BARBADOS

1. General trends

Barbados seems to be slowly recovering from the negative impacts of the recent global financial crisis. According to estimates released by the Central Bank of Barbados, the economy picked up in 2010, with 0.3% real GDP growth, after two years of negative economic performance. Tourism was the main contributor to this upturn, with value added growing by 3%, and this sector now accounts for 14.7% of GDP. Although the fiscal deficit remained high by historical standards, there was a slight improvement as it measured 7.8% of GDP. The government remains concerned about the public debt stock, which reached 102% of GDP in 2010, and fiscal consolidation remains a top government priority. Growth in tourism will remain vital to the economy, but the sector's performance is expected to be modest with revenue below the pre-crisis levels. Nevertheless, supported by a recovery in the financial services sector and increased private capital flows to fund a number of projects, the Barbados economy is projected to grow by 2% in 2011.

2. Economic policy

(a) Fiscal policy

During 2010, the government sought to exercise some fiscal discipline while at the same time adopting measures to protect the most vulnerable. Additional measures were introduced to maintain tourism competitiveness (such as marketing efforts and incentives directed at the United Kingdom stopover tourist market). Preliminary estimates from the Central Bank of Barbados suggest a small improvement in public finances in the 2010/2011 (April-March) fiscal year. The fiscal deficit to GDP is estimated to have narrowed to 7.8%, compared with 9.4% a year earlier. Tax revenues rose by 4% in nominal terms, as a result of higher tax rates introduced during the fiscal year. These included a higher rate of value added tax (VAT) (from 15% to 17%), collections of which grew by 13%. There was also a 50% increase in excise taxes on gasoline and the removal of some allowances. Personal income tax revenue rose by just 2%, while corporate tax revenue declined by 11% year-on-year.

On the expenditure side, capital expenditure contracted by 34% year on year as the government reduced outlays on major projects as part of its fiscal consolidation plan. Wages and salaries were 3% lower than the year before and expenditure on goods and services fell by 13%. However, these reductions were partly offset by higher spending on pensions and transfers (which were up by 6%) as well as grants to public corporations, in particular the University of the West Indies. Interest payments also increased by 10% year on year as the government debt continued to grow. As in the previous year, the fiscal deficit was funded mainly from domestic sources, particularly the national insurance scheme and private non-bank entities. Foreign inflows, principally from the capital market and policy loans, provided the balance of funding. Public-sector external debt and domestic debt both increased by 12% year on year. Total debt therefore surged to 102% of GDP at the end of 2010, and increased further to 105% of GDP by the end of March 2011, from 96.5% of GDP at the end of 2009. Fiscal consolidation is expected to continue in 2011, and the deficit is projected at 4% in 2011.

(b) Monetary and exchange-rate policy

The exchange rate of Barbados remained fixed (at BDS$ 2: US$ 1 since the 1990s) and the central bank's priority is to continue to support the exchange rate by ensuring that international reserves are adequate. At the end of 2010, the level of reserves reached US$ 833.5 million. Monetary policy also sought to manage liquidity and credit. This was designed to ensure that sufficient resources were available for economic growth to be achieved. Thus, domestic interest rates were lowered in order to stimulate aggregate credit growth. The average rate on domestic 3-month treasury bills fell by 0.09 percentage points to 3.35% in December 2010, compared with an average of 3.8% at the end of 2009. The commercial bank lending rate declined from 8.87% to 8.70%, reducing the spread between deposit and lending rates by up to 6.1 percentage points in December. Although interest rates fell, there was little improvement in credit demand due to the lacklustre economic performance. Total domestic credit declined from 90.9% of GDP in 2009 to 83.4% of GDP at the end of 2010. Private-sector credit decreased to 68% of GDP from 72% of GDP, while credit to the public sector diminished from 18.8% of GDP in 2009 to 15.2% of GDP at the end of 2010. Given the weak credit demand, liquidity (M3) fell from 109% of GDP to 103% of GDP. The monetary aggregates decreased during the year. M1 shrank by BDS$ 179 million while M3 contracted by BDS$ 20 million, a reflection of the weak economic conditions which prevailed in Barbados.

Nevertheless, Barbados's financial system remains broadly sound and stable. At the end of 2010, the capital adequacy ratio for the banking system was well above 18%, which was above the regulatory minimum of 8%. Banks remained liquid with the liquid asset ratio measuring 17% in 2010, up from 16% a year earlier. This occurred as a result of weak credit demand. However, asset quality deteriorated and non-performing loans increased to 10% in 2010 from 4.3% in 2009. The problem assets seem to be concentrated in one financial institution and relate mainly to large commercial loans, for the most part in the tourism sector. Loan loss provisions remain low at 15% of non-performing loans and 1.5% of total loans. This is adequate by regional and international standards.

In terms of policy, supervision and regulation in the banking sector remain solid. The Financial System Stability Assessment Update recently concluded by the International Monetary Fund (IMF) found that while the financial system remains broadly resilient, several reforms are still needed to increase its flexibility and stability. These include establishing a clear legal framework for the consolidated supervision of banking groups; updating the regulations on capital adequacy, asset classification and loan-loss provisioning; and ensuring that the mandate and structure of the financial services commission are adequate for the effective supervision of the non-bank financial sector.

3. The main variables

(a) Economic activity

Following two years of negative growth, the downward trend appears to have bottomed out and the Barbados economy grew by a modest 0.3% in 2010. However, business confidence still remained low. The overall positive performance was largely due to a 2.6% rally in long-stay tourist arrivals. The number of tourist arrivals from the United States of America and Canada increased by 17% and 13%, respectively, while British tourist arrivals remained weak (down by 6%). Overall, tourism grew by 2.9% in 2010 and contributed 12.7% to GDP. Marketing efforts and a number of events including the International Cricket Council's third Twenty-Twenty World Tournament helped to attract tourists to the island during the year, but these are one off events and will not be repeated in subsequent years. The tourism sector is expected to record 3% growth in 2011, supported by large investments such as the Four Seasons Hotel and increased arrivals in the winter season.

The international business and financial sector also contracted for a second year, but by less than in 2009. For the first nine months of 2010, the number of new licenses issued to companies operating in the sector was 8% below the number issued for the corresponding period of 2009. The number of registered offshore banks declined by 6% during the year and total assets fell by 12%. The offshore sector has significant growth potential and stands to benefit from the new double-taxation treaties pursued with Latin American countries. Barbados also remains attractive to offshore companies as a result of the "white list" drawn up by the Organization for Economic Cooperation and Development, which has enhanced the country's reputation. Barbados's inclusion on this list means that it is recognized as a jurisdiction that has substantially implemented the internationally agreed tax standard. Barbados was one of only seven international business centres to be included on the "white list", out of 40 countries.

Meanwhile, the agriculture sector declined by 4.5% and chemicals production declined by 8.3%. The construction sector, a major driver of growth and an important vehicle for job creation, contracted by 10.8% in 2010, as projects were postponed or cancelled. However, mining and quarrying showed improvements. Quarrying increased by 14% and crude oil production rose by 7%. Output in distribution and retail service industries remained stagnant, owing to the slow pace of economic growth occasioned by weak demand in the economy.

In the future, growth will be spurred by the international business sector, which should benefit from the general revival in global activity, and by the signing of new tax treaties. Private capital inflows are also expected to pick up and to fund projects such as the Four Seasons Hotel and Port Ferdinand. These projects should boost activity in the traded sectors, particularly wholesale and retail trade, and construction, and contribute to growth, which is forecast to stand at 2% in 2011.

(b) Prices, wages and employment

The end-of-year inflation rate was 5.8% in 2010, compared with 3.6% in 2009. Factors contributing to the inflation rate were international oil and commodity prices, and the fiscal measures announced in the 2010/2011 (April-March) budget, which pushed up the cost of food, housing and transportation. Wage rates remained largely unchanged in 2010 as the government extended a public-sector wage freeze, which was also observed by the private sector in the economy.

Meanwhile, according to the central bank's projections, the country's unemployment rate should not rise any further in 2011. Although the economy has levelled off, the continued under-performance of North Atlantic economies (United States, Canada and United Kingdom) has put a damper on tourism and international business and financial services, and the knock-on effects depressed cash flows throughout the economy. As a result, unemployment increased to 11.2% in the third quarter of 2010, which was 0.7 percentage points higher than a year earlier. Two years of economic contraction have made it difficult for private firms to avoid layoffs notwithstanding the Interest Waiver Programme which the government introduced to assist employers with the management of their national insurance contributions. With the upturn in economic activity, the unemployment rate should remain stable in 2011 and prices are expected to moderate, that is, barring any unforeseen increases in international oil and commodity prices.

(c) The external sector

Barbados's external accounts reflect the country's dependence on tourism and commodity imports and its open economy. Consequently, the current account deficit widened to 8.9% of GDP in 2010, reflecting higher oil imports and only a marginal increase in tourism receipts. Tourism imports (mostly oil-related), which account for more than 50% of total current account payments, rose by 8%, while travel receipts (48% of current account receipts) fell by 1.4%. Given the trend in commodity prices, the current account deficit is expected to stay at elevated levels, the forecast for 2011 being 9.3% of GDP because of the impact of higher global commodity prices on the import bill. Foreign direct investment inflows were recorded at US$ 150 million in 2010, up from US$ 79 million in 2009, and consisted primarily of real estate sales, financing for several tourist projects and funding for a major manufacturing project. Official inflows included a loan of US$ 90 million from the Inter-American Development Bank to support alternative energy production and a loan of US$ 50 million from the Caribbean Development Bank to support the government's development programme. Additionally, the government floated a US$ 200 million bond issue in August, part of which was used to repay maturing debt obligations. At the end of the year, gross international reserves stood at US$ 833.5 million or 7.2 months of imports.