THE CENTRAL BANK OF THE BAHAMAS

Financial Stability Report December, 2015

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EXECUTIVE SUMMARY

During 2015, the regulators of the domestic financial sector, inclusive of the Central Bank (banks and credit unions), the Securities Commission (securities industry) and the Insurance Commission (insurance industry), upheld their mandate of maintaining the strength and stability of the sector. Intrinsic in this process is ensuring that financial services providers are compliant with regulatory norms and guidelines. This Financial Stability Report (FSR) provides a context for assessing the stability of the sector, having regard to the economic and regulatory setting, and the evolution of the business environment of the institutions. While the overall structure of the industry is reviewed, the emphasis centers on the domestic market.

No new concerns about stability arose during 2015, or in respect of the near-term outlook for the sector. Risks remained well contained. The Banking sector continued to maintain comfortable capital and liquidity buffers, which are able to withstand reasonably severe shocks. Financial ratios strengthened incrementally, as bad debt expenses decreased. Risks for the sector remain most elevated for credit quality. While trends are stable to mildly improving, a speedier resolution is not expected to outpace improvements in the economic environment, for which growth prospects over the next 3 years are still constrained. Prudential ratios for credit unions and insurance companies also stayed favourable against prescribed international benchmarks.

As to the economic backdrop, prospects remained subdued over the review period. Real GDP decreased by 1.7%, following a revised 0.5% contraction in 2014. This outturn reflected mainly a sharp reduction in construction output, due to the winding down of work on the multi-billion dollar Baha Mar development. The resort's subsequent delayed opening, due to the developer's bankruptcy filing in June 2015, also muted the positive impulses from increases in the high value-added stopover segment of the tourism sector. Employment gains also stalled, as initial Baha Mar hires were laid-off. Weakness in private sector credit persisted, as households continued to deleverage and banks maintained their conservative lending posture. Overall, external economic developments continue to provide a favorable backdrop for expansion in tourism over the medium-term.

CHAPTER 1: MACROECONOMIC ENVIRONMENT

1.1. The Global Environment

During 2015, the global economy sustained its modest growth trajectory—albeit at an uneven pace—as total output firmed by 3.1%, a slowdown from the 3.4% gain registered in the prior year. Underlying this outturn, growth in both emerging market and developing economies, which accounted for over 70% of the global expansion, slowed by 60 basis points to 4.0%—the fifth consecutive year of declines—while output in advanced economies edged up by 10 basis points to 1.9%.

In terms of the major economies, real output in the United States stabilized at 2.4%[1], attributed to moderate increases in non-residential fixed investments and exports, which offset higher personal and Government spending. The performance in Europe was mixed, with euro area output growth strengthening by 70 basis points to 1.6%; however, the expansion in the United Kingdom softened to 2.2% from 2.9% in 2014, due mainly to a narrowing in construction sector growth. In Asia, Japan's economy expanded by 0.5%, improving from the flat outturn in 2014, whereas growth in China slowed by 40 basis points to 6.9%, amid decreased accretions to fixed asset investments and exports.

The Caribbean region continued to face headwinds, as real growth tapered to an annual average of 0.7% from 1.4% in the previous period. Most countries registered gains of less than 2.0%, while the sharp decline in global crude oil prices contributed to a 1.8% contraction in Trinidad & Tobago's GDP.

Employment conditions improved modestly in all of the major economies in 2015. Specifically, in the United States, the jobless rate decreased by 90 basis points to 5.3%, while the unemployment rates in the United Kingdom and the euro area narrowed by 80 and 50 basis points to 5.4% and 10.9%, respectively. Similarly in Asia, Japan's jobless rate decreased by 20 basis points to 3.4%, while unemployment in China steadied at 4.0%.

Buoyed by the significant fall in global oil prices and lower costs for other commodities, most of the major economies' inflation rates remained relatively subdued during the year, with the rate in the United States easing to 0.7% from 0.8%, while the United Kingdom's rate remained flat, following a 1.5% gain over the prior period. Similarly, in Japan, increases in average consumer prices tapered by 1.9 percentage points to 0.8%; however, China's rate firmed marginally by 10 basis points to 1.6%, while average prices in the euro area rose slightly by 0.2%, vis-à-vis a similar decline in the prior period.

[1] See Table 1.

With economic conditions remaining relatively subdued, most of the major central banks either maintained or heightened their highly accommodative monetary policy stance in 2015. In the United Kingdom, the Bank of England retained its benchmark interest rate at 0.5% and sustained the size of its Asset Purchase Programme at £375.0 billion. Further, the European Central Bank reduced its key interest rate on its deposit facility to an historic low of 0.30% and introduced a monthly €60.0 billion asset purchase programme in March, 2016, which is expected to last for six months. Given the challenges facing China's financial system, the People's Bank of China (PBoC) intervened extensively in the market during the year, by reducing its key loan and deposit rates by 125 basis points each to 4.35% and 1.50%, respectively, and undertook measures to boost banking system liquidity. In Japan, the central bank maintained its asset purchase programme at ¥80.0 trillion per annum and lengthened the average maturities of its Government bond purchases to 7-12 years from 7-10 years; the Bank also lowered its key interest rates by 25 basis points and the reserve requirement by 50 basis points. In contrast, faced with an improving labour market and relatively low inflation, the United States' Federal Reserve decided to raise the target range for its key federal funds rate for the first time in nearly a decade in December to 0.25%-0.50% from 0.00%-0.25%.

TABLE 1

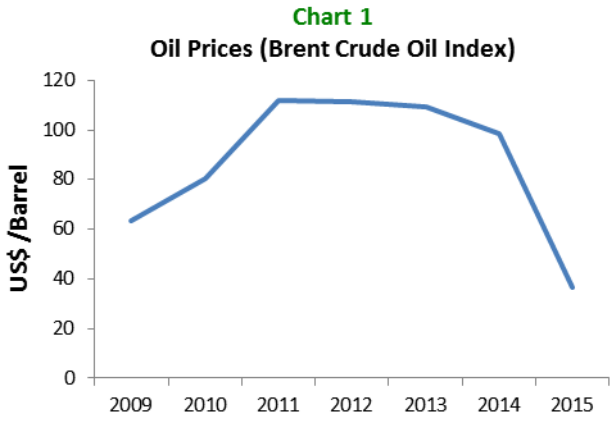
Selected Indicators for Developed Economies (%)

	2009	2010	2011	2012	2013	2014	2015
GDP Growth Rates							
United States	(3.1)	2.4	1.8	2.8	2.2	2.4	2.4
Euro Area	(4.4)	2.0	1.6	(0.7)	(0.5)	0.9	1.6
United Kingdom	(5.2)	1.7	1.1	0.3	1.7	2.9	2.2
China	9.2	10.4	9.3	7.7	7.8	7.3	6.9
Japan	(5.5)	4.5	(0.5)	1.4	1.6	0.0	0.5
Unemployment Rates							
United States	9.3	9.6	9.0	8.1	7.4	6.2	5.3
Euro Area	9.6	10.1	10.2	11.4	12.0	11.4	10.9
United Kingdom	7.6	7.9	8.1	8.0	7.1	6.2	5.4
China	4.3	4.1	4.1	4.1	4.1	4.1	4.0
Japan	5.1	5.1	4.6	4.4	3.4	3.6	3.4
Inflation Rates							
United States	(0.3)	1.6	3.1	2.1	1.5	0.8	0.7
Euro Area	0.3	1.6	2.7	2.5	0.8	(0.2)	0.2
United Kingdom	2.1	3.3	4.5	2.8	2.6	1.5	0.0
China	(0.7)	3.3	5.4	2.6	2.6	1.5	1.6
Japan	(1.3)	(0.7)	(0.3)	0.0	0.4	2.7	0.8

Sources: IMF, Internaional Statistical Bureaus

TABLE 2							
Selectd Caribbean Countries' GDP Growth Rates (%)							
	2009	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Bahamas	(4.2)	1.5	0.6	3.1	0.0	(0.5)	(1.7)
Barbados	(4.1)	0.2	0.8	0.0	(0.7)	0.2	0.5
Belize	0.3	3.1	2.1	4.0	1.6	3.6	1.5
Eastern Caribbean	(5.3)	(3.5)	(0.2)	0.4	1.7	2.9	2.6
Guyana	3.3	4.4	5.4	4.8	4.8	3.8	3.0
Jamaica	(3.4)	(1.4)	1.4	(0.5)	0.5	0.5	1.1
Suriname	3.0	4.2	5.3	4.8	4.7	1.8	0.1
Trinidad & Tobago	(4.4)	0.2	(2.0)	1.2	1.6	(1.0)	(1.8)
Average	**(1.8)**	**1.1**	**1.7**	**2.2**	**1.8**	**1.4**	**0.7**

Sources: IMF, International Statistical Bureaus, Regional Central Banks, Bloomberg



Source: Bloomberg

1.2. The Domestic Environment

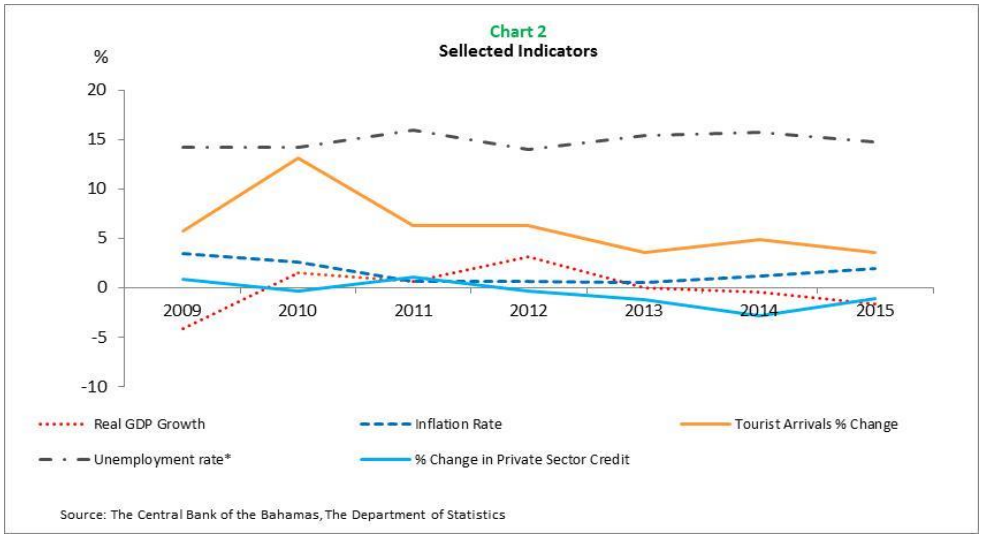
Reflecting mainly a sharp reduction in construction output, due to the winding down of activity on the large-scale Baha Mar development, and absent more robust tourism momentum which the resort's opening would have provided, the domestic economy contracted by an estimated 1.7% in 2015, extending the 0.5% decline a year earlier. Some demand softening also reflected the initial impact of the Government's fiscal consolidation initiatives.

Tourism output growth though more moderate, was propelled by stopover activity. Total visitor arrivals decreased by 3.3% to 6.1 million, reversing the prior year's 2.8% gain, with the dominant sea component falling by 5.1% to 4.7 million, following a 2.2% expansion in the previous year. This contrasted with the high value-added air segment—the source for most of the stopover arrivals—which grew by 3.6% to 1.4 million, albeit lower than the prior period's 4.9% improvement.

In addition to a decrease in foreign investment-led activity, the domestic construction sector showed mixed results. Although the amount of local financing increased, the value of new and completed projects declined. Specifically, total mortgage disbursements for new construction and building repairs rose by 23.8% to $120.8 million, surpassing the 8.9% gain in the prior year. However, direct construction sector data for the year indicated that the number of building starts in New Providence and Grand Bahama fell by a combined 8.0% to 412 and the corresponding value contracted by 9.4% to $117.1 million. The number of finished projects decreased by 7.0% to 586, and the total value contracted by 8.6% to $228.9 million, supported by the inclusion of several high-end properties.

Given the trends in the tourism and construction sectors, employment conditions remained mild. The jobless rate initially narrowed by 3.7 percentage point to 12.0% at end-May over the prior six-month period; however, following the Baha Mar adjustments, it increased to 14.8% at end-November 2015—only slightly improved on a 12-month basis.

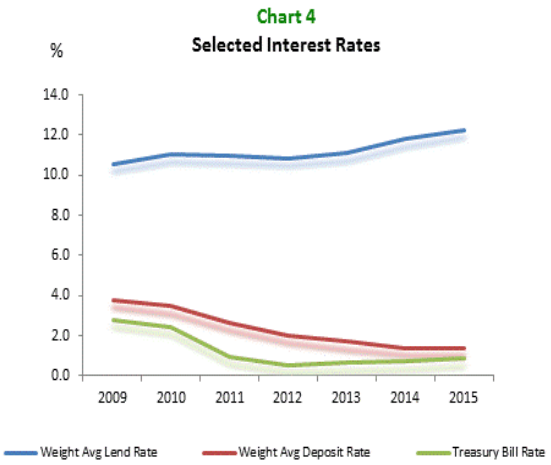
Domestic price pressures were well contained, despite significant VAT-led firming in several low-weighted categories of the Retail Price Index (RPI). This outturn reflected mainly a falloff in fuel-related transportation costs and a modest decline in the dominant housing component, which captured electricity price reductions.



Reflecting the implementation of the VAT and other measures geared towards broadening the tax base, Government's overall deficit contracted by $98.0 million (20.4%) to $382.0 million in FY2014/15. Total revenue expanded by $250.8 million (17.3%) to $1,701.5 million, outstripping the $152.8 million (7.9%) rise in aggregate expenditure to $2,083.5 million. On a calendar year basis, the deficit reduction was more pronounced at roughly one-half of the $531.1 million recorded in 2014 at $267.4 million.

In external sector developments, the estimated current account deficit narrowed significantly by $588.1 million (30.9%) to $1,339.9 million, attributed to a large reduction in net construction service outflows, linked to the winding down of the Baha Mar project, and lower fuel import payments following the sharp falloff in global oil prices. Also correlated with Baha Mar flows, the capital and financial account surplus declined considerably by $1,199.0 million (79.9%), to $301.5 million. In the mix, lower levels of public sector foreign currency borrowings also had a notable impact.

Source: Central Bank of The Bahamas



Source: Central Bank of The Bahamas

TABLE 3:
The Bahamas: Macroeconomic Indicators

	2009	2010	2011	2012	2013	2014	2015
B$/US$: Exchange Rate	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Nominal GDP Growth Rate (%)	(5.2)	1.1	(0.3)	6.5	1.5	1.1	2.7
Real GDP Growth Rate (%)	(4.2)	1.5	0.6	3.1	0.0	(0.5)	(1.7)
Inflation Rate (Average chg in RPI)	3.5	2.6	0.6	0.6	0.5	1.2	1.9
Unemployment Rate	14.2	n.a	15.9	14.0	15.4	15.7	14.8
Overall Fiscal Balance (B$M)	(403.1)	(376.7)	(319.8)	(557.5)	(485.3)	(531.1)	(270.7)
% of GDP	(5.2)	(4.8)	(4.1)	(6.6)	(5.7)	(6.2)	(3.1)
Private Sector Credit (B$000)	6,590.7	6,572.7	6,646.6	6,628.4	6,551.1	6,366.9	6,299.7
Weighted Average Lending Rate (%)	10.6	11.0	11.0	10.9	11.1	11.8	12.3
Weighted Average Deposit Rate (%)	3.8	3.4	2.6	2.0	1.7	1.4	1.4
Treasury Bill Rate (%)	2.8	2.4	1.0	0.6	0.7	0.7	0.9
Gross Int'l Reserves (B$M)	815.9	860.4	884.8	810.2	741.6	787.7	811.9
Import Cover Ratio (Non-Oil (CIF) in weeks)	20.8	21.6	19.7	16.0	15.4	14.9	16.8
Current Balance (B$M)	(808.5)	(796.8)	(1,192.1)	(1,504.6)	(1,493.9)	(1,928.0)	(1,214.5)
as % of GDP	(10.3)	(10.1)	(15.1)	(17.9)	(17.5)	(22.4)	(13.7)
Total Public Sector Debt (B$M)	4,266.1	4,799.9	4,948.2	5,770.4	6,346.7	7,096.2	7,453.9
of which: External	767.3	916.1	1,044.7	1,464.5	1,616.0	2,094.9	2,169.3
Internal	3,498.8	3,883.8	3,903.5	4,305.9	4,730.7	5,001.3	5,284.6
Total Arrivals ('000s)	4,645.1	5,254.8	5,587.6	5,940.2	6,150.8	6,320.2	6,114.3
Tourist Expenditure (B$M)	2,014.2	2,163.2	2,141.6	2,311.6	2,284.7	N/A	NA
Construction Number of Permits Issued	2,416.0	1,996.0	1,948.0	1,916.0	1,462.0	1,410.0	1,304.0
Value of Starts (B$M)	360.9	154.2	147.5	116.6	140.2	129.2	117.1
Value of Completion's (B$M)	297.0	337.6	500.6	317.1	216.6	250.5	228.9
Average Oil Prices (Brent Crude Oil Index)	63.5	80.3	111.8	111.4	109.1	98.5	52.6

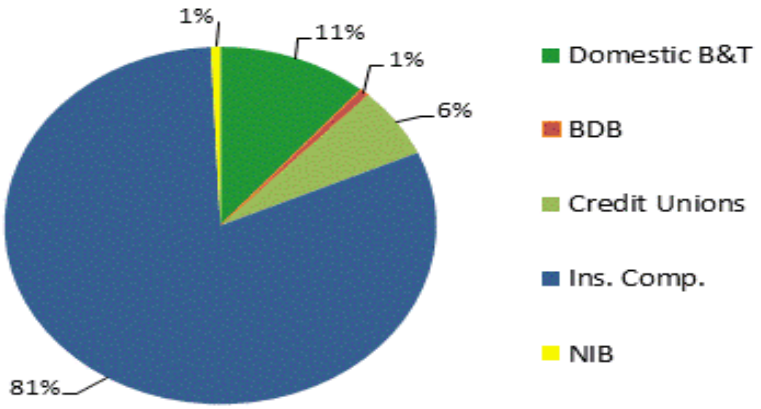
Source: Central Bank of The Bahamas, Department of Statistics, Bloomberg
N/A - Not Available

On the monetary side, banking sector liquidity remained buoyant, reflecting sustained weakness in private sector credit and foreign currency inflows from real sector activities. The average interest rate spread widened on account of an increase in the weighted average loan rate, combined with a decline in the average deposit rate (see Chart 4). In addition, the sector returned to profitability in 2015, after a significant loss in 2014, when entities' bad debt and goodwill write-offs were sizeable.

CHAPTER 2: FINANCIAL SYSTEM OVERVIEW

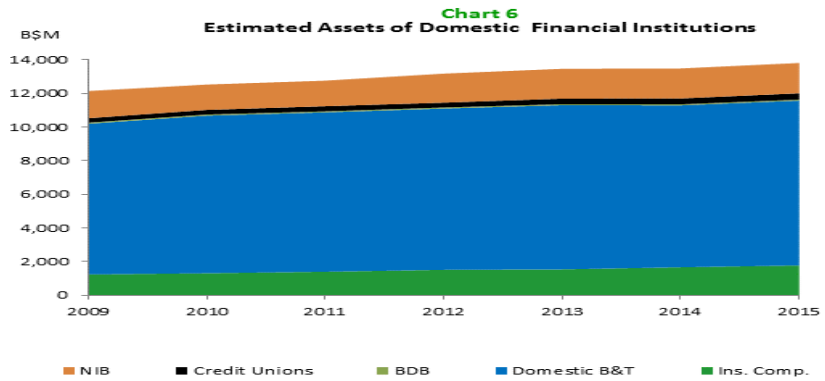
2.1. Overview of the Financial System

The Bahamian financial sector, which comprises an estimated 15% of the country's GDP, includes over 400 banks and non-banks and employs in excess of 6,500 individuals. In terms of its structure, the sector consists of domestic banks & trusts companies, money transmission businesses (MTBs), credit unions (CUs), insurance companies (Ins), financial and corporate service providers, capital market enterprises, the Bahamas Development Bank (BDB), the National Insurance Board (NIB) and the Bahamas Mortgage Corporation (BMC)[2] (see Chart 5). The external sector consists of international banks and trust companies (233), mutual/investment administration, and private trust companies (112). Domestic banking operations (B&Ts) number 16 and include an equal number of commercial banks and other local financial institutions (non-commercial banks and trust companies) or OLFIs.



Collectively, the banking industry recorded approximately US$209.8 billion[3] in assets, the bulk of which were held exclusively by international banks ($180.5 billion), with the remainder in domestic banks ($29.3 billion), which straddled the local and external sectors. Among non-banks, investment administrators managed the next largest concentration of reported assets ($134.6 billion[4]), followed by insurance companies ($1.8 billion). The credit union sector has the next notable stock of assets ($370.6 million). The strictly domestic asset exposure of banks was $9.8 billion. The National Insurance Board's holdings were the second largest domestic assets concentration, ahead of both insurers and credit unions (Chart 6).

[2] Balance sheet information for the Bahamas Mortgage Corporation is currently not available.
[3] The Bahamian Dollar is equivalent to the U.S. Dollar.
[4] Asset value is as at end-2014.



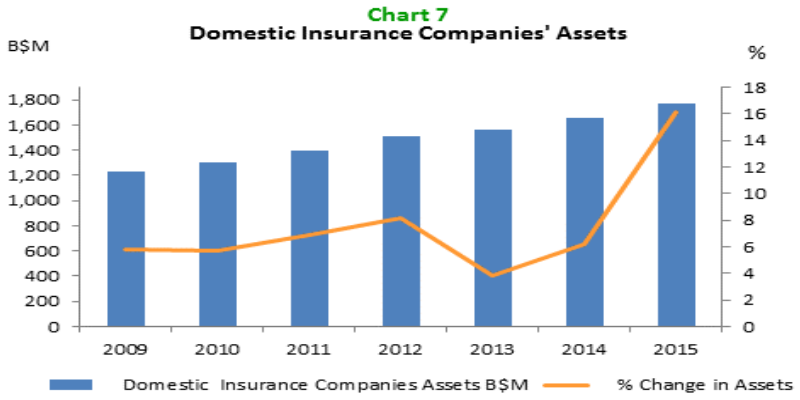
Source: The Central Bank of The Bahamas, Insurance Commision of The Bahamas

2.2. Bank & Trust Companies

During 2015, the number of bank and trust companies declined by 5 to 249, owing to a decrease in the number of international licensees by 4 to 233, while the domestic count fell by 1 to 16 (see Table 4). The total assets of domestic banks declined by 32.0% to $29.3 billion, albeit a slowdown from the 43.9% reduction in 2014, while the assets of international banks contracted by 6.4% to $180.5 billion, relative to a 22.1% falloff last year, as firms continued to make adjustments in light of global regulatory reforms and initiatives to promote tax transparency.

2.2.1. The Bahamas Development Bank

As the only state-owned lending institution[5], the Bahamas Development Bank offers financing for investments in agriculture, fisheries, tourism, manufacturing and transportation services. In 2015, total assets of the institution remained stable at $61.6 million, as declines in loans and other "miscellaneous" assets, were negated by a slight increase in deposits held by the institution.



Source: Insurance Commision of The Bahamas

[5] The Central Government also holds shares in the Bank of The Bahamas International (BOB).

TABLE 4							
Structure of the Financial System							
	2009	**2010**	**2011**	**2012**	**2013**	**2014**	**2015p**
Banks &Trusts							
International Banks	252	256	260	249	249	237	233
Domestic Banks	20	20	18	19	18	17	16
Total	**272**	**276**	**278**	**268**	**267**	**254**	**249**
The Bahamas Development Bank	1	1	1	1	1	1	1
Non-Bank Financial Institutions							
Mutual Funds	788	753	713	652	735	804	858
International Business Companies	160,383	160,793	163,499	166,342	169,575	172,698	175,675
Credit Unions	13	13	13	13	7	7	7
Insurance companies	174	178	127	139	140	143	148
Domestic Companies & Agents	*154*	*157*	*114*	124	121	122	125
External Insurers	*20*	*21*	*13*	15	19	21	23
National Insurance board	1	1	1	1	1	1	1

Source: Central Bank of The Bahamas

2.3. Non-Bank Financial Institutions

2.3.1. Credit Unions

At end-December 2015, total assets of credit unions—which numbered 9—advanced by 6.6% to $370.6 million, in line with 2014's 6.1% expansion. The loans category, which formed the bulk of assets, rose by 1.9% to $235.3 million—with consumer loans comprising the dominant share (73.7%), followed by mortgages (21.9%) and revolving lines of credit (4.4%). During the year, total deposits inside these cooperatives expanded by 8.3% to $315.9 million, exceeding the previous year's 6.2% ($16.9 million) improvement. In the meantime, the buffer against any potential losses was extended, with the capital & surplus position firming by 4.2% to $42.4 million.

2.3.2. Other Non-Bank Institutions

The Bahamas International Securities Exchange (BISX), which is the local equity market, trades both Government and private securities. In 2015, the volume of share traded was relatively subdued; however, as share prices increased, market capitalization appreciated.

CHAPTER 3: BANKING SECTOR

Owing to exchange control regulations that prevent international banks from operating in domestic markets, the impact of such licensees' activities on domestic financial stability is not material. Hence, the focus of the remainder of this section is on developments in the domestic banking sector.

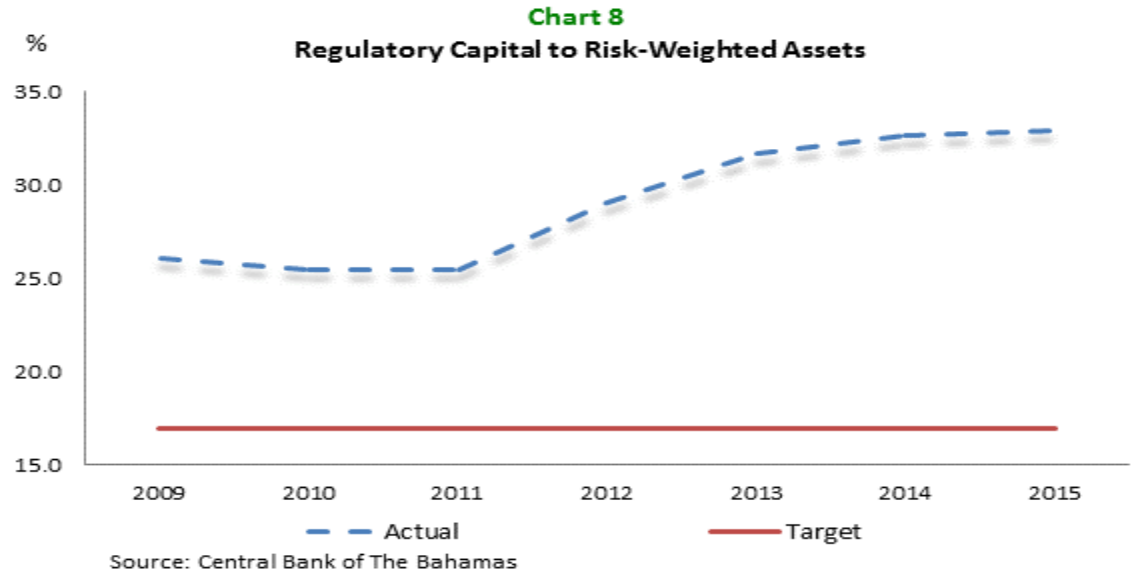
3.1 Domestic Banking Sector

The domestic banking sector is comprised of 8 commercial banks, of which 4 are subsidiaries of Canadian banks, 3 are locally owned and 1 is a branch of a United States' based institution. The banks funding sources are predominantly from deposits, while assets are comprised principally of credit to the private and public sectors. Private exposures include commercial loans, residential mortgages and consumer loans—although each institution tends to specialize in different segments of the market. The majority of the sector's assets—in excess of two-thirds—are concentrated in the 3 largest banks.

During the year, banks maintained high levels of liquidity, owing to their conservative lending stance. Meanwhile the widening of the spread between deposit and lending rates, as well as fee-based income, supported the overall profitability of the sector.

3.1.1 Capital Adequacy

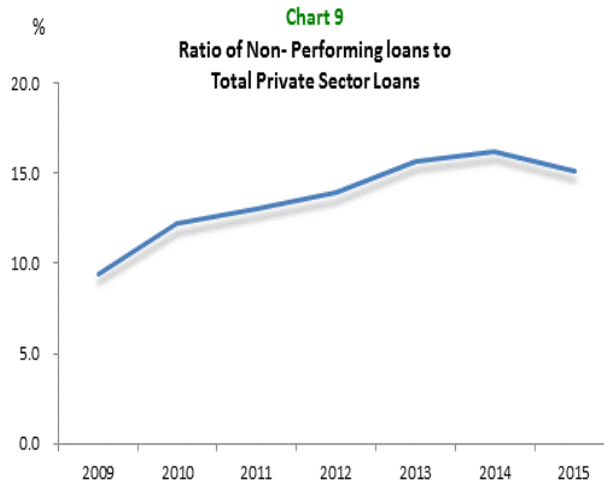
In 2015, the banking sector continued to be adequately capitalized, with estimated capital as a fraction of risk-weighted assets widening by 30 basis points to 30.9%. This remains well above the international benchmark of 8.0% (see Chart 8), and the Central Bank's target of 17% of risk-weighted assets (RWA). There is also a "trigger" ratio of 14.0%, below which banks would be required to implement measures to either reduce risk exposures or supplement capital.



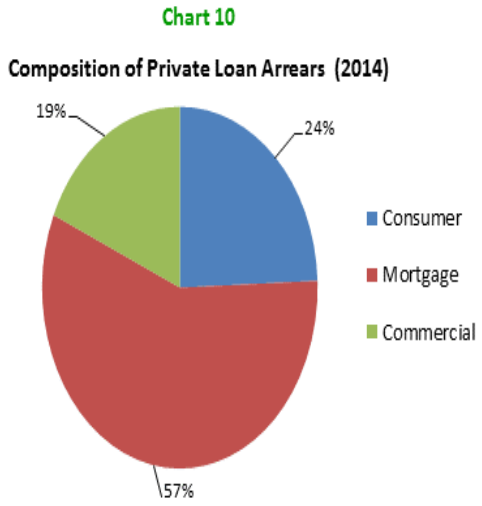
3.1.2 Asset Quality

Banks' credit quality ratios improved in 2015, reflecting continued loan write-offs and restructuring activities. Total private sector loan arrears decreased by 5.7% to $1,219.6 million, after a 4.3% reduction in the prior year. As a result, arrears narrowed by 1.1 percentage points to 20.3% of total private sector loans. The contraction in total delinquencies was led by the non-performing segment, which declined by $71.6 million (7.3%) to $906.6 million, partly reversing the year earlier 1.3% expansion. Similarly, the short-term (31-90 days past due) component, moved lower by 0.7% to $313.0 million, which tempered the 18.4% reduction in the previous year. At end-2015, the non-performing segment comprised 15.1% of total private sector loans, compared to 16.2% in the prior year, while short-term arrears accounted for a stable 5.2%.

A sectoral breakdown showed that credit quality shifts were led by consumer arrears, which fell by 10.5% to $297.5 million, following growth of 4.7% in the preceding year. Similarly, the dominant mortgage arrears component—at 57.2% of the total—decreased marginally by 0.2% to $697.2 million, partly countering a 1.1% advance in 2014. Meanwhile, commercial loan delinquencies also declined further by 14.4% to $224.9 million, although lower than the prior year's 23.6% reduction, which included significant bad debt write-offs.



Source: Central Bank of The Bahamas

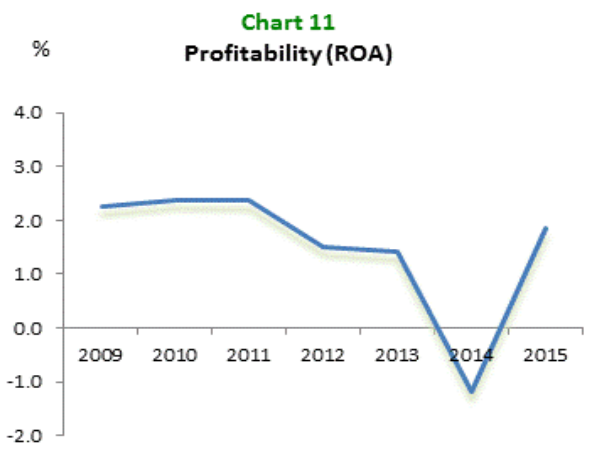


Source: Central Bank of The Bahamas

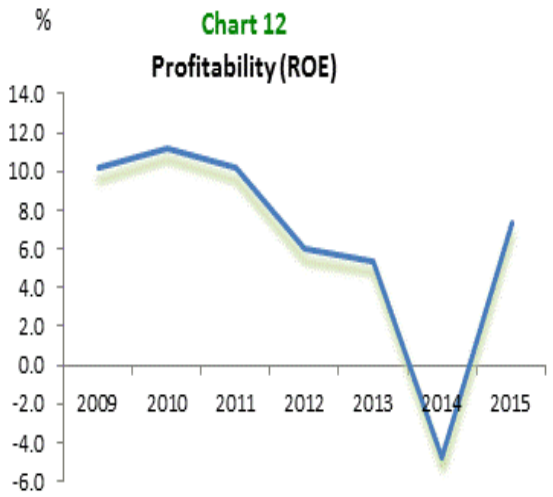
3.1.3. Profitability

Banks' operations reversed to a net income position of $185.4 million in 2015, following a net loss of $114.1 million in the prior year, when institutions' recorded significant one-off charges from non-operating activities. As a consequence, there was a turnaround of the respective ratios of net income to total assets (ROA) and equity (ROE) to 1.9% and 7.4%, from -1.2% and -4.7% in 2014. The improvement in these ratios was

attributed to gains in commission and foreign exchange income as a fraction of average assets to 0.30% from 0.23% in 2014. Also, banks' other net non-interest costs declined over the period to 3.50% of average assets from 4.89% in the prior period, corresponding to less marked bad debt expenses. In the meantime, although effective interest spreads widened, the ratio of net interest income to average assets was relatively stable at 5.4%, as the reduction in interest expense was outpaced by the growth in interest revenue.



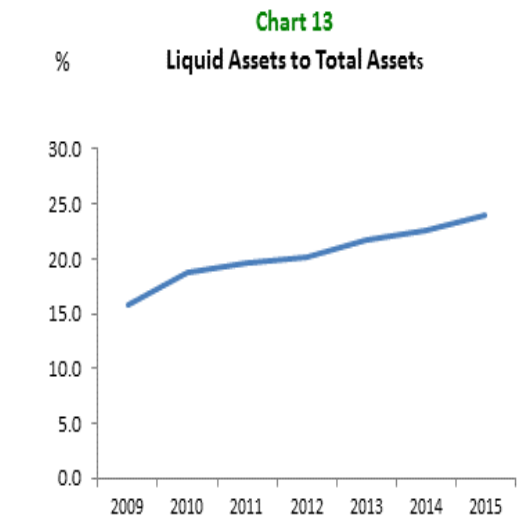
Source: Central Bank of The Bahamas



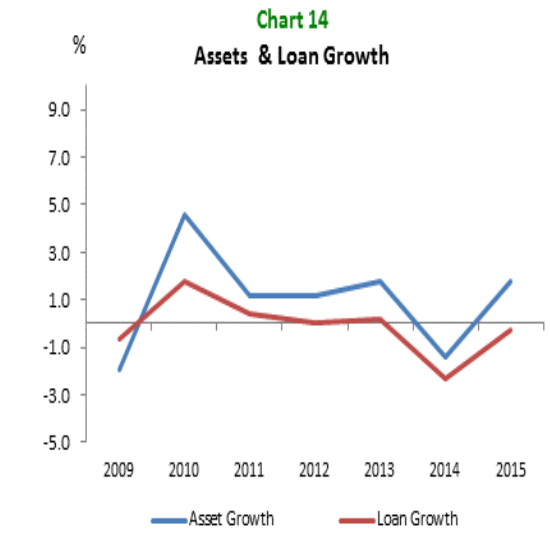
Source: Central Bank of The Bahamas

3.1.4. Liquidity

Banking sector liquidity remained robust in 2015, as conservative private sector lending practices kept pressures off funding resources and maintained exposures towards Government securities. As a consequence, the ratio of liquid assets to total assets firmed by 1.4 percentage points to 24.1%, following a 90 basis point rise in the prior period. In addition, the ratio of liquid assets to short-term liabilities firmed by 2.6 percentage points to 37.0%, after a 40 basis point gain in the previous year. The build-up in liquidity also contributed to the total deposits to loans ratio firming by 90 basis points to 92.1%, following a 3.5 percentage point increase in the preceding year, while the share of demand deposits to total balances also advanced by 90 basis points to 32.6%, after a 3.6 percentage points rise in the prior period.



Source: Central Bank of The Bahamas



Source: The Central Bank of The Bahamas

3.1.5. Growth in Assets

During the year, the total domestic assets of the banking system grew by 1.8% to $9.8 billion, a reversal from a 1.4% contraction recorded in the previous period (see Chart 14). Underlying this outturn was a 12.9% expansion in the holdings of securities to $1,803.4 million, extending the 7.2% gain in 2014, owing in large measure to a hike in investments in private sector instruments (45.3%) and Government paper (14.4%). In addition, other "miscellaneous" assets rose by 3.7% ($12.6 million), while the reduction in loans and advances narrowed to 0.3% ($22.9 million) from 2.3% in the prior year, as the decline in private sector credit tapered to 1.2% from 2.8%. The latter still contrasted with growth in total claims on the public sector of 8.6%, following the previous year's 3.4% expansion. In the meantime, banks' cash balances with the Central Bank decreased by 3.2%, partly to accommodate the purchase of Government paper.

At end-December, loans and advances remained the dominant component of the domestic assets (70.6%), followed by securities (18.4%), balances with the Central Bank (6.0%), "other" miscellaneous assets (3.6%) and till cash (1.4%).

TABLE 5							
Key Commerical Banks Finanical Stability Indicators (%)							
	2009	2010	2011	2012	2013	2014	2015
Liquidity Indicators							
Loan to Deposit Ratio	116.6	115.9	114.1	114.5	114.0	109.6	108.6
Deposits to Loan Ratio	85.8	86.2	87.6	87.4	87.7	91.2	92.1
Demand Deposits to Total deposits	22.4	22.6	23.5	25.9	28.1	31.7	32.6
Liquid Assets to Total Assets	15.9	18.7	19.7	20.2	21.8	22.7	24.1
Liquid Assets to Short-Term Liabilities	23.9	28.8	30.0	31.2	34.0	34.4	37.0
Credit Risk Indicators							
Total Assets Growth rate	(1.9)	4.6	1.1	1.2	1.8	(1.4)	1.8
Loans & Advances Growth rate	(0.7)	1.8	0.4	0.0	0.2	(2.3)	(0.3)
Capital Adequacy							
Regulatory capital to risk-weighted assets (avg)	26.1	25.5	25.5	29.1	31.7	32.7	33.0
Trigger Ratio Capital Ratio	14.0	14.0	14.0	14.0	14.0	14.0	14.0
Target Ratio Capital Ratio	17.0	17.0	17.0	17.0	17.0	17.0	17.0
Profitability Indicators							
ROAA (annualized)	2.3	2.4	2.4	1.5	1.4	(1.2)	1.9
ROAE (annualized)	10.2	10.7	10.1	6.1	5.6	(4.7)	7.4
Net interest income to average earning assets (annualized)	5.3	5.6	5.5	5.4	5.4	5.3	5.4
Net interest income to gross income	57.1	58.9	62.8	67.1	68.8	69.8	70.5
Noninterest expenses to gross income	32.3	34.7	37.9	40.8	47.1	66.3	47.4
Personnel expenses to noninterest expenses	54.5	52.0	53.2	51.2	50.3	34.8	46.8
Trading and fee income to total income	2.6	2.6	2.8	3.0	3.0	3.0	3.9
Spread between reference loan and deposit rates	6.3	6.2	6.1	6.4	6.9	6.8	7.1

Source: Central Bank of The Bahamas

3.1.6. Stress Testing

Stress testing during 2015, revealed that banks' capital and liquidity levels remained cushioned against potential negative shocks to the domestic system. Although extreme shocks would impose recapitalisation requirements, the Central Bank views these as highly remote likelihoods and not therefore a cause for concern. Simulations would however, have disproportionate timing in terms of when requirements are triggered for individual banks, as the size of existing buffers vary across banks.

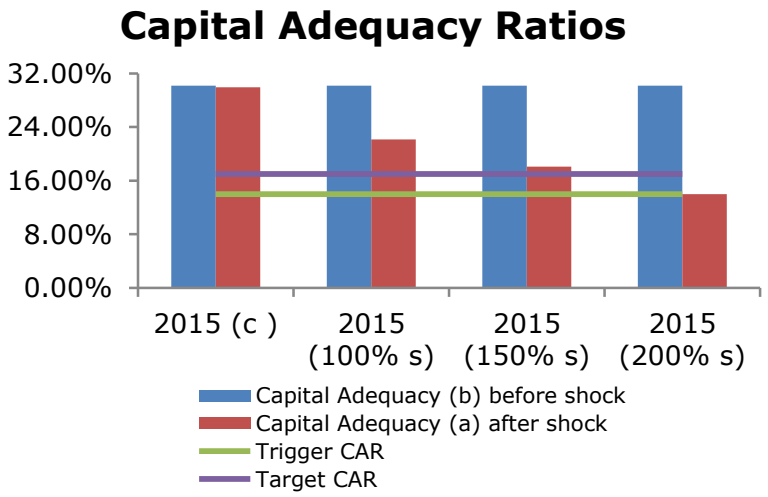
3.1.6.1 Credit Risk Stress Test

The credit stress scenarios used during the second half of 2015 did not change, although there were some forecasted changes to the macro-economic variables. In conducting the stressed scenarios and using shocks to the non-performing loan (NPL) rates of 100, 150 and 200 percent for forecasted years 2015 through 2017, deterioration in the non-performing loan book was forecasted to continue through 2017, but at a slower pace. At forecasted levels over the 3-year period, NPLs remain elevated at the $1.1 billion mark in and at shocked levels, NPLs increase within the $2.2 billion to $2.3 billion range (at 100 percent); $2.7 billion to $2.8 billion range (at 150 percent) and $3.2 billion to $3.4 billion (at 200 percent).

Chart 15 shows that, at the current (c) levels, the risk weighted capital ratio (CAR) is at 29.95%; however, because the loan portfolio remains under stress, the banks' bottom line would be negatively impacted. However, should NPLs reach the 150% shock level in 2016, a capital injection would be required, as the estimated capital would fall below the target ratio by 1.34 percentage points. Further, at the 200% shock

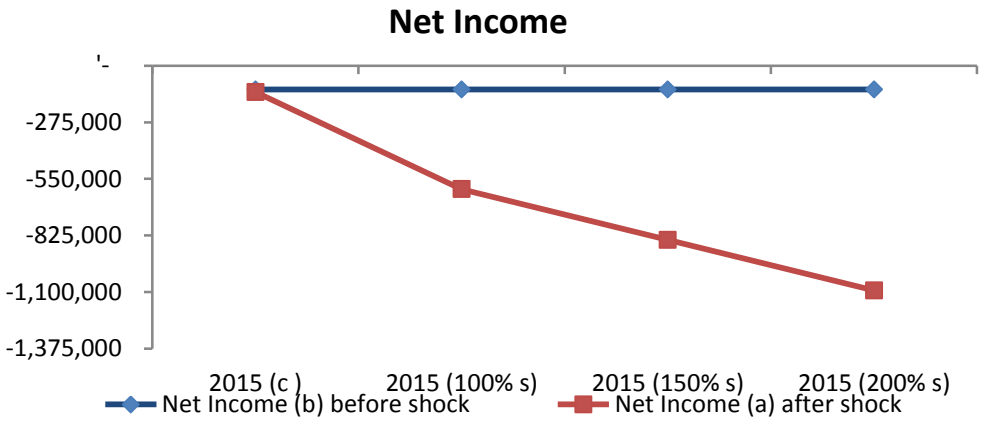
level in 2015, an extreme assumption, a capital injection would be required to eliminate a 2.97 percentage points deficit relative to the target ratio of 17%.

Chart 15



Varying the NPLs has direct impacts through the earnings of banks, from elevated bad debt provisions and loss in interest income. Therefore, as depicted in Chart 16, the projected net income before any shock shows a net loss of around $115.5 million, with further steady declines when shocks are applied.

Chart 16



3.1.6.2 Interest Rate Risk Stress Test

The interest rate stress test model used the duration method to estimate the impact of rate changes on both local and foreign currency exposures. This is in the context of very infrequent changes in benchmark rates such as the Bahamian dollar Prime rate. As such, sensitivity was estimated for a 100 basis points change in the yield curve for Bahamian currency exposures and 200 basis points for foreign currency. The

net impact was that the capital level increased by $0.5 million, underscoring that banks have very low downside exposures to domestic interest rate risks.

3.1.6.3 Liquidity Risk Stress Test

The liquidity risk stress test model projects the solvency of a bank should there be a run on deposits, using a baseline cash flow scenario, with focus on liabilities due within a 30-day period or less and how quickly long-term assets can be converted to cash to meet the obligations of the depositors. Using data reported at end-December, 2015, various assumptions are made relative to the inflows and outflows ranging from 0% - 80% to determine the level of cash flow needed to meet liquidity demands. The results from the test suggest that banks have adequate, highly liquid longer-term assets to cover the maturity mismatch on deposit exposures of up to 12 months.

CHAPTER 4: CREDIT UNIONS

Overview

Credit unions are currently the second largest and rapidly growing group of deposit taking institutions after commercial banks. They continue to broaden the range of financial products and services offered to their members and on June 1, 2015, the Central Bank assumed full regulatory and supervisory responsibility for the sector.

At end-2015, the number of active credit unions increased by 2 to 9, inclusive of the Credit Union League, with 1 institution dominating the market—holding 51.3% of the total assets—while the remaining 8 entities comprised smaller market shares ranging from 4.1% to 15.3%. These entities recorded gains in deposit assets and liabilities during the year, although, owing to an increase in the non-performing loan portfolio and a falloff in other "miscellaneous" income, both asset quality and profitability ratios weakened. The sector's capital levels exceeded the PEARLS[6] benchmark, although their buffers are considerably more compressed than for banks.

4.1. Capital Adequacy

During the review period, credit unions' financial stability indicators remained in line with international benchmarks. The level of capital & surplus resources expanded by 4.2% to $42.4 million at end-2015. On an aggregate basis, the capital stock, as measured by the ratio of total equity-to-total assets[7] (the gearing ratio), narrowed by 20 basis points to 11.5%, as the 6.6% gain in assets, outstripped the 4.3% expansion in capital. However, this ratio stayed just above the international PEARLS benchmark of 10.0% (see Chart 17).

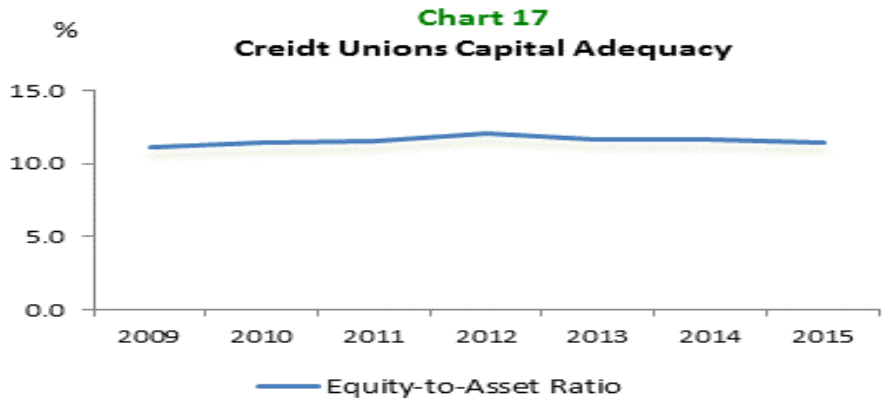
4.2. Asset Quality

In 2015, credit unions' aggregate impaired loans declined slightly by 1.3% ($0.4 million) to $30.5 million, vis-à-vis the prior year's 14.1% ($3.8 million) growth. At end-December, the ratio of impaired to total loans stood at 12.9%, vis-à-vis 2014 ratio of 13.4%. In terms of the components, the short-term segment—at 9.0% of the total—contracted by 14.1% to $2.7 million, after a 26.0% ($0.7 million) increase in the prior

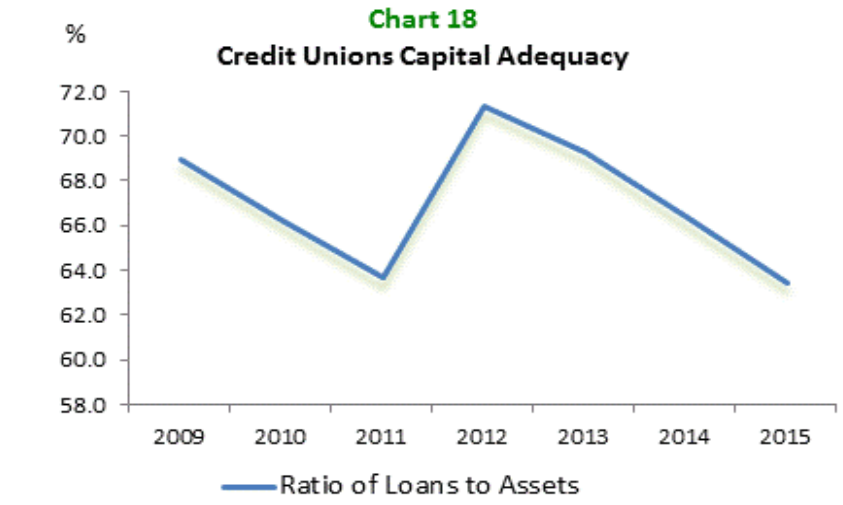
[6] PEARLS is a financial performance monitoring system, which consists, *inter alia*, of a series of financial ratios which provide an assessment of an institution's performance in the areas of: protection, effective financial structure, asset quality, rate of return and cost, liquidity and size of growth.

[7] Total equity is equivalent to capital & surplus resources and includes members' capital, institutional capital and the reserve fund.

year. In contrast, the larger non-performing component—arrears in excess of 90 days—rose by 6.9% ($1.5 million) to $24.0 million, albeit lower than the 23.4% ($4.3 million) expansion a year earlier.



Source: Bahamas Department of Cooperatives



Source: Central Bank of The Bahamas

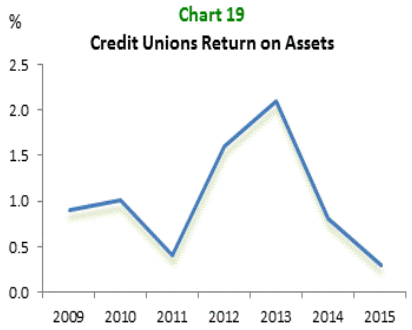
With the improvement in loan delinquencies, the value of collateral against these impaired loans fell modestly by 5.9% ($0.6 million) to $10.2 million, a reversal from a gain of 21.6% ($1.9 million) recorded in the previous year. Consequently, credit unions' exposure edged up by 1.2% ($0.2 million) to $20.2 million, while total provisions for loan losses increased by 19.6% ($2.3 million) to $14.1 million, resulting in the ratio of provisions to total loans moving higher by 50 basis points to 1.0%, while the coverage ratio for short-term arrears held steady at 35% and for the non-performing loans at 100%.

In terms of other credit quality indicators, credit unions' loan-to-asset ratio contracted by 2.9 percentage points to 63.5% at end-2015 (see Chart 18), while the ratio of loan loss allowances to gross loans firmed by 90 basis points to 6.0%.

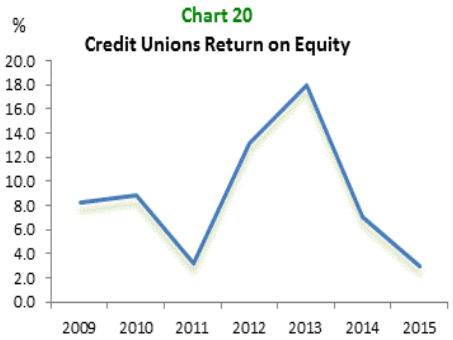
The value of non-earning assets, which included land, buildings, vehicles, furniture and cash, declined marginally by 0.7% to $25.2 million, vis-à-vis growth of 48.1% ($5.6 million) in 2014. As a result, the percentage of non-earning assets-to-total assets fell by 50 basis points to 6.7%; however, the ratio surpassed the prudential ceiling of 5.0% of total assets.

4.3. Profitability

Attributed to a reduction in other "miscellaneous" income and a modest rise in operating expenses, the credit unions' overall profits decreased by $1.6 million (54.7%) to $1.3 million in 2015, albeit a moderation from the $4.1 million (58.7%) decline in the prior year. This led to a 50 basis point softening in the return on assets ratio (ROA) to 0.3% and a 4.0 percentage point narrowing in the return on equity ratio (ROE) to 3.0%[8].



Source: The Central Bank of The Bahamas

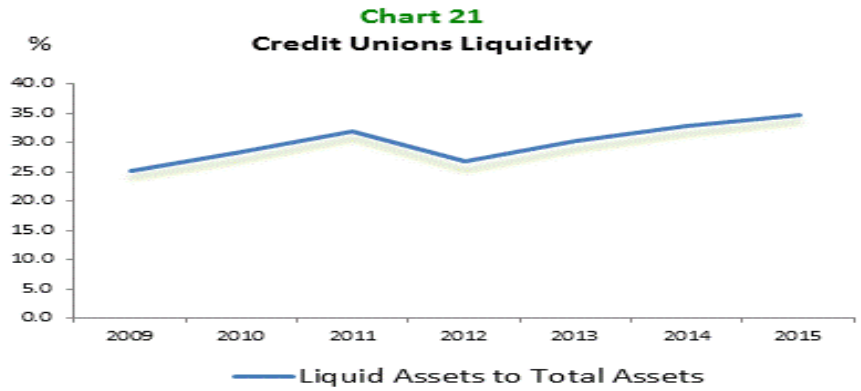


Source: Central Bank of The Bahamas

4.4. Liquidity

During 2015, credit unions' liquidity levels remained robust, bolstered by a combined 15.0% build-up in short-term financial and non-financial investments, which outweighed the 5.6% contraction in cash balances. As a result, the ratio of liquid assets-to-total assets firmed by 2.0 percentage points to 34.7%, year-on-year. Similarly, the alternative indicator, the ratio of short-term payables to total deposits, increased by 1.9 percentage points to 40.4% at end-2015. Both ratios exceeded the minimum prudential standard of 15.0% (see Chart 21).

[8] See Charts 19 and 20.

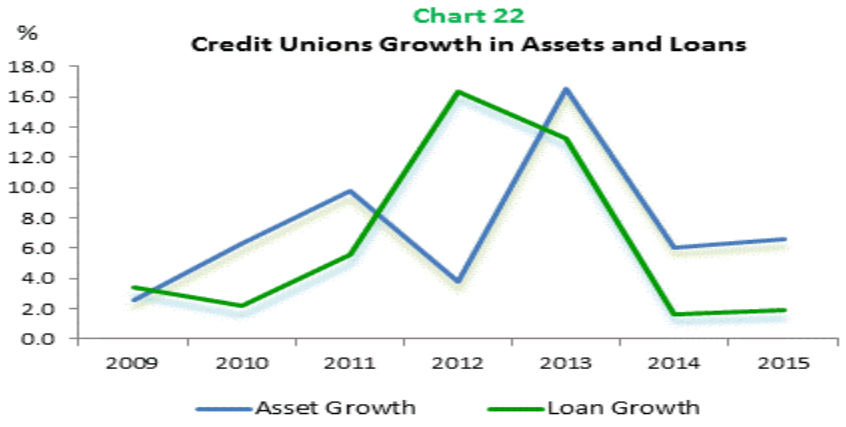


Source: Central Bank of The Bahamas

4.5. Assets

Credit unions' total assets advanced by 6.6% to $370.6 million at end-December 2015, extending the preceding year's gain of 6.1%. The growth in assets was led by a 21.7% ($11.0 million) build-up in deposit balances to $62.0 million, while loans to members—which represented the dominant 63.5% of total assets—grew by 1.9% ($4.4 million) to $235.3 million, after a 1.7% ($3.9 million) increase in the prior year. This outturn reflected broad-based gains, although declines were recorded for small & medium sized enterprises (SMEs) development and revolving lines of credit.

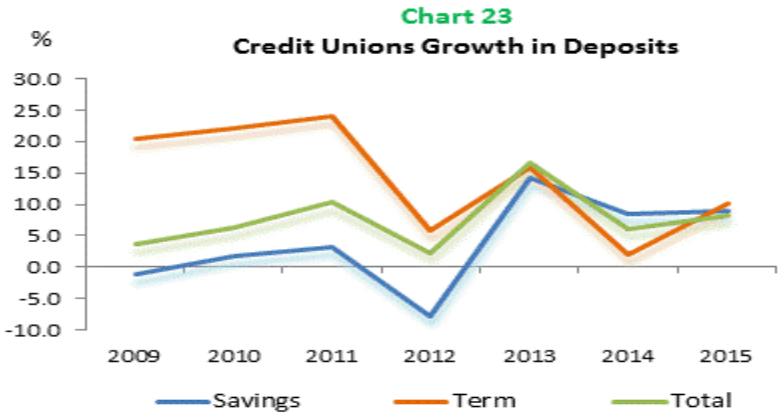
A further breakdown of the loan portfolio showed that the majority of the credit was extended for small-scale consumer purchases (73.7%), followed by mortgages/land (21.9%), and revolving lines of credit (4.4%).



4.6. Deposit Liabilities

Reflecting the continued growth in the sector's membership, which stood at 40,604 persons or approximately 19.4% of the workforce at end-2015, total deposits at credit unions rose by 8.3% ($24.3 million) to $315.9 million at end-December, surpassing the 6.2% expansion in the prior year. The growth in

total balances was due mainly to gains in savings deposits—which accounted for 50.5% of the total—by 9.1% to $159.6 million, following an 8.6% rise a year earlier. Term deposits (at 42.8% of the aggregate) rose by 10.2% to $135.3 million, also surpassing the previous year's 2.0% gain.



Source: Central Bank of The Bahamas

TABLE 6

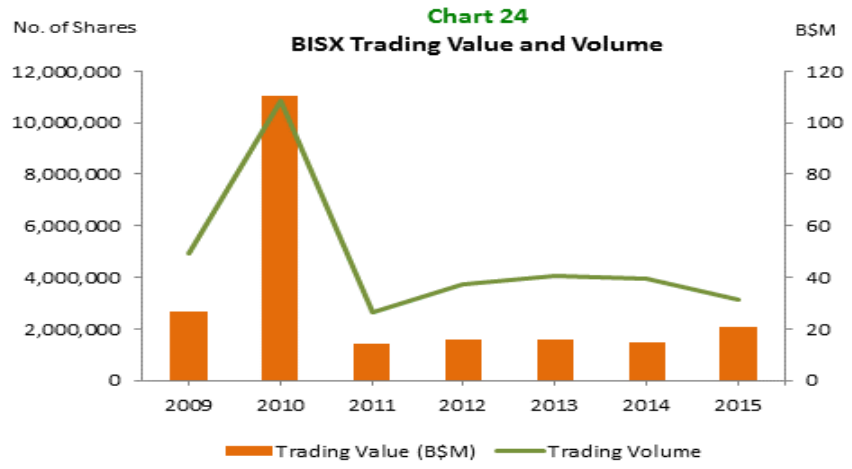
Selected Financials for Credit Unions (B$M)

	2009P	2010P	2011P	2012P	2013P	2014P	2015P
Assets	231.9	246.5	270.6	280.9	327.6	347.7	370.6
Loans	160.1	163.5	172.4	200.6	227.0	230.9	235.3
Deposits	195.9	208.2	229.7	235.3	274.7	291.6	315.9
Liquid Assets	58.6	69.8	86.2	74.7	98.6	113.8	128.4
Savings	121.1	123.4	127.6	117.8	134.8	146.4	159.6
Term Deposits	64.8	79.1	98.2	103.8	120.4	122.8	135.3
Total Deposits	195.9	208.2	229.7	235.3	274.7	291.6	315.9
Total Equity	2.7	2.8	3.6	34.1	38.4	40.7	42.4
Non-Earning Assets	10.8	15.8	12.7	11.6	17.2	25.2	25.0
Allowance	6.3	6.7	7.5	8.5	11.2	11.8	14.1
Short-Term (ST) Payables	n/a	6.5	6.4	0.7	1.2	1.4	1.0
Capital & Surplus	26.0	28.1	31.3	34.1	38.4	40.7	42.4
Provisions	0.6	1.3	1.7	2.7	1.6	1.1	2.3
Net Income	2.1	2.5	1.0	4.5	6.9	2.8	1.3
Institutional Capital	9.1	10.2	10.9	13.3	13.2	14.3	11.9
# of Credit Unions	13.0	13.0	13.0	13.0	7.0	7.0	9.0
Financial Ratios (%)							
Equity-to-Asset Ratio	11.2	11.4	11.6	12.1	11.7	11.7	11.5
Return on Assets	0.9	1.0	0.4	1.6	2.1	0.8	0.3
Return on Equity	8.2	8.8	3.2	13.2	18.0	7.0	3.0
Provisions to Loans	0.4	0.8	1.0	0.3	1.6	0.5	1.0
Loans to Total Assets	69.0	66.3	63.7	71.4	69.3	66.4	63.5
Liquid Assets to Total Assets	25.3	28.3	31.9	26.6	30.1	32.7	34.7
Non-Earning Assets/Total Assets	4.7	6.4	4.7	4.1	5.2	7.2	6.7
Allow. for Loan Losses-to-Gross Loans	4.0	4.1	4.4	4.2	4.9	5.1	6.0
(Liquid Asses-ST Payables)/Total Dep.	29.9	30.4	34.7	31.4	35.5	38.5	40.4

Source: Department of Cooperative Development

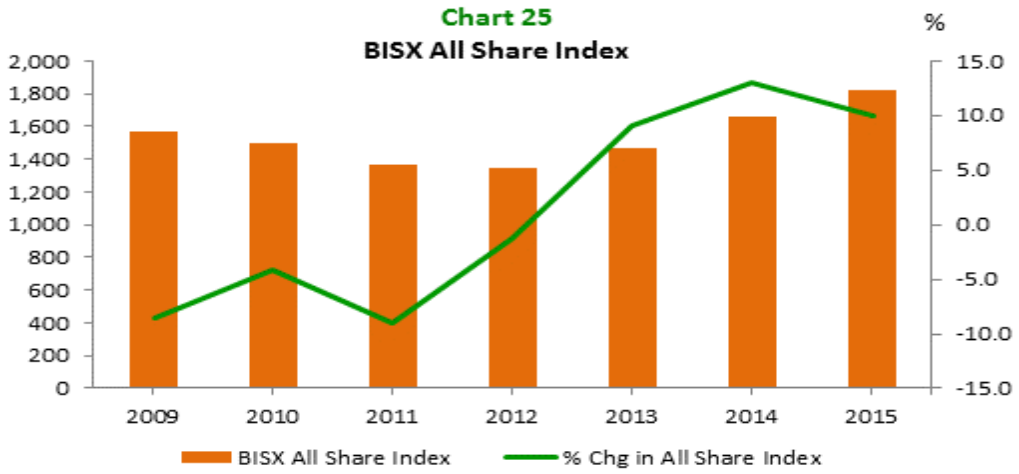
CHAPTER 5: CAPITAL MARKETS

The performance of the local equity market remained relatively subdued over the year, reflecting the challenging domestic economic environment. Specifically, the total volume of securities traded on the Bahamas International Securities Exchange (BISX) declined by 21.0% to an estimated 3.1 million, exceeding the preceding year's 2.0% contraction (see Chart 24), while the average daily trading volume narrowed by 16.2% to 14,694 shares, vis-à-vis a modest 0.6% upturn in 2014. In contrast, due mainly to the trading of higher priced shares, the aggregate trading value firmed by 36.8% to $20.5 million, a reversal from the previous period's 6.1% reduction.



Source: Central Bank of The Bahamas & BISX

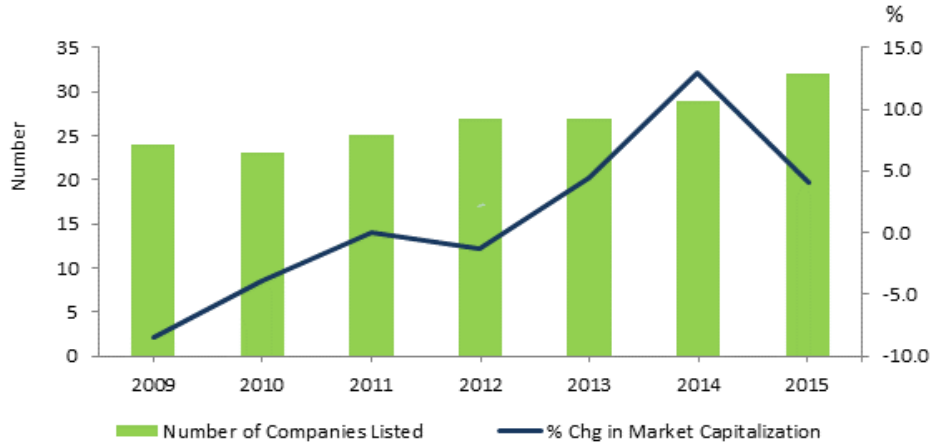
In terms of other market indicators, broad-based gains in share prices resulted in a 9.9% advance in the BISX All Share Index to 1,824.0 points, although lower than the previous year's 13.1% gain (see Chart 25).



Source: Central Bank of The Bahamas & BISX

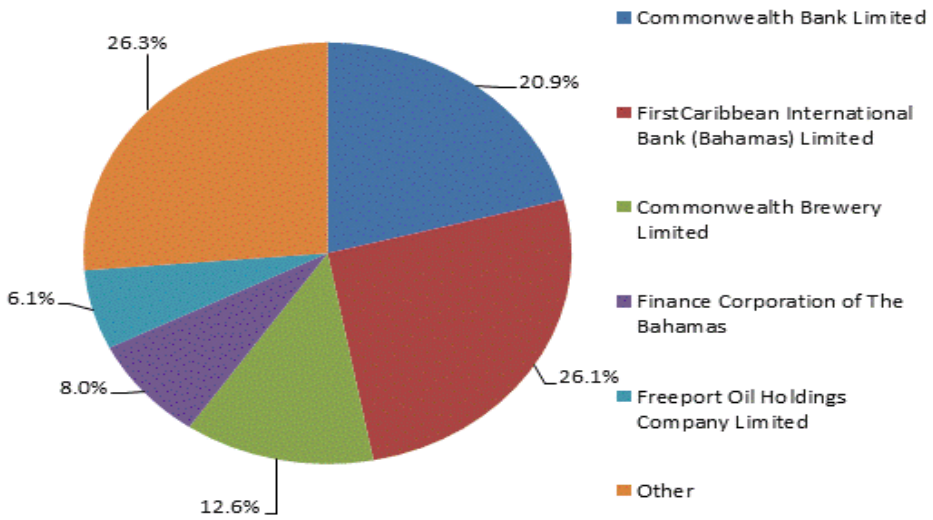
Similarly, market capitalization firmed by 4.1% to $3,684.5 million in 2015, albeit a moderation from the year-earlier expansion of 12.9%. The number of securities listed on the Exchange rose by 3 to 32 (see Chart 29) and comprised 20 common share listings, 8 preference shares and 4 debt tranches at end-2015. The 5 largest companies listed on the exchange accounted for a dominant 73.7% of the Index's total market capitalization, in line with the 73.8% recorded in the prior year (see Chart 27).

Chart 26
BISX Performance Indicators



Source: Central Bank of The Bahamas & BISX

Chart 27
Share of Total Market Capitalization at End-December 2015



Source: Central Bank of The Bahamas & BISX

CHAPTER 6: PAYMENT SYSTEMS

The shift towards automated payments systems continued in 2015, in line with less frequent reliance on checks and cash. In this regard, the Central Bank continued with its programme to improve the efficiency of payment systems operations, including the development of regulatory guidelines for licensing and supervising new and innovative services, including retail payments and mobile/electronic money businesses. Similarly, the Bank sustained its offsite and onsite review of systemically important payment systems.

6.1. Real Time Gross Settlement (RTGS)

The RTGS system is owned and operated by the Central Bank and processes large value transactions greater than B$150,000. Transactions processed through the RTGS in 2015 grew further by 15.9% to 75,654 items, following a 16.5% advance in the prior year. In addition, the value of transactions rose by 23.4% to $22.2 billion, following growth of 38.2% to $18.0 billion recorded in 2014.

6.2. Payment Instruments

6.2.1. Cash

Cash remains the dominant method of making payment, although electronic transactions have also been on the uptrend. Data for the period ending December 2015 revealed that currency in active circulation rose by 5.9% to $246.6 million, following an 8.6% gain in the prior year. Further, its share relative to the more encompassing broad money (M2), firmed slightly to 3.99%.

6.2.2. Automated Teller Machines (ATMs)

During the year, commercial banks continued to expand access to banking services beyond the traditional branch network, with ATM/ABM terminals being installed in non-traditional locations. In 2015, the number of machines installed throughout The Bahamas rose by 3.0% to 344. Of this number, 31 (9.0%) were configured to dispense only Bahamian currency, down incrementally from 10.1% recorded in the previous period, while the remaining installations provide both local currency and US Dollars. The volume of transactions processed through ATM/ABMs declined by 5.6% during the year to 2.6 million; however, the associated value rose by 32.3% to $432.0 million, reflecting larger withdrawals, as the frequency of usage decreased.

6.2.3. Cheques and Nacha Payments

Cheques remain the most dominant method of non-cash payment for goods and services, although recent evidence suggests that, with the exception of large value transactions, usage for routine payments continues to contract. Reflecting this trend, the volume of instruments presented for clearing through the

Automated Clearing House (ACH) in 2015 decreased again by 2.3% to 2,743,184 items, after a 2.9% falloff in the previous year. In contrast, the value of such payments grew further by 2.8% to $7.1 billion.

With regard to the National Automated Clearing House Association (NACHA), the volume of formatted payments processed by BACH—which consist primarily of direct deposits of salaries and transfers—firmed by 10.5% to 2.1 million items, with the associated value advancing by 11.7% to $1,490.3 million.

6.2.4. Debit Cards

As banks continue to convert their ATM/ABM cash cards to branded debit cards, the popularity and use of these payment instruments has grown. Both the volume and value of debit card transactions rose by 8.3% and 56.8% to 7.8 million items and $9.5 billion, respectively.

6.2.5. Credit Cards

Credit cards are issued by the local commercial banks and are generally branded with international logos, such as Visa and MasterCard. Most personal cards have limits which range from $500-$5,000, $5,000-$10,000 and over $10,000. For select high net worth individuals, the specific limits are negotiable.

An analysis of reported credit card data for the year, showed that the number of cards issued advanced by 19.8% to 190,712, relative to a 27.7% gain in 2014, supported in part by banks' incentive programs, such as the issue of pre-approved cards to existing customers. At end-2015, the total value of credit card debt stood at $249.2 million, a slight gain of 1.6% over the $245.3 million recorded at the end of the previous year. The overall growth was concentrated in cards issued with limits in excess of $10,000, which grew by 64.8%, while the value of loans outstanding for this category rose by 17.4% to $61.7 million. The number of cards with limits of $5,000-$10,000 and under $5,000, increased by 27.2% and 16.4%; however, the value of credit outstanding by these two categories contracted by 3.4% and 2.3% to $71.1 million and $116.4 million, respectively.

CHAPTER 7: ASSESSMENT OF RISKS

Financial stability risks remain well contained for The Bahamas and do not appear to be increasing. Although asset quality indicators are expected to show some stabilisation, substantive reduction in credit delinquencies is still dependent on more strengthened economic conditions. The downward revision in medium-term growth potential places upper limits on the pace at which banks' private sector loan servicing difficulties will subside. For banks, a component in resolution is the ability to dispose of real estate collateral, even though this is the least preferred action. A strengthening economy would provide both the demand impetus for asset sales, as well as inject more confidence in the valuation of collateral.

Prospects for reduced financial risks are favoured by the improving regulatory environment. On the supervisory front, the Central Bank's sustained focus on implementing risk-based frameworks is notable. As part of the ongoing rollout of the Basel II and III Programme, specific emphasis has been placed on licensees' internal capital adequacy assessment process (ICAAP), increasing the focus within licensees on assessing their own capacity to measure and mitigate risks. Advances also continue towards establishing a local credit bureau that would reduce information costs that hinder institutions' ability to identify creditworthy borrowers. The legislative framework is already drafted and expected to be approved by the Government in 2016.

In the meantime, the Central Bank remains engaged with other regulators and domestic stakeholders to finalize a national crisis management plan for the financial sector. This will result in additional proposed changes to the legal framework for the Central Bank and enhancements which impact deposit insurance operations.

Oversight of non-bank activities is also being strengthened. The supervision of credit unions now falls within the Central Bank's remit, placing these entities under enhanced monitoring. The Bank now intends to explore proposals for deposit protection schemes for credit unions. In the meantime, support from the IMF's Caribbean Regional Technical Assistance Centre (CARTAC), will advance development of a macro-oversight prudential framework for pension funds and more aspects of insurance companies' operations.

Finally, with regard to other regulatory initiatives, the Insurance Commission introduced a risk-based capital framework for long-term insurance—life and health—companies and stress tests of these entities were implemented. In addition, the Securities Commission of The Bahamas, in an effort to mitigate risk in investment funds, securities and capital markets, introduced the Securities Industry (Anti-Money Laundering and Countering the Financing of Terrorism) Rules, 2015. These rules are intended to address issues such as risk rating, verification of customer identity, as well as the preparation and maintenance of the records of regulated entities' business relationships and transactions.