

BAHAMAS

1. General trends

The Bahamian economy registered a modest recovery in 2010 with growth of 0.9% following a 5.4% decline in 2009. The economy benefited from a rebound in tourism triggered by the upturn in the United States, its major market. This rebound, together with buoyant activity in offshore financial services, helped to compensate for the weaker performance of the construction sector. Inflation declined as food and clothing prices fell. There are no official data, but employment, especially in tourism, was expected to pick up with the more buoyant economic activity. The fiscal situation deteriorated in fiscal year 2009/2010 as revenues declined more sharply than expenditure, but there was an improvement in 2010/2011. Meanwhile, the balance-of-payments current account deficit contracted moderately to 9.9% of GDP, as higher tourism receipts outweighed the increase in the trade deficit.

The economy is expected to continue recovering in 2011, with growth rising to 1.3%, propelled by continued improvement in tourism and in construction linked to foreign direct investment (FDI). Work on the Baha Mar Resort Complex, the largest tourism project in the history of the Bahamas, started in February. In the first year after completion, Baha Mar is expected to lead to \$1 billion of spending, create 6,500-7,000 permanent jobs and attract 430,000 stopover visitors (a 30% increase). Inflation is expected to rise due to higher fuel prices. The fiscal deficit is projected to increase marginally and the balance-of-payments current account will widen as a result of higher oil prices and import payments relating to major projects.

2. Economic policy

(a) Fiscal policy

In its 2010/2011 budget, the government projected a deficit of B\$ 227 million, equivalent to 3% of GDP. However, growth in revenue outstripped the increase in expenditure, leading to a fall in the deficit by an estimated B\$ 130 million (1.7% of GDP). Total revenue, underpinned by B\$ 210 million in receipts from the sale of the government's 51% holding in the Bahamas Telecommunications Company (BTC), was estimated to exceed the budgeted amount by 10%. Stamp tax proceeds were also bolstered by inflows from the sale of part of the stake in the Bahamas Oil Refining Co. (BORCO) to Buckeye Partners of the United States. In addition, business and professional fees also advanced owing to higher proceeds from international business companies.

Total expenditure exceeded the budget by 3.1% to stand at B\$ 1.88 billion. Recurrent spending increased partly due to the government's contribution to the BTC Feeder Trust for pension benefit entitlements for employees and a B\$ 25 million outlay for the government's new job readiness and training programme. Meanwhile, capital expenditure was 12.5% below the budgeted amount, reflecting the slow pace of implementation of some projects and the decision not to proceed with the purchase of a property. In June 2011, government debt was estimated at B\$ 3.5 billion, the equivalent of 45% of GDP. The debt of the Bahamas remains significantly below the average for the countries of CARICOM. Nevertheless, the government is concerned about the speed at which it is widening and has targeted medium-term debt consolidation.

By contrast, fiscal performance during fiscal year¹ 2009/2010 showed a decline in government revenue that just exceeded the fall in expenditure. As a result, the overall deficit edged up from 3.1% of GDP in 2008/2009 to 3.2% of GDP in 2009/2010. Total revenues fell by 1.6% to B\$ 1.303 billion, roughly 7% below the budget target as tax receipts decreased due to lacklustre domestic demand.

Total expenditure declined by 0.6% to B\$ 1.553 billion, reflecting lower current spending as the government moved to contain its consumption. This decline offset higher capital spending on the airport, harbour and other projects.

For fiscal year 2011/2012, the government forecasts a fiscal deficit of 3.0% of GDP, generated by higher capital spending as recurrent expenditure is expected to remain stable. Public debt is projected to increase by around 7% to B\$ 3.779 billion (46.2% of GDP).

(b) Monetary and exchange-rate policy

The monetary policy stance remained unchanged in 2010. External reserves were boosted by one-off foreign-exchange inflows aimed at capitalizing the local subsidiary of a foreign bank. Furthermore, there was no real threat of a loss of reserves through imports as consumer spending remained cautious. As a result, there was no pressure on the foreign-exchange peg. In this context, the central bank's policy discount rate remained at 5.25%, the commercial banks' prime lending rate was maintained at 5.5% and reserve requirements remained unchanged.

Credit grew by 5.2% in 2010, compared with 1.5% in 2009. Nevertheless, this growth was driven by public-sector demand for infrastructure projects, as credit to the private sector declined marginally, owing to flagging investor confidence. Tourism and construction registered average net repayments of B\$ 61.5 million and B\$ 11.6 million, respectively. Consumer credit declined for a number of categories except debt consolidation loans, as households attempted to put their finances in order.

Underpinned by the fledgling recovery, the broad money supply grew by 2.6% in 2010. Growth in savings deposits improved with the increase in incomes and employment in tourism, while time deposits maintained a similar rate of growth to 2009.

With consumer demand at a low ebb and foreign currency inflows steady (including the one-off transaction to capitalize a local bank), liquidity in the banking system strengthened in 2010. This led to a build-up of external reserves that far surpassed the previous years' level. The commercial banks' weighted average interest rate spread widened by 82 basis points to 7.61 percentage points despite high levels of liquidity, as banks discriminated in their lending owing to high levels of non-performing loans.

In 2010, commercial banks continued to face credit quality challenges associated with weak labour market conditions and poor business performance. Nevertheless, the rate of deterioration in loan quality slowed. Private-sector loans at least 30 days in arrears rose by 5.2%, compared with an increase of 42.4% in 2009. Moreover, banks remained profitable and liquid, although net income was down by 2.3%, owing to higher loan loss provisions and a fall in interest income. The exchange rate remained stable in 2010, with B\$ 1.00 equal to US\$ 1.00.

¹ The fiscal year in the Bahamas runs from July 1 to June 30.

3. The main variables

(a) Economic activity

Bolstered by the recovery in the United States, the Bahamian economy grew by 0.9% in 2010, compared with a contraction of 5.4% in 2009. Real output in tourism expanded by 4.7% after the slump of 2009 and this expansion had a positive effect on distribution and other sectors. Total visitor arrivals rose by 13% to 5.2 million, spurred by marketing initiatives such as the 'Companion flies free' programme. Value added in the sector was boosted mainly by a 3.1% increase in high spending stay-over visitors in 2010, reversing the 10% decline in 2009. In addition, a 10% rise in the number of port calls led to a further increase in cruise passenger arrivals in 2010.

Value added in the construction sector plummeted (-23.5%) in 2010, mitigating the improvement in tourism. The sharp fall in construction reflected a downturn in foreign investment-funded projects and domestic private investment as investors wait for the global and local recovery to strengthen. Underscoring the softness in the market, total loan disbursements for new construction and repairs fell by 37%, while mortgage commitments, an indicator of future activity, declined in number by over 10%. Indicators suggest that activity in the offshore financial services sector remained stable in 2010. Despite the nascent recovery in major markets, investor sentiment towards the sector remained weak, as a number of institutions undertook debt consolidation.

The growth momentum gained in 2010 will be maintained in 2011, with the economy expected to grow by 1.3%. Activity will be driven by increased stopover tourist arrivals, underpinned by stronger demand in major markets. Construction activity is also expected to pick up with outlays on foreign-funded tourism and other projects, including the Baha Mar project, which is set to almost double the room capacity on New Providence Island. Public construction will also strengthen with spending on the airport project and road infrastructure. Activity in the offshore financial services sector is also expected to improve following the firming of recovery in major markets.

(b) Prices, wages and employment

Although domestic demand rallied and international fuel prices continued to strengthen, the rate of inflation fell marginally from 1.59% in 2009 to 1.52% in 2010. The main contributors to the decline in inflation were the heavily weighted food and beverage subsector, clothing and footwear, and miscellaneous goods and services. On the other hand, the cost of housing, water, electricity, gas and other fuels increased by 3.4% and transport by 3.7%, propelled in part by the hike in international fuel prices. Wage growth was contained in 2010 as salary increments for public officers were not paid and public employment was frozen in an effort to contain costs. Employment was expected to pick up in tourism and related segments of distribution as a result of the improvement in the tourism sector. Employment in construction and other sectors is expected to pick up in 2011, as work continues on the Baha Mar project.

(c) The external sector

In 2010, the balance-of-payments current account deficit contracted marginally relative to GDP. The deficit declined in nominal terms by US\$ 94 million, while it narrowed by over 1 percentage point in relation to GDP (from 11% to 9.9%). The trade deficit contracted by 20.6%, a continuation of recent trends. This contraction was due to an improvement in the services account associated with higher tourism receipts in keeping with the recovery in the sector. Imports were down by (2.9%), reflecting reduced demand due to delays in construction projects.

In a significant turnaround from the 5.4% decline in 2009, the services account surplus expanded by 5.5% to stand at US\$ 1.138 billion. Services inflows increased in line with a rise in net tourism receipts. Lower net transportation outflows, partly linked to higher port fees and reduced outflows for government services also contributed to the surplus, while the limiting factors were increased net payments for insurance services and reduced net receipts due to offshore companies' local expenses.

Increased interest and profit repatriations by domestic companies, together with workers' remittance payments, caused the income account deficit to widen by 28% (US\$ 55.2 million).

The capital and financial account surplus contracted by almost 19% to US\$ 931.2 million. The erosion of the surplus resulted from a sharp decline in public-sector inflows, which offset higher private-sector loan inflows and a recovery in FDI inflows. In 2009, public-sector inflows had benefited from a US\$ 300 million bond issue and a substantial special drawing rights (SDR) allocation under the International Monetary Fund's global initiative, but, since these extraordinary inflows were not repeated in 2010, public inflows contracted sharply. By contrast, other private-loan financing produced a net inflow of US\$ 115.4 million in 2010, following net outflows in 2009. Net FDI inflows were up by 31.1% to US\$ 870.6 million, a substantial turnaround from the sharp decline in 2009. Nevertheless, FDI was driven by inflows for the Baha Mar project and the one-off transaction involving a foreign entity's capitalization of a domestic bank. Indeed, land purchases were down, reflecting a sluggish second home market.

The balance-of-payments current account deficit is projected to widen to 15% of GDP in 2011. The trade deficit is expected to expand owing to the hike in oil prices and higher non-oil imports of materials and equipment for major FDI projects, including the Baha Mar project. This expansion would only be partly offset by an improved services account, based on the continued recovery in tourism. Meanwhile, the capital and financial account surplus is forecast to expand in line with higher FDI inflows into tourism and, to a lesser extent, construction. Between April 2010 and April 2011, external reserves expanded by 32.7% to stand at B\$ 1.134 billion.