International Monetary Fund

St. Kitts and Nevis
and the IMF

Press Release:
IMF Executive Board
Completes Third
Review Under Stand-
by Arrangement with
St. Kitts and Nevis
and Disburses US$
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St. Kitts and Nevis: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

July 16, 2012

The following item is a Letter of Intent of the government of St. Kitts and Nevis, which describes the policies that St. Kitts and Nevis intends to implement in the context of its request for financial support from the IMF. The document, which is the property of St. Kitts and Nevis, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Basseterre, St. Kitts
July 16, 2012

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington DC, 20431

Dear Ms. Lagarde:

Since the approval of the Stand-By Arrangement in July 2011, economic activity has contracted in St. Kitts and Nevis, reflecting the challenging global economic conditions. However, with tourism activity registering a marked rebound for January – March 2012 and with a number of major construction projects in the pipeline, the economic decline is expected to bottom out in 2012 with economic activity either being flat or showing a mild recovery. In addition, given our prudent macroeconomic management, we are well positioned to meet our 2012 fiscal targets under the program. This achievement has been possible thanks to the sacrifice and efforts of the people of St. Kitts and Nevis, and with strong support from our commercial creditors, the donor community and international financial institutions, including the Caribbean Development Bank and the IMF.

The Government of St. Kitts and Nevis reaffirms its commitment to the success of its home-grown medium-term reform program (supported by the Fund's Stand-By Arrangement (SBA)), which will benefit the people of St. Kitts and Nevis and is fast becoming a model for other countries in the region. Since the SBA was approved in July 2011, we have been determined to advance our reform agenda and successfully implement our policies. This is reflected in having met our fiscal target and all other quantitative performance criteria and the structural benchmark for end-March 2012, as well as the structural benchmarks for end-June 2012. Our debt restructuring process is proceeding well and the domestic debt for land swap is under way. A shareholders' agreement has been signed, a management company responsible for selling the land assets incorporated, and lands have been registered and are in the process of being transferred. We welcome your continued strong support for these initiatives.

In the attached Memorandum of Economic and Financial Policies (MEFP) and the Technical Memorandum of Understanding (TMU), we present our plans to achieve the 2012 objectives of our program supported by the IMF. Based on the strength of these policies, and given our performance under the program and our continued commitment, we request the completion of the third program and financing assurances reviews, waiver of applicability for the end-June 2012 performance criteria, and the release of the fourth tranche of SDR 3.161 million.

We are confident that the policies that we have committed to are adequate to achieve the objectives of our program. However, we need to remain vigilant to downside risks of lower-than expected growth in the global economy and stand ready to take additional corrective actions that may become appropriate for this purpose as circumstances change. We will continue to consult with the Fund on the adoption of such actions in advance of necessary revision of policies contained in this letter and the attached Memorandum, in accordance with the IMF's policies.

The Government authorizes the IMF to make public the contents of this letter, the attached MEFP and TMU, and the Staff Report to clearly communicate our policies and to signal the seriousness of our commitment to the program to the people of St. Kitts and Nevis and to the international community.

Sincerely,

/s

Rt. Hon. Dr. Denzil Douglas
Prime Minister and Minister of Finance
St. Kitts and Nevis

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

1. St. Kitts and Nevis has made significant advances in implementing its home grown economic program supported by the IMF Stand By Arrangement (SBA). Our economic reform program continues to focus on putting public finances on a sustainable trajectory, finalizing a comprehensive debt restructuring to address the debt overhang, and further strengthening the financial system, in order to boost growth and employment. This Memorandum of Economic and Financial Policies (MEFP) updates these policies in the context of the third review under the SBA.

I. PERFORMANCE UNDER THE PROGRAM

2. We remain committed to successfully implementing our policies since the SBA was approved in July 2011 and have fulfilled our commitments under the program at end-March 2012 as detailed below. In addition, we expect to be on track to meet the program's end-June 2012 quantitative and structural reform targets. In this context, we request completion of the third program review and financing assurances review and request a waiver of applicability for the end-June 2012 performance criteria.

- **Growth and inflation.** Available indicators point to a softening of economic activity in January-March 2012. Construction continued to contract, by an estimated 20 to 25 percent (y/y), primarily on account of an under-execution of public investment in Nevis and sluggish FDI inflows. This dominated the effect of a relatively strong outturn in tourism, notably stay-over arrivals growing by 5.3 percent (y/y) relative to 0.4 percent (y/y) in January-March 2011. Inflation declined from 2.9 percent at end-December 2011 to 1.9 percent (y/y) at end-March 2012, with a fading impact of the introduction of the VAT at end-2010 and moderating commodity prices.[1]

- **External sector.** Imports contracted relative to program expectations in January-March 2012, reflecting lower domestic demand. Combined with a good outturn for export and tourism receipts, the trade balance improved sufficiently to raise international reserves, net of IMF SBA resources, by EC$25 million.

- **Fiscal performance.** All fiscal targets were met at end-March 2012, despite the continued challenging global environment and the much weaker-than-anticipated economic outturn for the first quarter of 2012. The overall fiscal balance at end-March 2012 reached a surplus of EC$20 million, significantly above the adjusted program floor of EC$-24 million. Similarly, the primary surplus of EC$46 million also exceeded the program's indicative floor of EC$7 million. Most gains came from

[1] Methodological improvements in the treatment of missing data in the CPI survey have resulted in an updated inflation time series.

a sharp tightening in expenditure, particularly capital outlays, as total revenue was largely aligned with program expectations, buttressed by a strong performance of non tax revenue collected from the CIP. Tax revenue collection, particularly from VAT and customs duties, fell somewhat short of program expectations.

- **Other performance criteria.** The ceilings on central government budget expenditure arrears accumulation, the stock of external short-term debt, and the central government or guaranteed external arrears accumulation have all been met (Table 2).

- **Debt restructuring.** We have made progress in our comprehensive debt restructuring by:

  - **Initiating a debt/land swap with our domestic creditors.** In conjunction with the shareholders' agreement signed on April 18, 2012, the management company responsible for selling the land assets was incorporated on April 5, 2012. About EC $900 million of loans will be exchanged for land. In this context, an additional 600 acres of land have been registered and valued (structural benchmark for end-June). Negotiations are under way with the remaining domestic creditors.

  - **Concluding an agreement with our Paris Club creditors**. On May 24, Paris Club creditor countries agreed on a flow rescheduling of 20 years with a 7 year grace period, a consolidation of 93 percent of current arrears, a full payment of moratorium interest during the consolidation period, and the inclusion of a goodwill clause pertaining to a future stock treatment. This agreement reduces by over 90 percent the debt service due to Paris Club creditors during the current Stand-By Arrangement program. We have contacted the United Kingdom and the United States bilaterally, with a view to agreeing to specific terms by end-October 2012. We have contacted our other bilateral creditors and discussions are ongoing.

  Upon completion of the debt/land swap, we expect these operations, combined with our fiscal efforts, to reduce total public debt from 154.4 percent of GDP at end-2011 to just below 100 percent at end-2012, on the path to reach the ECCU target of 60 percent by end-2020.

- **Financial sector**. As of end-March 2012, the domestic financial sector remained adequately capitalized and liquid. Liquidity coverage of total deposits increased in the first quarter of 2012, as deposits—particularly time deposits— increased by more than credit to the private sector. The capital to risk-weighted asset ratio was maintained above 40 percent, far exceeding the prudential regional norm. The NPL ratio for locally incorporated banks declined from 6.8 percent at end-December 2011 to 6.4 percent at end-March 2012. Updated stress tests as of March 2012, completed by the Eastern Caribbean Central Bank (ECCB), confirm that the domestic banking sector is resilient to a range of shocks and would weather the full impact of the government debt restructuring. The ECCB's preliminary assessment of the impact of the debt/land swap is that the capital adequacy would remain above the prudential benchmark while the NPL ratio would increase due to the change in asset composition. There has been no request to date to access the Banking Sector Reserve Fund (BSRF) set up under the SBA.

- **Trade Policies**. We have actively engaged in trade agreements to promote trade, investment and employment in St. Kitts and Nevis. In addition to our existing bilateral non-reciprocal agreements with the Dominican Republic, Costa Rica, Cuba, Venezuela, and Colombia, we recently concluded a Partial Scope Agreement with Brazil and Guyana. The agreement, covering the electronic manufacturing sector, should be ratified by end-2012. Tariff reductions under the CARICOM Economic Partnership with the EU are scheduled for 2013. Implementation of the trade agreements is facilitated by the national trade policy committee—an inter-ministerial entity—which coordinates the harmonization of these agreements with domestic policies.

- **Structural benchmarks.** We met the structural benchmarks on submitting to Cabinet the proposal to rationalize the subsidy on LPG and the strategy for social safety net reform at end-March 2012. We have also completed the following structural benchmarks for end-June 2012: (i) we have established the land asset management company, and (ii) updated the registry for and, (iii) undertaken the valuation of, an additional 600 acres of land, (iv) we have established a medium-term expenditure framework with agreed fiscal targets, (v) we have submitted procurement legislation to Parliament and (vi) Cabinet has approved a comprehensive plan for civil service reform, covering human resource policy, reviewing the organization and structure of the civil service and addressing wage policy and payroll management.

II. Policies During 2012

3. **A difficult first quarter and challenging global conditions suggest that economic activity will be flat in 2012.** Economic growth is revised from 1 percent to zero in 2012. Growth in tourism is expected to moderate for the remainder of the year, due to uncertainty surrounding airlift capacity. However, construction activity should recover modestly, on the back of CIP approvals and stronger FDI inflows. Real GDP growth is projected to reach 1¾ percent for 2013 and 4 percent over the medium term as tourism and construction continue to recover. Nonetheless, we remain mindful of the continued downside risks presented by the difficult global environment and are committed to implementing the necessary contingency measures to ensure that our fiscal strategy for 2012 remains fully aligned with the program.

A. Debt Restructuring

4. **Once the debt/land swap is completed, a swift pace of land sales is needed to adequately safeguard the financial position of the domestic creditors.** We are proceeding with making the land asset management company fully functional, including in terms of operational guidelines, governance structure and staffing arrangements. In doing so, we intend to follow best practices related to transparency, accountability and the design of management incentives. We will submit to Parliament legislation for the transfer of land and plan to complete the transfer by end-September 2012. We count on the ECCB to continue to monitor the situation closely to ensure the health of the banking sector.

B. Financial Sector

5. **We are committed, in conjunction with the ECCB, to continue to safeguard the stability of the financial sector.** The ECCB's quarterly stress tests of the banking sector continue to be of great value to closely monitoring the banking sector. The BSRF will remain in place as an insurance policy. We remain committed to working with the CDB-ECCB-IMF-World Bank Joint Financial Sector Task Force on addressing, as necessary, broader financial sector challenges in the region through a comprehensive regional approach. Finally, consistent with the IMF's safeguards policy requirement and current practice, we will continue to maintain all foreign exchange balances at the ECCB.

C. Fiscal Policy

6. **We remain committed to the 2012 program target for the overall fiscal deficit of EC$60 million, even if downside risks to the macroeconomic outlook are realized.** Given increased uncertainty about achieving the annual tax revenue target, we will review the administrative practices with respect to the recording and offsetting of duties and taxes in order to strengthen the accounting procedures and minimize such occurrences. With the objective of bolstering tax revenue, in the short term, we will also seek technical assistance from our international partners to conduct an in-depth review of the concession regime on import duties and taxes, including the review of related legislation to determine the relevance and effectiveness of existing incentives. On the expenditure side, we intend to remove bottlenecks so that the implementation of the approved 2012 capital budget can proceed on a timely basis, within the confines of the 2012 budget, in order to provide additional impetus for economic growth. In the event that the revenue outturn exceeds program projections, we would see merit in further reducing the stock of budgetary arrears.

Revenue

7. **We are pursuing further revenue administration reforms.** Building on the institution of a single taxpayer identification number in 2011, we are strengthening verification controls by improving communication between the Customs and Excise Department (CED) and the Inland Revenue Department (IRD) and moving towards

unification of the data bases. We have strengthened our control over large taxpayers, including the enforcement of assessments and have implemented the Tax Roll and Intelligence Unit. We are developing risk-based audit methods for the corporate income tax and customs duties and expect over the medium-term to commence joint audits by the CED and the IRD. We have also strengthened accountability of the IRD by implementing performance indicators in each of its sections and systematized the cross-checks between the Housing and Social Development Levy and social security contributions for all large taxpayers. We have drafted a new Customs Law, which harmonizes the systems and procedures of the CED and clarifies guidelines on investigation methods. While 90 percent of Customs declarations are already made electronically, we aim to extend the regime of electronic registry to all taxpayers registered as businesses and are harmonizing the International Standard Industrial Classification (ISIC) codes.

8. **We are broadening the tax base.** The Income Tax Act was amended in April 2012 to include in-kind payments in the tax base, which is expected to generate approximately EC$2 million (0.1 percent of GDP) in additional revenue on an annual basis and limit to one cost center per business the eligible threshold of deductible remuneration paid to an employee. We also intend to update the model for calculating the tax obligations of insurance companies. We continue to monitor the revenue cost of customs duties and tax exemptions, the former estimated at EC$24 million (1.2 percent of GDP) in January-March 2012, with the intention of completing their review and streamlining them over the medium-term.

Expenditure

9. **We will continue to tightly control current expenditure while accelerating priority capital spending.** We will maintain the freeze on the wage bill and limit the growth of expenditure on goods and services. As an additional step towards improving the efficiency of government operations we intend to close the Supply Office in St. Kitts by end August 2012 and are assessing options for a more cost-effective management of price controls for staple food items.

Fiscal structural reforms

10. **To increase fiscal space for priority spending, following our recent advances in public expenditure management, we are improving the efficiency of public outlays by:**

- **Rationalizing social protection programs.** We have initiated the process of consolidating four of the existing cash transfer programs and improving their targeting by shifting the recipients from individuals to households. We also aim to limit the time duration of these benefits per beneficiary by strengthening support for its eventual exit from the program. With technical assistance, we will focus on the establishment of the legislative framework to support the safety net program and ascertain a means test (SB for end September 2013) to determine eligibility to the program as well as a system to facilitate graduation from the program. Once this new system of delivery of social protection programs is in place, we will examine the scope for extending it to subsidies on LPG and basic food staples, in order to improve their targeting to the neediest.

- **Containing contingent liabilities from public enterprises.** The Finance Administration Act requires that overdrafts of public enterprises that are guaranteed by the government, currently amounting to EC$ 2.5 million (0.1 percent of GDP) be given in accordance with the provisions of an Act authorizing the guarantee or by resolution of the National Assembly. To enhance the government's oversight of public enterprises and their compliance with financial reporting requirements, we plan to formally recognize the authority of the Government Entities Oversight Board to engage auditors for investigative purposes and strengthen its enforcement capacity by including a provision to that effect in the Finance Administration Act (SB for end-March 2013). We have clarified the government's financial relationship with the St. Kitts Electricity Company (SKELEC) and intend to settle mutual claims of cross-arrears that have accumulated since its corporatization in August 2011 by August 2012. As SKELEC continues implementing its program of revenue recovery and adjusting electricity tariffs in line with international fuel prices, we expect that it will generate sufficient resources to cover its debt servicing obligations over the medium term.

- **Enhancing the Public Sector Investment Program.** We have formulated a Public Financial Management (PFM) Action Plan for 2012–15 in May, 2012. In the context of the Medium-Term Expenditure Framework, we are refining the three-year fiscal forecast to be included in the 2013 Budget. Inter alia, this will allow us to strengthen the monitoring of capital projects and their recurrent cost implications in light of sectoral strategies.

11. **We continue to strengthen our cash management system to avoid the accumulation of arrears.** We are improving our systems to identify payment deadlines based on terms of sales, limiting departments' access to spending lines once they exceed their limit for incomplete purchase orders, and eliminating inactive donor accounts.

12. **In the context of the OECS Pension Commission, we are exploring a number of pension reforms that would help ensure long-term sustainability.** One of the important milestones is the tenth actuarial review of the Social Security fund. Due to administrative delays, we now envisage that this review will be completed by end-December 2012, resulting in the rephasing of the relevant structural benchmark. After consulting with stakeholders, policy options under consideration include increasing the retirement age, reducing the accrual rate and modifying the pensionable base. We anticipate having a firm proposal on these reforms developed by end-June 2013 (SB).

13. **Progress has been made in improving fiscal transparency.** We intend to commence quarterly publication of reports on fiscal operations by end-2012 and gross financing needs starting in June 2013. The audited financial statements of the Sugar Industry Diversification Foundation (SIDF), a private foundation, have been published for the years 2007–2010 and the publication of the accounts for 2011 should take place later in 2012.

Table 1. St. Kitts and Nevis: Schedule of Review and Purchases

Availability date	Amount of Purchase: Millions of SDR	Amount of Purchase: Percent of Quota	Conditions
July 27, 2011	22.150	248.9	Approval of arrangement
January 25, 2012	11.470	128.9	First review and end-September 2011 performance criteria
May 21, 2012	3.161	35.5	Second review and end-December 2011 performance criteria
May 25, 2012	3.161	35.5	Third review and end-March 2012 performance criteria
August 15, 2012	3.161	35.5	Fourth review and end-June 2012 performance criteria
November 15, 2012	3.161	35.5	Fifth review and end-September 2012 performance criteria
February 15, 2013	1.105	12.4	Sixth review and end-December 2012 performance criteria
May 15, 2013	1.105	12.4	Seventh review and end-March 2013 performance criteria
August 15, 2013	1.105	12.4	Eight review and end-June 2013 performance criteria
November 15, 2013	1.105	12.4	Nineth review and end-September 2013 performance criteria
February 15, 2014	0.913	10.3	Tenth review and end-December 2013 performance criteria
May 15, 2014	0.913	10.3	Eleventh review and end-March 2014 performance criteria
Total	**52.510**	**590.0**	

Source: Fund staff estimates

Table 2. St. Kitts and Nevis: Quantitative Performance Criteria and Indicative Targets
(In EC$ millions)

	End-Dec 2011			End-Mar. 2012				
	Prog.	Adjusted	Actual	Prog.	Adjusted	Actual	Difference	Status
Performance Criteria:								
Central government overall balance including grants (floor) 1/ 2/	-60	-35	43	-24	-24	20	43	met
Stock of central government budget expenditure arrears accumulation (ceiling) 3/	0	0	-16	0	0	-27	-27	met
Stock of external short term debt (ceiling)	0	0	0	0	0	0	0	met
Central government or guaranteed external arrears accumulation (ceiling) 4/	0	0	0	0	0	0	0	met
Indicative Target:								
Central government primary balance (floor) 1/ 2/	76	101	169	7	7	46	39	met

1/ Cumulative within each calendar year.
2/ See the TMU for a description of adjustors.
3/ Including the estimated stock of expenditure payable on electricity.
4/ To be monitored on a continuous basis.

Table 3. St. Kitts and Nevis: Quantitative Performance Criteria for 2012 and Indicative Target for 2013
(In millions of Eastern Caribbean dollars)

	Performance Criteria			Indicative Target	
	End-Jun. 2012	End-Sep. 2012	End-Dec. 2012	End-Mar. 2013	End-Jun. 2013
Performance Criteria:					
Central government overall balance including grants (floor) 1/ 2/	-53	-91	-60	-5	-11
Stock of central government budget expenditure arrears accumulation (ceiling)	0	0	0	0	0
Stock of external short term debt (ceiling)	0	0	0	0	0
Central government or guaranteed external arrears accumulation (ceiling) 3/	0	0	0	0	0
Indicative Target:					
Central government primary balance (floor) 1/ 2/	19	8	68	20	42

1/ Cumulative within each calendar year.
2/ See the TMU for a description of adjustors.
3/ To be monitored on a continuous basis.

Table 4. St. Kitts and Nevis: Structural Benchmarks

Action	Target Date	Objectives	Status
I. Fiscal and Public Sector Reforms			
Public financial management			
Submit to Cabinet proposal to rationalize the subsidy on liquefied petroleum gas (LPG)	End-March 2012	Strenghten public financial management	completed
Update the registry of additional 600 acres of land	End-June 2012	Strenghten public financial management	completed
Undertake valuation of additional 600 acres of land	End-June 2012	Strenghten public financial management	completed
Submit draft of new Procurement Act to Parliament	End-June 2012	Strenghten institutional framework	completed
Draft proposal for the establishment of an asset management company	End-June 2012	Strenghten public financial management	completed
Establish a medium-term expenditure framework with agreed fiscal targets	End-June 2012	Improve medium-term orientation of the budget	completed
Civil service reform			
Cabinet to approve a plan for civil service reform covering human resource policy, reviewing the organization and structure of the civil service and addressing wage policy and payroll management	End-June 2012	Strenghten public financial management	completed
Structural Benchmarks for Upcoming Reviews			
Actuarial review of Social Security			
Regular review of the Social Security Scheme.	End-September 2012	Strenghten public financial management	reset for end-December 2012
Public enterprise reform			
Rationalize public land sales and development agencies	End-September 2012	Strenghten public financial management	
Include in the Finance Administration Act provisions recognizing the Government Entities Oversight Board and strengthening its enforcement authority	End-March 2013	Strenghten public financial management	new
Strengthen social safety net			
Submit social safety net reform strategy to Cabinet	End-March 2012	Streamline social safety nets	completed
Develop method for the proxy means testing for the eligibiity criteria of the planned consolidated cash transfer program	End-September 2013	Streamline social safety nets	new
II. Financial Sector Reforms			
Update the existing stress tests of banks	To be monitored on a quarterly basis	Financial sector stability	completed
III. Medium-term benchmark			
Develop an explicit medium-term debt management strategy that takes account of the cost-risk tradeoff of alternative financing options, within the context of the overall macroeconomic environment	End-December 2012	Improve medium-term orientation of the budget	
Draft proposal for a comprehensive pension reform	End-June 2013	Strenghten public financial management	

Sources: St. Kitts and Nevis authorities; and Fund staff.

TECHNICAL MEMORANDUM OF UNDERSTANDING

1. St. Kitts and Nevis' performance under the Stand-By Arrangement (SBA) will be assessed on the basis of the quantitative performance criteria and indicative targets, as well as the structural benchmarks. This Technical Memorandum of Understanding (TMU) defines the variables set out in Table 2 of the Memorandum of Economic and Financial Policies (MEFP). It also lays down the reporting requirements to adequately monitor the program.

2. For the purposes of the program, the exchange rate of the East Caribbean dollar (EC$) to the U.S. dollar is set at EC$2.70 = US$1 and the exchange rate of the Euro to the U.S. dollar is set at EUR1 = US$1.3. Foreign currency accounts denominated in currencies other than the U.S. dollar and the Euro, excluding SDRs, will be first valued in the U.S. dollar at actual end-of-period exchange rates used by the ECCB to calculate the official exchange rates. SDR-denominated accounts will be valued at the program exchange rate of U.S. dollar 1.6 per SDR.

III. COVERAGE

3. For the purpose of the program, **central government** will cover all items included in the government budgets of the Federation (both St. Kitts and Nevis).

4. The **nonfinancial public sector** is defined as the total central government and nonfinancial public enterprises. Public enterprises consist of the Development Bank of St. Kitts and Nevis, Financial Services Regulatory Commission, Frigate Bay Development Corporation, La Vallee Greens Ltd, National Housing Corporation, Nevis Air and Sea Port Authority, Nevis Cultural Development Foundation, Nevis Electricity Corporation, Nevis Housing and Land Development Corporation, Nevis Solid Waste Management Authority, Nevis Tourism Authority, St. Christopher and Nevis Solid Waste Management Corporation, St. Christopher Tourism Authority, St. Kitts Urban Development Corporation, St. Christopher Air and Sea Ports Authority, WhiteGate Development Corporation, and ZIZ Broadcasting Corporation.

5. **External debt** is defined as all debt owed to creditors residing outside of St. Kitts and Nevis, while **domestic debt** covers all debt owed to residents of St. Kitts and Nevis. The latter covers all T-bills, including those held by creditors residing outside of St. Kitts and Nevis, and the bond issued at the Regional Government Securities Market (RGSM).

IV. QUANTITATIVE PERFORMANCE CRITERIA

A. Central Government's Overall Deficit (PC)

6. The **central government overall balance** will cover all of its revenue, grants, expenditure, and transfers. Revenues will exclude any proceeds from the sale of public assets

such as land, which will be considered as financing below the line. Expenditures will exclude clearance of arrears, which will be considered as financing below the line.

7. The central government's overall balance will be measured from the financing side as the sum of the net domestic financing, net external financing, plus proceeds from the sale of public assets, minus clearance of arrears.

8. **Net domestic financing** of the central government is defined as the sum of:

- net domestic bank financing as measured by the change in the domestic banking system credit to the central government net of deposits, as reported by the consolidated balance sheet of the monetary authorities and commercial banks, including special tranches from the ECCB;
- net nonbank financing as measured by the net changes in holdings of government securities by nonbanks, and net borrowing from nonbank institutions;
- the changes in the stock of domestic arrears of the central government defined as net changes in unpaid checks issued, unprocessed claims, pending invoices, plus accrued interest payments, and other forms of expenditures recorded above the line but not paid;
- gross receipts from divestment defined as proceeds received from any privatization, divestment, and sale of asset (land); and
- any exceptional financing, including rescheduled principal and interest.

9. **Net external financing** of the central government is defined as the sum of:

- disbursements of project and non-project loans, including securitization;
- proceeds from bonds issued abroad (with an original maturity of one year or greater);
- net changes in short-term external debt (with an original maturity of less than one year), excluding exceptional financing;
- net changes in cash deposits held outside the domestic banking system;
- any changes in arrears on external interest payments and other forms of external expenditures recorded above the line but not paid;
- any exceptional financing, including rescheduled principal and interest;

<u>less</u>:

- payments of principal on current maturities for bonds and loans on a due basis, including any prepayment of external debt.

10. The **floor on the overall balance of the central government** will be adjusted as follows:

- **downward** (i.e., a larger overall deficit target would apply) to the extent that budgetary grants fall short of the programmed amounts by less than EC$3 million.

- **upward** to the extent that budgetary grants exceed the annual amounts specified in the program.

- **downward** by the cumulative amount of up to EC$15 million spent on bank recapitalization and support to the British American Insurance Companies or CLICO as part of a regional solution—any amounts spent in excess of this programmed contingency will need to be funded within the program limit on the overall deficit.

- **upward** to the extent that clearance of arrears fall short of the amounts specified.

- **upward** to the extent of exceptional financing achieved through debt restructuring.

Table 1. Programmed Disbursements of Budgetary Grants in 2012
(in EC$ millions)

Quarters	I	II	III	IV
Grants	0.0	0.0	0.0	27.4

Sources: St. Kitts and Nevis authorities; and Fund staff estimates.
Note: Values presented are cumulative and Euro 1 = US$1.3.

B. Stock of Central Government Short-Term External Debt (PC)

11. The **limit on short-term external debt** applies to debt owed or guaranteed by the central government of St. Kitts and Nevis, with an original maturity of up to and including one year. Excluded from the limit are any rescheduling operations (including the deferral of interest on commercial debt) and normal import-related credits. Normal import credit is understood to be a self-liquidating operation where the proceeds from sales of imports are

used to retire the debt. Debt falling within the limit shall be valued in U.S. dollars at the time of the contract or guarantee becomes effective.

C. External Arrears of the Public Sector (PC)

12. The **non-accumulation of arrears to external creditors** will be a continuous performance criterion under the program. This performance criterion applies to arrears accumulated related to debt contracted or guaranteed by central government. External payment arrears consist of external debt service obligations (principal and interest) falling due after December 31, 2010 that have not been paid at the time due, taking into account the grace periods specified in contractual agreements. Arrears resulting from nonpayment of debt service for which a clearance framework has been agreed or a rescheduling agreement is being sought are excluded from this definition.

D. Budget Expenditure Arrears (PC)

13. A ceiling is set on central government budget expenditure arrears, equal to the stock of such arrears as at December 31, 2010 (Table 2). The ceiling applies to the increase in the sum of: (1) any invoice that has been received by a spending agency from a supplier of goods, services, and capital goods delivered and verified, and for which payment has not been made within the contractually agreed period, or in the absence of a grace period, within 60 days; and (2) unpaid wages, pensions, or transfers, pending for longer than 60 days to domestic or foreign residents, irrespective of the currency denomination of the debt. Interest and amortization arrears on domestic debt resulting from nonpayment of debt service for which a clearance framework has been agreed or a rescheduling agreement is being sought are excluded from this ceiling. For ease of monitoring, all debt issued on the Regional Government Securities Market (RGSM), irrespective of who holds it, will be regarded as domestic debt.

Table 2. Stock of Budget Expenditure Arrears at end-December, 2010
(in EC$ millions)

Stock of arrears 1/	133
Unpaid check issued	…
Unprocessed invoices	…
Pending invoices	…
Interest and amortization arrears on domestic debt	0
Total	133

Source: St. Kitts and Nevis authorities.
1/ Including the stock of arrears related to fuel purchases audited by international auditors.

V. Indicative Target on the Primary Balance of the Central Government

14. The **central government's primary balance** is defined as revenue and grants minus non-interest expenditures. As in the definition of the overall balance, revenue will exclude any proceeds from the sale of public assets. Net lending is a non-interest expenditure item (negative net lending is a revenue item). Interest expenditures include interest payments on outstanding arrears, as defined above in sections IIC and IID (at their contractual rates) converted to a cash basis.

15. The **floor on the primary balance of the central government** will be monitored from the financing side as the sum of the net domestic financing, net external financing, proceeds from the sale of public assets, plus domestic and external interest payments on a due basis.

16. The floor on the primary balance of the central government will be adjusted as follows:

- **downward** (i.e., a smaller primary surplus target would apply) to the extent that budgetary grants fall short of the programmed amounts by less than EC$3 million.
- **upward** to the extent that budgetary grants exceed the annual amounts specified in the program.
- **downward** by the cumulative amount of up to EC$15 million spent on bank recapitalization and support to the British American Insurance Companies or CLICO as part of a regional solution.
- **upward** to the extent of exceptional financing achieved through debt restructuring.

VI. Data and Information

17. To enable monitoring of performance relative to the above quantitative performance criteria and indicative targets, the St. Kitts and Nevis authorities will provide Fund staff with the following specific data and information within 8 weeks after the end of each month.

Fiscal sector

- Central government budgetary accounts.
- Capital expenditure.

- Total monthly disbursements and grants receipts, disaggregated into: (a) budgetary support (by type—either loans, external "bonds" and/or other securities); (b) project loans; (c) budgetary grants; and (d) project grants.

- Central government domestic debt data (St. Kitts and Nevis).

- Stock of domestic arrears, including unpaid checks issued, stock of unprocessed claims due and invoices pending; interest and amortization on domestic debt.

- Stock of external arrears by creditor.

- Detailed monthly external debt report from the Debt Unit in the Ministry of Finance, showing fiscal year-to-date disbursements, amortization, interest payments and outstanding stocks, for the central government and public enterprises.

- Copies of loan agreements for any new loans contracted, including financing involving the issue of government paper, and of any renegotiated agreements on existing loans.

Financial sector

- Monetary survey for St. Kitts and Nevis as prepared by the Eastern Caribbean Central Bank.

Real sector

- Consumer price index.

18. Reporting on a **quarterly basis** will include the following:

Fiscal

- A detailed overview of capital expenditures on a project by project basis and the composition of financing.

- Financial position of the public enterprises (as listed in paragraph 4).

Real sector

- Economic indicators under the real sector.

External sector

- Economic indicators under the external sector.

19. Reporting on an **annual basis** will include the following:

External and real sectors

- GDP and its components.
- Balance of payments accounts.

20. **Other reporting** will include:

- Reports of legislative changes pertaining to economic matters.
- Notification of any establishment of new public enterprises.
- All disbursements and outstanding balances from the use of the Banking Sector Reserve Fund on a weekly basis.