

## CREDIT RATING REPORT

# The Government of the Commonwealth of Dominica

**CariCRIS**

Caribbean Information &  
Credit Rating Services Limited

September 2014

INSTRUMENT RATED	RATING
USD 25 million Debt Issue (Notional)	CariBBB- (Foreign Currency)

RATING HISTORY			
Date	Foreign Currency	Local Currency	Instrument/Remarks
September 19, 2014	CariBBB-	CariBBB-	USD 25 million Debt Issue (Notional)
May 27, 2013	CariBBB-	CariBBB-	USD 25 million Debt Issue (Notional)
February 2, 2012	CariBBB-	CariBBB-	USD 25 million Debt Issue (Notional)
June 18, 2009	CariBB+	CariBB+	USD 25 million Debt Issue (Notional)
December 21, 2007*	CariBB+	CariBB+	USD 25 million Debt Issue (Notional)

\*Initial Rating Assigned

### RATING DRIVERS

#### Strengths

- Prudent fiscal management evidenced by a modest current account balance and comfortable debt servicing ratios
- Monetary and exchange rate stability underpinned by membership in a quasi-currency board arrangement
- Stable political environment with good implementation of broad based social policies
- Moderate though declining external sector performance

#### Weaknesses

- Small, open economy with a relatively narrow economic base
- Severe capacity constraints

#### Rating Sensitivity Factors

- Discontinuation of the ongoing geothermal project
- An increase in debt to GDP to 80% or more
- Deterioration in the ratio of NPLs to gross loans to 20%

#### Analytical Contacts:

**Andre Joseph**  
Tel: 1-868-627-8879 Ext. 227  
E-mail: [ajoseph@caricris.com](mailto:ajoseph@caricris.com)

**Paul Birchwood**  
Tel: 1-868-627-8879 Ext. 229  
E-mail: [pbirchwood@caricris.com](mailto:pbirchwood@caricris.com)

Website: [www.caricris.com](http://www.caricris.com)  
Email: [info@caricris.com](mailto:info@caricris.com)

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## **SOVEREIGN BACKGROUND**

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Dominica is a small island located in the Eastern Caribbean, between the French islands of Guadeloupe to the north and Martinique to the south. The island has a tropical climate, with temperatures averaging twenty five degrees Celsius (25C), and with a relatively high humidity averaging 70%. The dry season is between January and June and the wettest months are between August and October. Dominica is mountainous and volcanic with tropical rainforest covering two thirds of the island and is home to the world's second largest boiling lake. Total population is estimated at 69,971 persons, with the majority of the population living around the capital of Roseau. The official language is English but French patois is also spoken. The primary economic drivers are agriculture, government services and wholesale and retail trade.

## RATIONALE

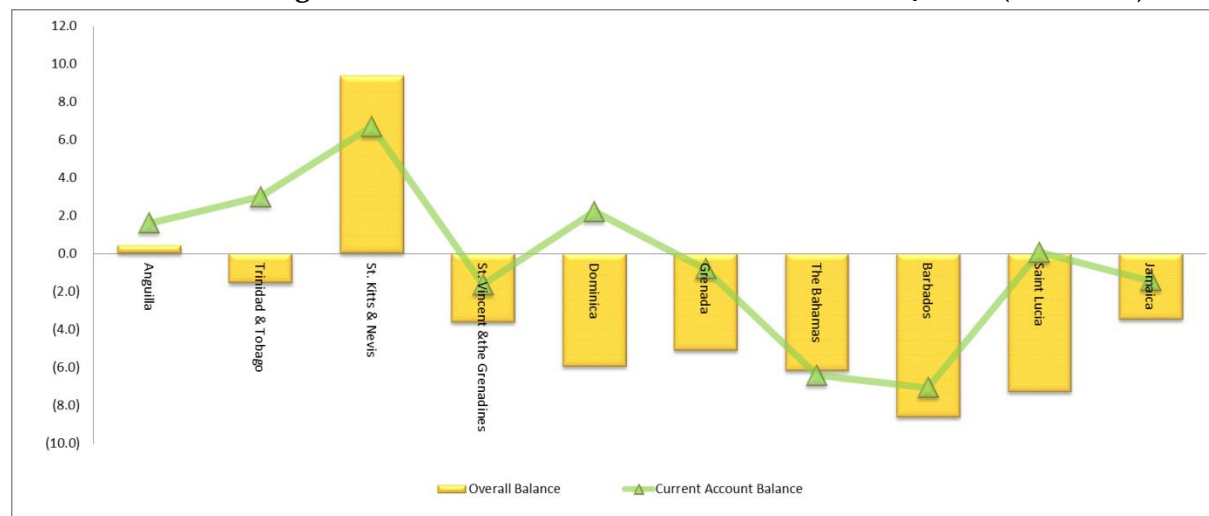
Caribbean Information and Credit Rating Services Limited (CariCRIS) has reaffirmed its ratings of **CariBBB-** (Foreign Currency and Local Currency Ratings) on its regional scale of the notional debt of USD 25 million of the Government of the Commonwealth of Dominica (GOCD). The ratings indicate that the level of creditworthiness of this obligation, adjudged in relation to other obligations in the Caribbean<sup>1</sup> is **adequate**.

The factors supporting these ratings are:

### *Prudent fiscal management evidenced by a modest current account balance and comfortable debt servicing ratios*

Dominica has attained a relatively strong fiscal position compared to its regional peers, due primarily to the two International Monetary Fund (IMF) programs entered into during the period 2002–2006. These programmes resulted in large fiscal adjustments, debt restructuring (2004), and a fairly consistent flow of low-cost funding. Despite gradual decreases, the country's current account surplus averaged 2.2% of GDP over the last 3 years; the third highest amongst CariCRIS' regional sample (see Chart 1 below).

**Chart 1: 3-Year Average Overall Fiscal and Current Account Balance/GDP (2011-2013)**



Source: CariCRIS' sovereign data

<sup>1</sup> The term Caribbean as used here covers the following countries: The Bahamas, Barbados, Belize, Costa Rica, the Dominican Republic, Guyana, Haiti, Jamaica, Panama, Suriname, Trinidad and Tobago and the following countries in the OECS: Anguilla, Antigua & Barbuda, Dominica, Grenada, Montserrat, St. Kitts & Nevis, Saint Lucia and St. Vincent & the Grenadines. Refer [www.caricris.com](http://www.caricris.com) for a more detailed explanation on CariCRIS ratings and rating definitions.

In FY2013/14, Dominica managed to reduce its fiscal deficit to EC \$60 million or 4.3% of GDP, from a prior year deficit of EC \$71.8 million or 5.2% of GDP (see Table 1 below). The improvement in Dominica's overall fiscal balance relative to the prior year was driven by a 2.8% increase in total revenues. This was mainly attributable to a 3.5% increase in tax income to EC \$30.9 million, coupled with the receipt of grant income of EC \$45 million, the latter increasing by 22.9% over the prior 12-month period. The higher tax revenue was due in turn to changes in the GOCD's approach to tax administration, whereby heavier emphasis was placed on the collection of taxes from higher income earners. As such, a new department was formed within the internal revenue division to focus on the collection of taxes from large and medium-sized companies for all tax categories. At 73.6%, tax revenue represents the largest component of total revenue, while non-tax, capital and grant revenue account for 15.6%, 1.5% and 9% respectively. Non-tax revenue and capital revenues from the sale of assets declined by 8.9% and 79.8% respectively to EC \$65.5 million and EC \$0.3 million in FY2013/14.

**Table 1: Current Account, Primary and Overall Fiscal Balance (FY2009/10 - FY2013/14)**

	FY2013/4*	FY2012/13	FY2011/12	FY2010/11	FY2009/10
<b>Current Account Balance (EC \$'000)</b>	24,064.7	34,182.4	34,358.6	36,961.9	67,443.7
(% of GDP)	1.7	2.4	2.5	2.7	5.0
<b>Primary Balance (EC \$'000)</b>	(33,702.8)	(46,493.9)	(41,470.4)	(32,116.1)	18,648.3
(% of GDP)	(2.4)	(3.3)	(3.0)	(2.4)	1.4
<b>Overall Balance(EC \$'000)</b>	(60,068.0)	(71,842.9)	(59,598.5)	(52,726.0)	853.3
(% of GDP)	(4.3)	(5.2)	(4.3)	(3.9)	0.1

\* Projected

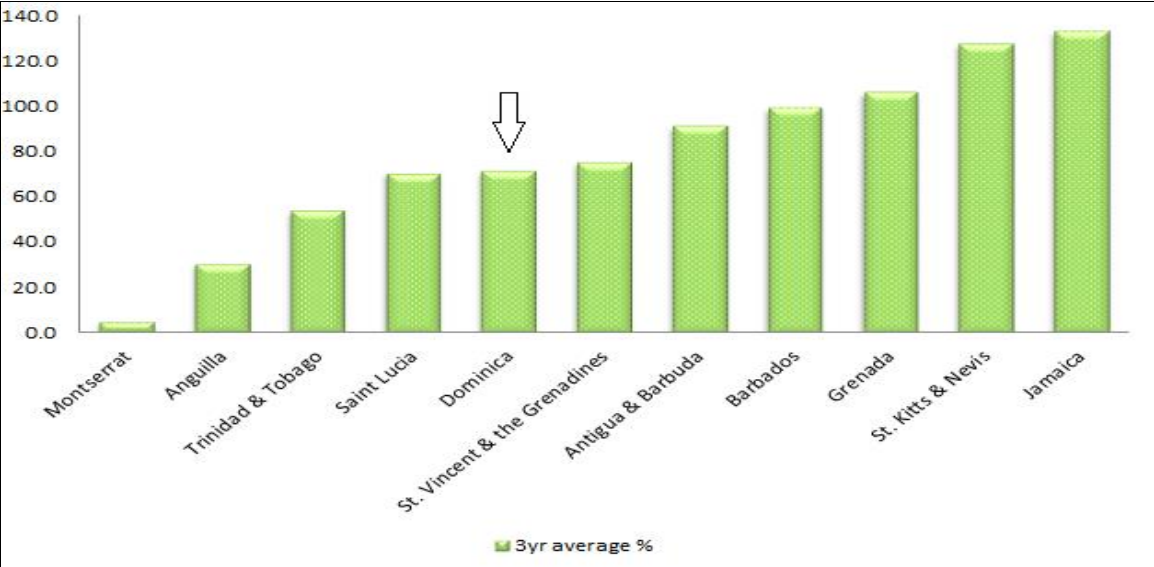
Source: GOCD

Total expenditure remained flat at EC \$480.3 million in FY2013/14. Though current expenditure rose by 4.2% primarily due to an 11.7% increase in the wage bill, this was offset by a 10.1% reduction in capital expenditure. Expenditure on goods and services, which comprised 26.3% of current expenditure in FY2013/14, fell by 4.4% to EC \$92.4 million from EC \$96.7 million in the previous year. CariCRIS expects a further decline in Dominica's current account surplus over the next year and we expect the country's overall fiscal deficit position to widen marginally due to a lower-than-expected receipt of grant income. Notwithstanding this, Dominica's fiscal performance is expected to improve in the medium term and remain favourable compared to some of its regional peers.

Dominica has a moderate level of indebtedness compared to its regional peers, as illustrated in Chart 2 below. Total public sector debt grew 9.6% to EC \$1 billion (75.3% of GDP) in FY2013/14

from EC \$971.2 million (69.8% of GDP) in FY2012/13. This growth was largely due to disbursements received from the Caribbean Development Bank (CDB), the People’s Republic of China (PRC) and France. CariCRIS expects this trend of moderate increases in debt to continue in the short to medium term and the country’s debt to GDP ratio to remain in the 75% - 80% range over the next 2 to 3 years. Beyond this, should investments in the renewable energy industry prove successful, the resultant economic growth should outstrip the rate of increase of debt and moderate the country’s debt to GDP ratio.

**Chart 2: 3-Year Average Public Sector Debt/GDP (2011-2013)**



Source: CariCRIS' sovereign data

External debt represented 76.8% of total public debt in FY2013/14, up slightly from 72.5% in the prior year. This was largely comprised of loans issued on concessional terms from multilateral and bilateral lenders. Additionally, 67.4% of external debt was issued at fixed interest rates, thereby reducing interest rate volatility. Furthermore, approximately 42.2% of external debt is denominated in US\$ which minimizes currency risk due to the fixed exchange rate. Following the restructuring exercise in 2004, the GOCD self-imposed a 3% interest rate ceiling on externally borrowed funds in an effort to ease its debt service obligations. In FY2013/14, the ratio of interest expense to GDP remained flat at 1.9%, while the ratio of interest expense to total revenue increased marginally to 6.3% from 6.2% previously, well below the CariCRIS’ regional sample average of 11.6%.

### *Monetary and exchange rate stability underpinned by membership in a quasi-currency board arrangement*

As a member of the Eastern Caribbean Currency Union (ECCU) the minimum deposit rate of 3% is set by the Eastern Caribbean Central Bank (ECCB)<sup>2</sup>, while lending rates are market determined. This structure has served to promote a stable interest rate environment within the OECS. For the quarter ending March 2014, weighted average lending and deposit rates declined slightly to 8.9% and 2.9% respectively from 9% and 3% in the December 2013 quarter, resulting in a marginal increase in the net interest spread to 6% from 5.9%. Additionally, the longstanding currency peg<sup>3</sup> and monetary arrangement with the ECCB has aided in maintaining price stability, attracting foreign direct investments (FDIs) and facilitating real GDP growth. For the quarter ended March 2014, the rate of deflation averaged (0.8%), down from (0.1%) in the December 2013 quarter and well below the average inflation rate for the OECS of 0.1%. This was chiefly due to decreases in the Housing & Utilities (3.3%) and Clothing & Footwear (0.8%) sub-indices.

Dominica's financial market infrastructure and legislation is comparable to the rest of the region. Trading on the Eastern Caribbean Securities Exchange (ECSE) occurs daily. The Regional Governments Securities Market (RGSM), a regional market for the issuance of debt instruments of the member states of the ECCU, operates on a fully electronic platform. In FY2013/14, the GOCD issued 5 securities totalling EC \$95 million on this platform.

Asset quality in the financial system continued to deteriorate in 2013. The ratio of non-performing loans (NPLs) to total loans worsened to 13.9% from 12.7% in 2012; the fourth consecutive annual increase. This ratio continued to be above the ECCB's guideline of 5%, but lower than the ECCU average of 18.3% in 2013. Although provisioning coverage of NPLs improved to 29.1% in 2013, it remained well below the ECCU average of 38.5%. Notably, the capital adequacy ratio for the banking system in Dominica is no longer available; this is following the ECCB's decision to report the ratio on a consolidated basis for the entire ECCU sub-region.

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<sup>2</sup> Financial sector supervision is provided jointly by the Financial Services Unit (FSU), a division of the Ministry of Finance in Dominica, and the ECCB. The ECCB has responsibility for all banks in the OECS registered under the Banking Act, while offshore banks are regulated by the FSU.

<sup>3</sup> Fixed exchange rate of EC \$2.70 to US \$1.00, which has been in effect since July 1976

### *Stable political environment with good implementation of broad based social policies*

There is little variance in the economic philosophies of the major parties, as the common focus is on economic development, poverty reduction and education. The ruling Dominica Labour Party (DLP) is currently serving its third consecutive term in office having won 18 out of 21 seats in the December 2009 election. The party's majority in Parliament enables it to pass legislation requiring a simple majority and pursue its development objectives. Elections are constitutionally due in 2015. The economy continues to face significant challenges from high unemployment and poverty, estimated at 11.3% and 28.8%<sup>4</sup> respectively. As such, to reduce youth unemployment, the GOCD launched the National Employment Programme (NEP) in December 2013. Under this programme, temporary employment was provided to over 700 youths, above the target of 400 persons. Additionally, under the medium term Growth and Social Protection Strategy, the GOCD continues to implement policies aimed at skills training and capacity development.

Dominica has a low international perception of corruption based on the Transparency International Corruption Perception Index<sup>5</sup>. The country was ranked 41 out of 177 countries in 2013, which was the fourth highest rank in the Caribbean. Major crimes declined by 10.2% relative to a decline of 9.7% in the prior 12-month period. To date, there have been no negative travel advisories in the international tourist markets. Industrial relations have been generally cordial. There is the perception in society that trade unions are aligned to specific political parties, but not openly partisan.

### *Moderate though declining external sector performance*

Dominica realized a small overall balance of payments (BOP) deficit in 2013, the first in 4 years, estimated at EC \$17.5 million (1.2% of GDP); compared to the BOP surplus of EC \$15.9 million (1.1% of GDP) reported in 2012. The deterioration was attributable to a 47.4% fall in the financial and capital account surplus to EC \$131.4 million, largely due to declining international capital flows. Notably, in 2013, the external current account deficit narrowed by 21.7% to EC \$194.8 million or 13.9% of GDP from EC \$248.7 million or 17.8% of GDP previously. This was primarily driven by a 12.4% decrease in the trade deficit to EC \$214.4 million, stemming from a 4.9% contraction of the visible trade deficit, coupled with a 7.6% increase in the invisible trade surplus. The 3-year average current account deficit of 15% of GDP is less favourable than the regional sample average of 12.4%. To finance the overall deficit, imputed reserves declined 7% to EC \$230.5 million.

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<sup>4</sup> 2011 estimates

<sup>5</sup> The higher the ranking, the lower the perception of corruption

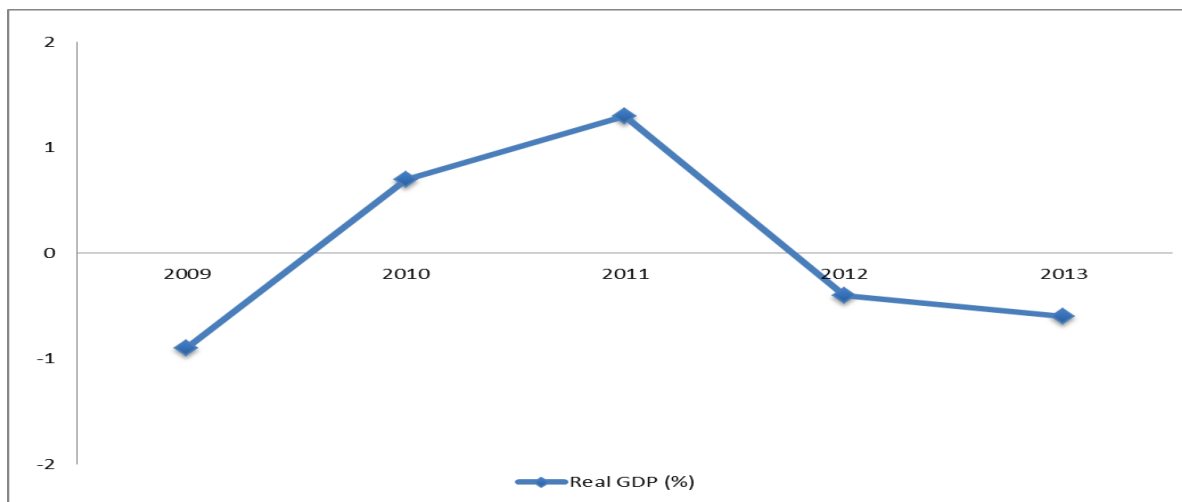
In 2013, net international reserves grew by 4.1% to US \$143.2 million from US \$137.6 million previously. Net reserves continue to be small relative to peers with import cover improving to 8.5 months from 7.9 months in the prior year.

These rating strengths are tempered by:

*Small, open economy with a relatively narrow economic base*

In 2013, nominal gross domestic product (GDP) stood at US \$516.7 million and GDP per capita at US \$7,176 making Dominica the third smallest economy in the OECS. Real GDP contracted by 0.6% relative to a decline of 0.4% in 2012. This was primarily due to downturns in construction (16%), transport, storage & communications (1.6%) and financial intermediation (7.2%), though the contraction was somewhat tempered by expansions in the agriculture and government services<sup>6</sup> sub-sectors of 2.2% and 1.9% respectively. Chart 3 below shows real GDP growth rates for the past 5 years.

**Chart 3: 5-Year Real GDP Growth**



Source: GOCD

The banana industry, the country's main export earner, continued to be plagued by the Black Sigatoka disease<sup>7</sup> during the year. Exports are estimated to have declined by 17.6%, generating revenue of EC \$4 million, down 25% from the prior year. As such, the GOCD pledged an additional EC \$3 million to fight the disease. Efforts to diversify the agriculture industry by the production of root and beverage<sup>8</sup> crops are still ongoing. This has led to the rehabilitation and

<sup>6</sup> Includes public administration, defense, social security, and health and social work

<sup>7</sup> Black Sigatoka was first detected in Dominica in July 2012. The disease causes significant reductions in leaf area, yield losses of 50% or more and premature ripening.

<sup>8</sup> Cocoa and coffee



cultivation of 150 acres of cocoa fields, as well as the distribution of 10,000 coffee plants to local farmers. Additionally, with the construction of the coffee processing plant and plans for the construction of a cocoa production facility, Dominica continues to make advances towards the further development of its agro-processing industry.

The country's geothermal energy project remains largely on track. This is anticipated to significantly reduce the island's dependency on imported fuel, reduce the cost of electricity generation and improve economic performance. Notably, between May 2013 and June 2014, 2 geothermal wells, a reinjection well and a production well were drilled and tested. Preliminary findings indicate that the production well has the capacity to generate approximately 11.4 megawatts (MW) of electricity, enough to meet the existing domestic base load. Upon completion, the projects would increase total generation capacity by 25MW compared to current estimated usage of 17.8MW. Excess electricity derived from the project will be sold to neighbouring countries, including Guadeloupe and Martinique. Barring any external shocks and natural disasters, CariCRIS expects marginal growth driven by increased investment in the geothermal energy industry, and higher production and exports from the agriculture industry.

### *Severe capacity constraints*

Dominica is faced with severe capacity constraints particularly in its human resources, similar to many small Caribbean islands. The island is one of the most sparsely populated in the OECS, with a population density of 96 per square kilometre (sq. km) as compared to its regional peers which average 258 per sq.km. The high rate of emigration of skilled labour due to the weak employment-generating capacity also impedes the island's ability to effectively execute its development projects. Additionally, inadequate road networks and rugged terrain present some challenges for the expansion of farmlands and the transportation of agricultural produce. However, recent infrastructural projects aimed at the improvement of feeder roads are expected to significantly improve the transportation system.

The absence of an international airport and lack of direct air access by major airlines to Dominica acts as a deterrent to increased tourism activity and international trade. Total visitor arrivals fell for the fourth consecutive year to 307,552 in 2013, down 11.4% from 347,247 in 2012, partially due to the decline in cruise ship calls by 16.1% during the year. This is somewhat tempered by the small contribution of tourism to Dominica's total output relative to its regional peers. Notably, in February 2014, the Windward Island Airways International (Winair) began offering 3 direct flights per week to Dominica from St. Maarten, which serves as a hub

connecting with the US, Europe, and South America. This is estimated to provide 15,000 additional seats per year and slightly improve access to the island.

## ECOMIC PERFORMANCE

### SELECTED ECONOMIC INDICATORS

	2013	2012	2011	2010	2009	Average 2013-11
<b>Income &amp; Economic Structure</b>						
Nominal GDP (US \$ Mn)	516.7	514.7	508.5	493.0	498.9	513.3
Nominal GDP Per Capita (US \$)	7,176.0	7,183.7	7,132.1	6,686.5	6,939.4	7,163.9
Real GDP Growth (%)	0.0	0.3	1.9	0.7	-0.8	0.8
Unemployment Rate (%)			14.0	14.0	14.0	14.0
Human Development Index	72/186	72/187	81/187	81/187	73/182	72/186
Transparency International Corruption Perception Country	41/177	41/176	44/178	44/178	34/180	41/176
	2013	2012	2011	2010	2009	Average 2013-11
<b>Fiscal Accounts (% of GDP)</b>						
Central Gov't Current Revenue	27.4	26.2	27.6	30.6	31.8	27.1
Central Gov't Current Expenditure	25.3	23.8	25.3	27.6	28.5	24.8
Central Gov't Current Balance	2.0	2.4	2.3	3.0	3.3	2.2
Central Gov't Capital Expenditure	2.2	12.6	13.6	13.7	15.6	9.5
Central Gov't Primary Balance (after grants)	(6.0)	(7.5)	(6.9)	(5.3)	(3.5)	(6.8)
Central Gov't Overall Balance (after grants)	0.0	(9.1)	(8.8)	(7.1)	(5.7)	(5.9)
Central Gov't Gross Debt	62.9	61.6	53.8	56.8	52.6	59.4
General Gov't Gross Debt	75.2	73.9	66.5	68.7	63.1	71.9
	2013	2012	2011	2010	2009	Average 2013-11
<b>Monetary, Financial &amp; Exchange Rate Indicators</b>						
Consumer Price (end of period)	(1.1)	2.0	2.0	0.2	3.0	1.0
Consumer Price (annual average)	(0.2)	1.4	1.3	2.9	0.0	0.9
Credit to the Private Sector & NFPE (% GDP)	59.7	63.3	61.1	56.8	51.3	61.4
Credit to the Private Sector & NFPE (YOY change %)	(0.8)	4.3	8.1	9.1	6.8	3.8
Non-Performing Loans/Total Loans (%)	13.9	12.7	9.2	8.7	5.5	11.9
Provision for NPL (% of NPL)	29.1	18.3	18.3	14.2	20.6	21.9
Banking Sector Capital Adequacy Ratio (%)	na	na	7.2	17.5	15.1	13.3
Base Money (YOY change)	2.2	16.6	17.9	8.2	14.5	12.2
Broad Money or Money Supply (YOY change %)	1.8	10.1	2.3	3.8	9.9	4.7
Average Bank Deposit Rate (%)	3.0	3.0	3.1	3.3	3.2	3.1
Average Bank Lending Rate (%)	9.0	9.0	8.8	8.9	10.0	8.9
Interest Rate Spread	5.9	6.0	5.6	5.7	6.8	5.9
Nominal Exchange Rates (lc per US\$)	2.7	2.7	2.7	2.7	2.7	2.7
Real Effective Exchange Rates (YOY change %)	(1.8)	(1.1)	(3.4)	(1.5)	2.9	(2.1)
	2013	2012	2011	2010	2009	Average 2013-11
<b>External Sector Indicators</b>						
Current Account Balance (% GDP)	(14.0)	(17.9)	(13.4)	(16.5)	(21.9)	(15.1)
Capital & Financial Account Balance (% GDP)	9.4	18.0	17.3	17.8	22.0	14.9
Overall External Balance (% GDP)	(1.3)	1.1	1.3	1.3	0.1	0.4
External Public Debt (% GDP)	44.3	42.8	41.1	45.1	36.4	42.8
Gross International Reserves (US\$ Mn)	181.0	176.3	128.6	126.0	144.3	162.0
Net International Reserves (US\$ Mn)	143.2	136.6	109.1	112.8	124.2	129.6
Gross International Reserves (in months of imports)	8.7	9	6	6	7	7.7
Debt Service (incl. STD) (% of exports of GNFS)	na	na	na	15.3	12.9	14.1
Debt Service (excl. STD) (% of exports of GNFS)	3.84	2.14	3.41	15.3	12.9	3.1
Total External Debt (% of exports of GNFS)	129.9	130.5	116.5	105.1	117.4	125.6
Gross Financing Requirements / Reserves (%)	42.5	36.59	59.17	67.58	74.30	46.1

na – not available

September 2014