

COUNTRY REVIEW

St Kitts and Nevis



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EULER HERMES COUNTRY RISK GRADE: C

**Country Risk Grades are on a scale of AA, A, BB, B, C, D
where AA is the lowest and D the highest risk.**

COUNTRY PROFILE

Capital city:	Basseterre
GDP:	USD552mn (2008e)
Population:	.05mn (2008e)
GDP per capita:	USD11,000 (2008e)
Currency:	East Caribbean Dollar (XCD)
Form of state:	Parliamentary democracy
Head of government:	Prime Minister Denzil Douglas
Next elections:	2009

St Kitts & Nevis is a two island Caribbean Federation that has been independent of the UK only since 1983. PM Douglas and his St Kitts & Nevis Labour Party (SKNLP) were re-elected for a third consecutive term in October 2004 with a large majority. The next elections should have been held by October 2009 but have been delayed by legal wrangles. However, this does not seem likely to undermine underlying stability. A recurring issue has been pressure from Nevis for separation from St. Kitts, but a referendum in Nevis in 1998 failed to secure the necessary two-thirds majority to proceed

The loss-making sugar industry, once the mainstay of the economy was closed down in 2005, and has been largely replaced by tourism. Real GDP grew by an annual average 4.2% in 2004-08, but in 2009 is expected to contract, followed by a slow pick-up through 2010. The fall in 2009 is partly related to the impact of the global recession on tourism, but also reflects the aftermath of Hurricane Omar which struck in October 2008 and led to the indefinite closure of Nevis' largest tourist resort, as natural disasters continue to be one of the key risks.

The legacy of long running losses in the state-owned sugar sector was high public debt-GDP ratios. Although the ratio is down from a peak of almost 200% in 2005 it remained excessively high at 178% at end-2008. The government has a medium-term strategy to lower this ratio and have run large primary surpluses in recent years. However, heavy debt servicing means that the fiscal deficit was still 3.5% of GDP in 2008. Moreover, in 2009 the deficit will widen and the public debt-GDP ratio will begin to rise again. There is no room for countercyclical fiscal policy and the large financing requirement, which is increasingly met from the banking system, is a severe constraint and the major risk. The IMF has agreed an Emergency Natural Disaster Assistance, however, to offset the impact of Hurricane Omar and relations with the Fund are good.

There is a large current account deficit, but between 2005 and 2008 it was more than fully covered by net FDI inflows. The deficit should narrow in 2009-10, but FDI will also weaken. Importantly, St Kitts & Nevis is a member of the East Caribbean Currency Union, which operates via a currency board and uniquely among currency unions pools its FX reserves. The shared Central Bank has maintained the XCB pegged to the USD since 1976. As required by the currency board foreign assets of the ECCB cover demand liabilities, but the reserves to broad money ratio is relatively low and the current account deficit is large. The exchange rate could be vulnerable, therefore, though it has withstood the recent global crisis and international support would probably be forthcoming if necessary. (The islands are small in terms of aggregate GDP and overall liabilities).

Overall public debt ratios are a serious concern and along with natural disasters represent a serious growth constraint. Delays to payments in the public sector are a possibility at some point and cover for public sector projects should be assessed with care. The ECCU mitigates exchange rate and transfer risk to some extent.

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