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Research Update:

Grenada 'B-' Long-Term Rating Affirmed; Outlook Remains Stable

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Rationale

On May 21, 2008, Standard & Poor's Ratings Services affirmed its 'B-' long-term and 'C' short-term sovereign credit ratings on Grenada. The outlook remains stable.

The ratings are supported by the robust economic growth expected over the next several years and Grenada's membership in the Eastern Caribbean Currency Union. The ratings remain constrained by the minimal and uneven progress in reducing the large size of the government debt because of lax fiscal discipline. In addition, the weak strategic planning and political will to address Grenada's pressing fiscal and structural issues are a significant credit weakness.

Grenada is recovering from Hurricane Ivan's 2004 devastation. Reform momentum to restore fiscal sustainability has been uneven since the 2005 debt restructuring. Specifically, fiscal performance has been disappointing in the past two years. The central government deficit was 6.7% of GDP in 2006 (compared with the budgeted target of 3.1% of GDP), followed by even wider deficit of 7.5% of GDP in 2007 (budgeted target of 2.7% of GDP). Fiscal setbacks reflect the significant underperformance of grants (only 18% of the budgeted amount was received in 2007), which was not compensated for by lower spending. The delayed reform of tax concessions, a twice-postponed introduction of a VAT, and hard-to-contain spending pressures have impaired Grenada's fiscal performance and--if not addressed in a timely manner--will negatively affect the 2008 fiscal outcome. Standard & Poor's conservatively projects a central government fiscal deficit of 6.2% of GDP for 2008 (4.1% of GDP on general government level, including social security surpluses) compared with the announced budget target of 4.6% of GDP, reflecting continuous underperformance of grants and pre-election spending pressures.

As a result of this worse-than-expected fiscal performance, Grenada's progress in reducing the large government debt has been minimal and uneven. Government debt (the fourth-largest among speculative-grade-rated countries) rose to 113% of GDP in 2006 from 107% just a year ago and came down to 108% in 2007. The expectation of the future declining debt trajectory--to a forecasted 96% of GDP by 2010--reflects both successful (albeit gradual) fiscal consolidation efforts and a strong-performing economy.

The rebound of the real economy is the bright side of Grenada's credit story. Though uneven, Grenada's real GDP growth has averaged 4.3% during the past three years (since Hurricane Ivan hit the island in 2004). Real GDP growth of 4.3% in 2007 reflects continuing gains in tourism (increases of 9% in stay overs, 3% in total arrivals, and 30% in visitors' expenditures), transportation, electricity, water, and manufacturing. We expect that economic growth will hover at about 3.5% of GDP in the next few years, reflecting ongoing large tourism developments, further pickup in agriculture, and

expansion in electricity and water (reflecting demand from new residential and hotel constructions) counterbalanced by uncertain global environment.

Political dynamics center on the upcoming general elections (officially due by November 2008). A close race is expected between the ruling New National Party (NNP), which has just a single-seat majority in Parliament, and the strong opposition. The preelection period will likely hurt fiscal performance, but it could benefit investment and economic growth, as the NNP will try to increase infrastructure spending and move ahead with other major investments.

The ratings remain constrained by the lack of a determined fiscal effort to sustainably reduce the large government debt as well as a poor strategic planning and weak political will, in general, to address pressing fiscal and structural issues. Without resolute fiscal consolidation, the positive momentum brought about by the 2005 debt restructuring will be lost, and much-needed domestic and foreign investment will be undermined. In fact, the disbursements under the International Monetary Fund's Poverty Reduction and Growth Facility, though now being reconsidered by the fund, have been on hold since 2006 because of the lack of fiscal discipline.

Given the crucial importance of keeping debt dynamics under control to avoid new arrears and future debt-default pressures, Standard & Poor's expects the authorities to adhere to fiscally responsible policies and embark on a more resolute and proactive policy stance. This would support stronger business and investor confidence that is so crucial for bolstering the country's economic growth.

Outlook

The stable outlook balances out the risk of continuing fiscal underperformance with a relatively favorable amortization profile on Grenada's debt. Downward rating pressure would stem from the government's inability to keep deficits under control, which would make resolute debt reduction difficult and, hence, increase the risk of new debt renegotiations.

Ratings List

Ratings Affirmed

Grenada

Sovereign Credit Rating	B-/Stable/C
Senior Unsecured	
Local Currency	B-
Recovery Rating	3
Transfer & Convertibility Assessment	
Local Currency	BBB-

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