicated that there were no apparent signs of price hikes in

established enterprises. However, there have been price increases reported in some of the retail outlets.

The level of employment will be severely affected. In the manufacturing sector unemployment will increase significantly with the temporary halt in operations of some enterprises. Job losses will be particularly visible in the industries related to the production of garments and furniture.

The tourism industry will also register important increases in unemployment. It is estimated that the job losses could amount to more than 60% of the total labor force of that sector. In the tour operator industry only 3% to 4% of the labor force are likely to be retained while the rest will be in the more optimistic scenario temporarily unemployed.

The construction sector, will be the main drive of employment. However, the sector will not be able to absorb all the labour released from the other sectors because of the specialised skill requirements for rehabilitation and reconstruction purposes.