

BAHAMAS

1. General trends

Reflecting the pervasive impact of the pandemic and the carryover effects of Hurricane Dorian, the Bahamian economy contracted by 14.5% in 2020, reversing growth of 0.7% in 2019. The decline was mainly driven by a sharp decline in tourism value added, on account of border closures and other measures to contain the spread of coronavirus disease (COVID-19). Limited offset was provided by construction activity, driven by tourism projects receiving foreign direct investment (FDI) and reconstruction following Hurricane Dorian in 2019. Inflation was dampened by lower international fuel prices and transport and communication costs. Unemployment picked up, owing to sharp fall in tourism activity and knock-on effects on transportation, distribution and other sectors.

The pandemic necessitated unplanned spending on health services and to reduce the impact on poor households and small businesses. This, combined with plummeting revenue inflows, led to an expansion in the fiscal deficit from 1.6% of GDP in the 2018/19 fiscal year to 6.4% of GDP in 2019/2020. Similarly, the external position worsened, with the balance of payments current account showing a deficit of 18.1% of GDP in 2020, from a surplus of 4.0% of GDP in 2019. The reversal was influenced mainly by a shift in the services account from a surplus to a deficit, owing to a sharp fall in net travel receipts owing to the pandemic. This was only partly offset by an improved capital and financial account on account of a surge in debt inflows, partly to fund reconstruction after Hurricane Dorian.

Despite the continued impact of the pandemic, growth of 2.3% is projected in 2021. The turnaround from the previous decline is expected to stem from a recovery in tourism, with the rollout of vaccines and a return to overseas travel from major markets. This will be buttressed by FDI-related tourism construction projects and continued post-hurricane reconstruction activity. The rate of unemployment is expected to remain high, as job gains in construction are offset by losses in tourism. Inflation is expected to pick up slightly due to higher international fuel prices. The fiscal situation is expected to remain challenging, with high deficits as the Government maintains spending on social welfare to deal with the fallout from the pandemic and post-hurricane reconstruction, in the wake of dampened revenues. Monetary developments will be marked by high banking sector liquidity, as banks remain prudent in the wake of economic uncertainty. The external position is expected to improve, as a modest recovery in tourism bolsters the services account and external reserves are expected to cover more than the three-month benchmark of imports.

2. Economic policy

(a) Fiscal policy

COVID-19 and post-hurricane reconstruction necessitated expansionary fiscal policy in 2020. The fiscal deficit widened from 1.8% of GDP in the 2018/19 fiscal year to 6.8% of GDP in 2019/20. This outturn stemmed from a sharp spike in spending alongside a fall in government revenue. Total expenditure increased by 8.2% to 2.505 billion Bahamian dollars (B\$). Higher spending was driven mainly by a 64.8% expansion in capital expenditure to B\$ 368.8 million, reflecting capital transfers for post-hurricane reconstruction and the acquisition of fixed assets. Growth in current spending was more modest at 3.0%, linked to higher allocations for wages and salaries and subsidies. The growth in outlays on subsidies partly reflected spending to cushion the impact of COVID-19 on households and businesses. Increased borrowing

in the previous and current year led to a 3.2% increase in debt interest payments to B\$ 339.1 million. Public sector debt expanded by 21.8% to B\$ 9.418 billion, rising from 72.6% of GDP to 87.7% of GDP, owing in part to the sharp decline in GDP in 2020. As a result, the Government's debt consolidation programme has been put on hold to cope with the pandemic and hurricane reconstruction.

During first six months of the 2020/21 fiscal year, the worsening effects of the pandemic led to expansion in the fiscal deficit from B\$ 194.1 million to B\$ 736.1 million. A large decline in revenues was reinforced by increased spending on health, social relief and post-Hurricane Dorian reconstruction. Revenue contracted by B\$ 430.0 million to B\$ 671.4 million, reflecting lower tax and non-tax proceeds due to the dampening impact of the pandemic. Meanwhile, expenditure rose by B\$ 111.9 million to B\$ 1.408 billion, propelled by higher spending on health, social welfare and subsidies.

(b) Monetary and exchange-rate policy

Monetary policy remained neutral in 2019, with the Central Bank of The Bahamas holding its policy discount rate steady at 4.0%. The highlight of monetary developments in 2020 was a marked build-up of banking sector liquidity and external resources, which were bolstered by external borrowing by the Government. Banking sector excess liquid assets surged by 18.5% compared with 2019.

The broad money supply increased by 2.7% to B\$ 597.8 million. Savings deposits expanded by 9.2%, slower than the previous year's 14.7%. There was a further extension of the decline in time deposits from 5.2% in 2019 to 7.4% in 2020. Domestic credit reversed from a small increase of 0.4% in 2019 to a decline of 4.0% in 2020. The Government's borrowing from the domestic banking sector contracted, as it used external borrowing to reduce local debt. Credit to the private sector declined by 2.3%, owing to banks adopting a conservative approach to lending amidst the slowdown caused by the pandemic. Credit to the personal sector, which represents over 72% of the total, fell by 1.4%, while credit to the construction sector posted a modest gain.

The weighted average interest rate spread narrowed by 5 basis points, to 9.89%. The loan rate declined by 7 basis points to 10.39%, while the deposit rate fell by 12 basis points to 0.45%.

(c) Other policies

The new Progressive Liberal Party government is focused on economic adjustment and change to bounce back better after the pandemic. To provide short-term relief and a boost to the economy, the Government plans to reduce value added tax (VAT) by two percentage points to 10% and raise the minimum wage to B\$ 250 per week. The government also plans to increase revenue collections, particularly from property taxes and through carbon credit payments for use of natural resources. The Government also plans to invest B\$ 50 million to fund entrepreneurship activities to help revitalize the economy.

3. The main variables

(a) The external sector

The external position worsened significantly in 2020. The balance of payments current account reversed from a surplus of 4.0% of GDP to a deficit of 18.1% of GDP. The merchandise deficit narrowed from 18.3% of GDP in 2019 to 16.0% of GDP in 2020, on account of a 37% fall in imports payments, which outweighed the decline in exports in absolute terms. Reduced imports payments were influenced by lower international fuel prices on account of sluggish global demand during the pandemic and lower outlays on non-oil imports.

The services account turned around from a surplus of US\$ 2.63 billion in 2019 to a deficit of US\$ 94.4 million in 2020. This major reversal stemmed from a 76.5% contraction in net travel receipts to US\$ 891.6 million, associated with the near collapse of tourism arrivals and spending during the pandemic. This was aggravated by higher net payments for government services.

The deficit on the income account declined by 10.7% to US\$ 488.5 million in 2020, mainly linked to an 18.7% fall in investment-related outflows, especially private sector interest and dividend payments. Net current transfers normalized, following substantial inflows of US\$ 846.3 million in 2019, owing to significant re-insurance claims after Hurricane Dorian.

The capital and financial account surplus expanded substantially from 3.6% of GDP to 24.4% of GDP. This mainly reflected government external borrowings of US\$ 1.294 billion in 2020, a major reversal from net payments of US\$ 44.6 million in 2019. Similarly, the banking sector's short-term transactions turned from net liabilities of US\$ 158.6 million in 2019 to net receipts of US\$ 272.9 million in 2020. Net FDI increased by 35.8% to US\$ 359.3 million. Burgeoning net equity receipts of US\$ 252.4 million more than offset the US\$ 66.9 million decline in real estate sales. International reserves increased by US\$ 624.1 million to US\$ 2.382 billion, covering 43.7 weeks of merchandise imports, up from 27.7 weeks in 2019.

(b) Economic activity

After marginal growth of 0.7% in 2019, GDP contracted by 14.5% in 2020, associated with the severe effects of the pandemic on activity. Tourism value added plunged by 38.2% in 2020, following growth of 5.0% in 2019, reflecting the collapse of demand during the pandemic. Following growth of 9.5% to 7.2 million visitors in 2019, arrivals contracted by 75.2% to 1.8 million in 2020. Air arrivals, which include the high value added stopover segment, declined by 74.8% to 418,329, following a 6.7% increase in 2019 to 1.7 million. Performance indicators in the sector deteriorated sharply in 2020. Occupancy rates for hotel-comparable properties fell by 12.2% and the average daily rate (ADR) declined by 1.0% to US\$ 152.88.

Construction value added contracted by 35.1%, owing in part to reduced bank lending for residential and commercial properties. Mortgage disbursements declined by 26.7% (B\$ 32.5 million) in 2020, adding to the reduction in 2019. Further, the outlook for construction remains subpar, with mortgage commitments for new construction and repairs falling by 15.1% to 400 loans, valued at B\$ 83.4 million, 3.9% lower than before.

With the wider rollout of vaccines and some containment of the pandemic, growth is projected to pick up to 2.3% in 2021. Growth is expected to be bolstered by a modest recovery in tourism, with the return of visitors from major markets. In addition, construction activity is expected to improve as an increase in domestic construction supports tourism-related FDI construction activities.

(c) Prices, wages and employment

Inflation fell slightly from 1.4% in 2019 to 1.2% in 2020, largely owing to lower international fuel prices. This had a favourable impact on transport and communication costs, which declined by 7.8% and 12.7%, respectively. By contrast, the costs of food and non-alcoholic beverages increased by 4.2%, after falling by 1.1% in 2019. The rate of unemployment rose significantly during the year, particularly in the tourism and commerce sectors.