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## Bahamas

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### 1. General trends

After posting modest growth of 2.3% in 2002, the Bahamian economy stalled in 2003 (0.2%), despite an expansion in tourism. This was due to the poor performance of the construction sector and reduced financial activity as a result of new legal restrictions established to bring national regulations into line with international standards.

The economic slowdown had a negative effect on tax receipts. Despite attempts to increase the tax burden through measures to enhance the efficiency of tax administration, the government authorities were unable to consolidate their fiscal position and the central government deficit remained at a level similar to the one observed in 2002 (3% of GDP). This situation was attributable to the high level of public spending, mostly on external debt servicing. The deficit and the issuance of a bond on international capital markets drove up the external public debt stock.

The commercial banking system's international reserves and liquidity increased. This enabled the authorities to maintain a tight monetary policy stance.

Accordingly, the central bank did not change the reserve requirement on deposits (50%) or the ceiling it had imposed on the growth of private bank credit after the events of 11 September 2001.

The foreign-exchange inflows generated by the above-mentioned bond issue served to improve the balance on the capital and financial account of the balance of payments and to finance the current account deficit.

For 2004, the upturn in tourism activity in the first quarter and the beginning of construction work in connection with phase III of the Kerzner project are expected to have a positive effect on economic growth. Inflation, which is determined by external factors, will probably remain close to its 2003 level.

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### 2. Economic policy

#### (a) Fiscal policy

The government is unlikely to meet its fiscal targets, which include the reduction, to 2.2%, of the deficit of 3.6% of GDP recorded in fiscal year 2002. In fact, the

deficit is expected to be even bigger than the one posted that year. In the first eight months of fiscal year 2003, the deficit (B\$ 97.2 million) was double the preceding fiscal year's figure (B\$ 47.3 million). This suggests that the government's strategy of avoiding the imposition of

Table 1  
**BAHAMAS: MAIN ECONOMIC INDICATORS**

	1995	1996	1997	1998	1999	2000	2001	2002	2003 <sup>a</sup>
<b>Annual growth rates</b>									
<b>Real sector indicators</b>									
Tourist arrivals	-6.0	5.5	1.1	-3.1	9.0	15.2	-0.5	5.2	4.4
Value of building starts	-32.0	51.1	154.4	-64.3	-0.6	19.0	-8.0	55.0	-59.0
Value of building completions	-12.7	42.5	9.2	187.9	-7.4	-34.2	8.0	-5.9	-57.0
Electricity generation (mwh)	2.2	2.9	5.7	8.6	5.1	6.9	3.9	5.6	...
<b>Millions of dollars</b>									
<b>Balance of payments</b>									
Current account balance	-146	-263	-472	-995	-672	-471	-348	-339	-427
Merchandise trade balance	-931	-1 014	-1 116	-1 374	-1 428	-1 371	-1 151	-1 151	-1 204
Exports, f.o.b.	225	273	295	363	380	805	614	...	...
Imports, f.o.b.	1 157	1 287	1 411	1 737	1 808	2 176	1 765	...	...
Services trade balance	903	862	757	542	857	1 029	951	980	901
Income balance	-136	-149	-153	-198	-138	-173	-190	-211	-163
Net current transfers	18	37	39	34	37	43	42	42	39
Capital and financial balance <sup>b</sup>	143	256	529	1 115	737	410	318	400	538
Net foreign direct investment	107	88	210	146	144	250	101	...	...
Financial capital <sup>c</sup>	36	168	319	969	593	161	217	...	...
Overall balance	-3	-8	57	119	65	-61	-30	61	111
Variation in reserve assets <sup>d</sup>	3	8	-57	-119	-65	61	30	-61	-111
<b>Other external-sector indicators</b>									
Total gross external debt	303	284	319	339	353	368	346	311	349
<b>Prices</b>									
Variation in consumer prices (December-December)	...	1.1	0.8	1.9	1.4	1.0	2.9	2.2	3.0
Real deposit rate (weighted average)	2.0	3.6	4.8	4.1	3.2	2.2	2.2	2.1	1.0
Real lending rate (weighted average)	10.9	11.0	12.2	10.8	10.4	9.9	9.3	9.1	8.1
<b>Millions of Bahamian dollars</b>									
<b>Central government</b>									
Current income	686	763	804	...	918	957	864	958	973
Current expenditure	678	714	747	...	817	846	836	954	969
Net capital expenditure	112	89	95	...	107	85	...	122	102
Overall balance <sup>e</sup>	-140	-73	-70	...	-38	-16	-95	-147	-98
<b>Millions of dollars</b>									
<b>Public debt</b>									
Public debt	1 577	1 625	1 812	1 883	2 043	2 001	2 059	2 309	...
Domestic	1 273	1 338	1 477	1 545	1 690	1 654	1 733	2 018	...
External	305	286	336	339	353	347	326	291	349
<b>Percentages of GDP</b>									
<b>Money and credit</b>									
Net domestic credit	73.9	80.1	97.5	109.2	121.7	135.5	152.4	161.0	162.1
To the public sector	16.0	16.0	16.5	19.1	21.6	21.1	25.2	28.4	28.7
To the private sector	57.9	64.1	81.1	90.2	100.1	114.4	127.1	132.6	133.4
Liquidity (M3)	61.2	64.7	80.3	93.1	103.5	112.9	118.1	122.1	130.4
Money stock and local-currency deposits (M2)	60.1	63.8	79.0	91.2	101.8	110.1	115.1	119.1	127.1
Foreign-currency deposits	1.1	0.9	1.4	2.0	1.7	2.8	3.0	3.0	2.9

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Includes errors and omissions. <sup>c</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>d</sup> A minus sign (-) denotes an increase in reserves. <sup>e</sup> Includes interest.

new tax measures and focusing instead on strengthening tax administration to reduce tax evasion and fraud has not been sufficient to meet the established objectives.

Nevertheless, in submitting its budget for fiscal year 2004, the government indicated that it would maintain the current strategy and avoid introducing new taxes. It

also announced the creation of a venture capital fund in the 2004-2005 biennium to boost government support for the establishment of new enterprises.

In fiscal year 2002 current revenues, at B\$ 901.8 million, were 5.2% higher than they had been in fiscal year 2001 but still fell short of the amount budgeted

(B\$ 962.8 million). This trend will continue in fiscal year 2003, since data for the first three quarters show that tax collection has reached only 70% of the established target; over the same period, receipts from taxes on hotel rooms and vehicle purchases, in particular, were 60% below target.

The disappointing revenue performance was partly due to the economic standstill. In addition, the authorities were unable to implement the planned Flight Information Region project, under which the Bahamas would have regained control of its airspace. This project would have generated an estimated B\$ 40 million to B\$ 50 million in revenues from air navigation charges (the Bahamian airspace is currently controlled by the United States). Lastly, the failure to complete the privatization of the Bahamas Telecommunications Company (BATELCO) resulted in a loss of fiscal income.

Total expenditure rose by 5% in fiscal year 2003, reflecting wage adjustments and transfers to non-financial public entities to cover high interest payments, which were running at 60% over the annual budget for fiscal year 2003. Capital expenditure shrank by 6%.

For fiscal year 2004, the government is projecting a 14% increase in current income over the preceding fiscal year's level. This estimate is based on the expectation that the amendment to the Stamp Tax Act will close loopholes in the payment of this tax, thereby increasing its revenue-generating capacity. Also noteworthy is the sale of a hotel belonging to a multinational chain, which will increase non-tax current revenue. Meanwhile, budgeted expenditure for fiscal year 2004 will be 11% higher than the level of the preceding fiscal year.

The public debt was 7% higher than its 2002 level and reached 45% of GDP, largely because of a US\$ 200-million Eurobond issue in July 2003. Interest payments on the public debt also rose—from 5.6% to 13.6% of government revenues between 2002 and 2003—and principal payments doubled, rising from 8% to 17% of government revenues over the same period.

### **(b) Monetary and exchange-rate policy**

Following the events of 11 September 2001, the central bank adopted a tight monetary policy to avoid unsustainable shortfalls in the balance of payments and to ease pressure on international reserves. Quantitative instruments have been the primary means of managing monetary policy. To date, the discount rate has remained at 6% and the reserve requirement on bank deposits, at 50%.

In 2003 and 2004 the authorities did not change this policy stance or the ceiling imposed on the growth of commercial bank credit. The increase in international reserves as a result of the above-mentioned bond issue was partly offset by the refinancing of the government's multilateral debt. International reserves nonetheless increased (by 30%) to a level equivalent to 16.5 months' worth of non-oil imports. Net purchases in the foreign-exchange market tripled, from B\$ 37.3 million to B\$ 97.1 million.

The accumulation of net external assets was reflected in an expansion of deposits, which increased liquidity in the commercial banking system. However, the sluggish economy and the restrictions imposed kept the rise in liquidity from pushing up commercial bank credit to the private sector, and the growth of such credit actually fell in relation to its rates in previous years (9.5%, 5.3% and 1% in 2001, 2002 and 2003, respectively). The sectors that received the most credit were agriculture (17% in 2003 and 32% in 2004) and, especially, the fishing industry, which received three times the amount of credit it had incurred the preceding year. The combined effect of this situation and the downturn in lending to the public sector (-22%) was reflected in the growth of monetary aggregates (4.2% for M2 and M3).

The commercial banking system took advantage of the increase in its liquid liabilities to purchase treasury bonds, which brought down interest rates on such bonds (from 1.6% in December 2003 to 0.9% in March 2004). This, in turn, lightened the government's domestic debt-servicing burden.

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## **3. The main variables**

### **(a) Economic activity**

Despite further recovery in the tourism sector (which expanded by 4.3%), economic activity barely grew in 2003 (0.2%) owing to the weak performance of construction and the restrictions imposed on the financial sector's development.

Construction activity faltered slightly. The number of permits granted and the average value of building starts slipped between 2002 and 2003. However, the number of building starts increased by 12% to reach 1,485 units in 2003. Much of this increase was in residential construction, which posted a 17% increase in the number of housing starts, whose average value

climbed as an effect of pent-up demand. The fact that the country is perceived as a market for second homes, mainly for United States residents, and the increase in the number of mortgage loans are two of the factors that contributed to the buoyancy of housing construction.

In 2004 the construction sector will be invigorated by the launching of phase III of the Kerzner project to expand the US\$ 1-billion Atlantis tourist complex on Paradise Island.

Financial services, which constitute the main economic activity of the Bahamas (accounting for 15% to 20% of GDP), suffered a downturn that reduced their capacity to contribute to national development when the Bahamas International Securities Exchange (BISX) sustained a B\$ 7.4-million loss in the value of its assets. This reduced the value by 50% in relation to the preceding year's level, although the loss is unlikely to have a strong impact on bank capitalization, which is still at a record high (B\$ 1.7 billion).

The financial sector's poor performance was due to constant changes in the legislative framework for financial activity, which have generated higher operating costs and lower profitability. These legislative changes are being implemented to comply with international rules intended to prevent financial centres from being used for purposes of money laundering. One such change was the introduction of stricter identification requirements for banks and customers. Banks licensed to operate are now required to have a physical presence within the jurisdiction of the Bahamas, and identity checks are now required on customers with deposits in excess of B\$ 15,000.

The number of tourists rose less than it had the preceding year (5.3% in 2002 and 4.3% in 2003) as a result of the modest 1.9% increase in air arrivals (i.e., arrivals of long-stay visitors, who bring in the most foreign exchange), as against the 5.4% rise in sea arrivals. Tourist arrivals in the first quarter of 2004 far exceeded their level of the year-earlier period (-7.4% in 2002 and 23.6% in 2003). The increase was led by a 15.6% rise in sea arrivals, compared to a 7.9% upturn in air arrivals. The fact that tourism revenues climbed only slightly, despite the expansion of hotel room capacity (5.3%), was due to a 2.8% contraction in the occupancy rate.

The fishing sector expanded considerably in 2003, with a volume increase of 8.6% that brought in earnings of B\$ 108.1 million.

### **(b) Prices, wages and employment**

The inflation rate rose from 2.2% in 2002 to 3% in 2003. A breakdown of the price index shows that the

costs of medical and health care and of recreation and entertainment went up considerably in 2003 (by almost 10%, compared to increases of 1.2% to 2.4% in 2002). Food and beverage prices, on the other hand, edged up by just 0.5%, while education costs rose by 1%, in a sharp slowdown from the 2002 increase of 12.8%.

In March 2004 the rate of price increases stood at 1.1%. Unless appropriate measures are taken, however, the upward trend in international oil prices could change the behaviour of goods and services prices.

The unemployment rate was 10.8% in 2003, or 1.7% higher than the 2002 rate. This continued the rising trend that began in 2002 after unemployment had reached its lowest level in a decade in 2001 (6.9%).

### **(c) The external sector**

The overall balance-of-payments outcome was positive in 2003 (US\$ 111 million), as the current account deficit (US\$ 427 million) was amply offset by the capital and financial account surplus (US\$ 538 million, including errors and omissions). This, in turn, led to an increase in international reserves.

The widening of the current account deficit reflected a bigger merchandise trade deficit and a smaller services trade surplus. The situation of the merchandise trade balance was due in part to a drop in exports, despite an increase in the fishing industry's exports (9%), particularly lobster (10%). Moreover, imports expanded as a result of an upsurge in non-oil purchases. The value of oil imports declined, notwithstanding higher international oil prices, because the country's economic doldrums had the effect of reducing fuel consumption.

The services trade surplus dipped because residents spent more abroad than they had in 2002, thereby eroding the increase in tourism revenues. The rise in net outflows corresponding to transport and insurance services was offset by downturns in construction and government services.

The income account posted a smaller deficit owing to a decline in the repatriation of bank profits. This was in response to the lethargic economy and the stricter controls on offshore banking introduced through changes in the regulatory framework.

Lastly, the performance of the capital and financial account reflected an upturn in foreign-exchange inflows from the Eurobond issue. These inflows were counterbalanced by capital outflows associated with the refinancing of the multilateral external debt, which involved the public sector and the local banking system.