Financial Stability Report January - June 2014

Issue No. 3

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EXECUTIVE SUMMARY

Over the first six months of 2014, the Central Bank, and its associate regulators—the Securities Commission and Insurance Commission, maintained their oversight of the financial services industry, with the overriding objective of promoting stability and compliance with international principles and practices. This semi-annual report provides an overview of the domestic and global macroeconomic environment, as the context for a review of key outcomes within the various segments of the financial sector. It then concludes with an assessment of the key risks which affect the sector.

Financial sector regulators continued to gather information on, *inter alia,* licensees' assets, capital and income, through onsite and offsite examinations, with the objective of ensuring that they comply with both domestic and international prudential requirements, and maintain the integrity of the financial system. Stress testing conducted by the Bank and the Insurance Commission, aimed at measuring the ability of their domestic licenses to withstand severe and unexpected shocks and confirmed the resilience of the domestic financial sector's capital and liquidity levels.

In the case of the domestic economy, indications are that real GDP continued to expand at a modest pace, benefitting from a rebound in the high value-added stopover segment of the tourism market, owing to the sustained strengthening in fundamentals in key source markets and ongoing private/public sector promotional campaigns. Similarly, construction output remained positive, bolstered by a number of varied-scale foreign–investment funded projects in Nassau—including the multi-billion dollar Baha Mar resort—and the Family Islands. These developments resulted in a marginal reduction in the unemployment rate during the six months to May. However, business conditions remained challenging in the absence of a more broad-based recovery, as evidenced by weakness in private sector credit growth and the excessively high levels of bank liquidity.

Faced with higher loan arrears, banks raised their level of provisioning for bad debts and maintained capital levels in excess of international requirements, thereby mitigating any threats to the sector's financial soundness.

In terms of non-bank financial institutions, preliminary indications are that over the first half of 2014 the insurance sector remained stable, as the assets of both the life and non-life insurance sector continued to expand. Similarly, credit unions—which continue to be a viable vehicle for savings and credit for residents—posted strengthened gains in assets, liquidity and capital levels.

CHAPTER 1: MACROECONOMIC ENVIRONMENT

1.1. The Global Environment

The global economy continued to expand at an uneven pace during the first half of 2014, impacted by sustained softness in developed economies' domestic demand and slow export-led expansions in the emerging markets. As a consequence, the IMF reduced its real GDP forecast for global growth in 2014, by 30 basis points, to 3.3%.

In terms of the developed markets, real GDP in the United States grew by 4.6% in the second quarter of 2014, in a turnaround from the 2.1% decrease in the prior three-month period (see Table 1). In Europe, where outcomes were mixed, output growth in the United Kingdom steadied at 0.8%, vis-à-vis the previous quarter, to contrast with a loss of momentum in the euro area's recovery, to a flat position, following a gain of 0.2% in the prior period. The Asian economic performance featured China's relatively stable 7.5% rate of expansion in the second quarter, benefitting from increases in manufacturing, mining and quarrying output. However, the Japanese economy contracted by 1.8%, due predominantly to the imposition of a new sales tax in April, in contrast with a 1.6% expansion recorded in the previous period.

TABLE 1

Selected Indicators for Developed Economies (%)

	2012	Q1 2013	Q2 2013	Q1 2014	Q2 2014
GDP Growth Rates					
United States	2.8	1.8	2.8	-2.1	4.6
Euro Area	-0.7	-0.2	0.3	0.2	0.0
United Kingdom	0.3	0.5	0.7	0.8	0.8
China	7.7	7.7	7.6	7.4	7.4
Japan	1.4	1.2	0.8	1.6	-1.8
Unemployment Rates					
United States	8.1	7.5	7.5	6.7	6.1
Euro Area	11.4	12	12.1	11.7	11.5
United Kingdom	8.0	7.8	7.8	6.8	6.4
China	4.1	4.1	4.1	4.1	4.1
Japan	4.4	4.1	3.9	3.6	3.7
Inflation Rates					
United States	2.1	1.4	1.7	1.5	2.1
Euro Area	2.5	1.7	1.6	0.5	0.5
United Kingdom	2.8	2.8	2.9	1.6	1.9
China	2.6	2.1	2.7	2.4	2.3
Japan	0.0	-0.6	-0.3	1.5	3.6

Sources: IMF, International Statistical Bureaus

Reflecting the tepid level of economic growth, employment conditions improved modestly in most of the leading economies. Specifically, in the United States, the unemployment rate fell by 60 basis points over the quarter to 6.1%, while the United Kingdom's jobless rate decreased by 40 basis points to 6.4% and the euro area's rate softened by 20 basis points to 11.5%. Employment conditions remained favourable in Asia, although the jobless rate in Japan inched higher by 10 basis points to 3.7% and China's rate steadied at 4.1%.

Buoyed by higher costs for fuel and other commodities, most of the major economies recorded slight gains in inflation rates, albeit from a low base. The largest increase was noted in Japan, where the rate more than doubled to 3.7% from 1.5% in the prior quarter.

Over the first six months of the year, leading economies' central banks continued their efforts to stimulate economic activity, by either maintaining or expanding their highly accommodative monetary policy stance. In particular, the United States' Federal Reserve held its policy rates at historic lows and scaled back the pace of its asset purchases, as near-term economic prospects improved. The European Central Bank (ECB) reduced its key rates, in a bid to encourage growth within its member states, while the Bank of England left its Bank Rate unchanged and maintained its "quantitative easing" programme. In Asia, the People's Bank of China's stimulus initiatives included the lowering of the reserve requirement ratios, for both rural deposit taking entities and commercial banks, while the Bank of Japan kept its ¥50 trillion asset purchase programme in place and announced a target for its monetary base.

TABLE 2

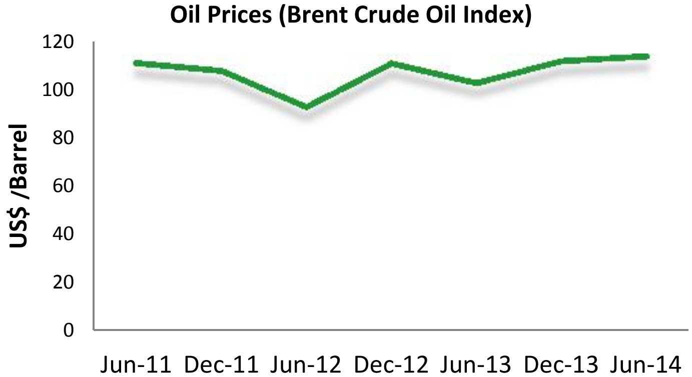
Selected Caribbean Countries GDP Growth Rates (%)

	2008	2009	2010	2011	2012	2013
Bahamas	-2.3	-4.2	1.5	1.1	1.0	0.7
Barbados	0.3	-4.1	0.2	0.8	0.0	-0.7
Belize	3.8	0.3	3.1	2.1	4.0	1.6
Eastern Caribbean	2.6	-5.2	-3.3	-0.1	0.2	0.7
Guyana	2.0	3.3	4.4	5.4	4.8	4.8
Jamaica	-0.8	-3.4	-1.4	1.4	-0.5	0.5
Suriname	4.1	3.0	4.2	5.3	4.8	4.7
Trinidad & Tobago	3.4	-4.4	0.2	-2.0	1.2	1.6

Sources: IMF, international statistical bureaus and regional central banks

Chart 1

Oil Prices (Brent Crude Oil Index)



Source: Bloomberg

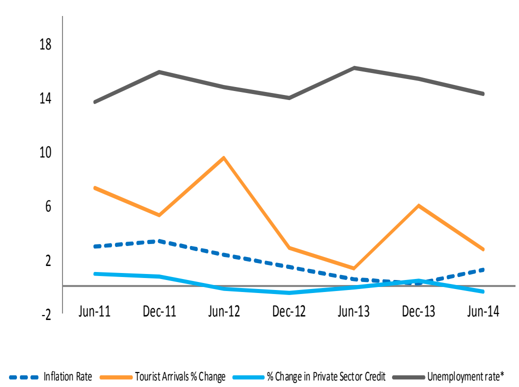
1.2. The Domestic Environment

The domestic economy maintained its mildly positive growth trajectory during the first half of 2014, as a rebound in the high value-added stopover segment of the market led to growth in tourism sector output. Total visitor arrivals expanded by 2.8% to 3.3 million (see Table 3), vis-á-vis the first six months of 2013, owing to gains in both the air (2.6%) and sea (2.9%) segments. Similarly, construction sector output was sustained by foreign investment-led activity, even as the Government scaled-back its capital works programme and domestic building projects continued to face the challenges of both low demand and more stringent lending conditions. In this environment, the jobless rate narrowed by 1.1 percentage points to 14.3% during the six months ending May, a turnaround from a 2.2 percentage point increase a year earlier, while inflation edged upwards, led by higher costs for alcoholic beverages, food and transportation.

During the second half of FY2013/14, the central Government's overall deficit narrowed by 44.7% ($123.5 million) to $152.7 million, as a 14.3% ($98.7 million) expansion in revenue outpaced the slight gain in spending. Financing, totalling $487.4 million, was sourced from a combination of domestic and external sources—including a US$300 million international bond and internal short-term foreign currency loans.

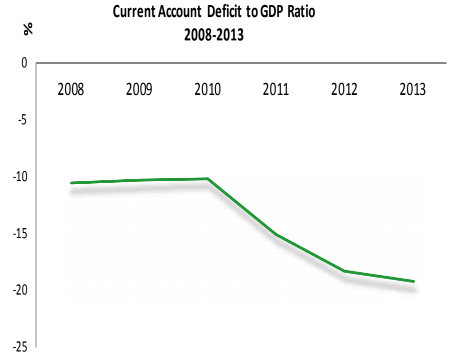
In external developments, the current account deficit widened during the first half of the year, by an estimated 40.6% ($193.3 million) to $669.7 million. This outturn was attributed to a deterioration in the goods deficit and a reduction in the services account surplus, as an increase in construction services related outflows overshadowed gains in tourism earnings. In contrast, foreign investment-related inflows supported a more than two-fold expansion in the capital and financial account surplus, to $810.2 million from $314.0 million, in 2013.

Chart 2
Sellected Indicators



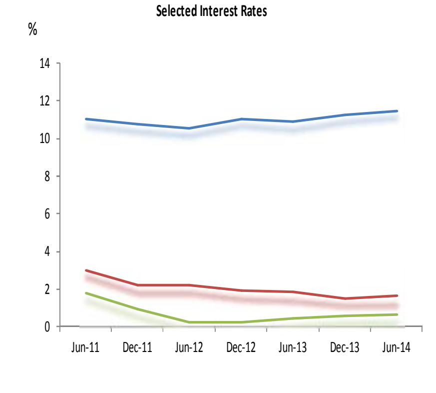
Source: The Central Bank of the Bahamas, The Department of Statistics

Chart 3
Current Account Deficit to GDP Ratio
2008-2013



Source: Central Bank of The Bahamas

Chart 4
Selected Interest Rates



Source: Central Bank of The Bahamas

Second quarter monetary developments were dominated by Government's foreign currency borrowings, and to a lesser extent foreign currency inflows from real sector activities. Together, these supported a robust expansion in both bank liquidity and external reserves, by $222.4 million and $275.2 million, to $1.4 billion and $1.0 billion, respectively at end-June. Reflecting the challenging employment and business conditions, private sector credit remained flat and bank loan arrears and non-performing loans firmed, by 0.3 and 0.7 percentage points, to 22.2% and 16.4% of the total loan portfolio, respectively. Another outturn was the widening of the average interest rate spread, due to an increase in the weighted average loan rate and a softening in the corresponding deposit rate (see Chart3).

TABLE 3:

The Bahamas: Macroeconomic Indicators

	2009	2010	2011	2012	2013	Jun-12	Jun-13	Jun-14
B$/US$: Exchange Rate	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Nominal GDP Growth Rate (%)	-5.2	1.1	0.3	3.6	2.5	n.a.	n.a.	n.a.
Real GDP Growth Rate (%)	-4.2	1.5	1.1	1.0	0.7	n.a.	n.a.	n.a.
Inflation Rate (Avg. chg. in RPI)	1.9	1.3	3.2	2.0	0.4	2.5	1.0	0.8
Unemployment Rate	14.2	n.a.	15.9	14.0	15.4	n.a.	16.2	14.3
Overall Fiscal Balance (B$M)	-403.1	-376.7	-319.8	-557.3	-485.3	-287.3	-276.2	-152.7
as % of GDP	-5.2	-4.8	-4.1	-6.8	-5.8	n.a.	n.a.	n.a.
Private Sector Credit (B$000)	6,595.9	6,572.7	6,647.5	6,629.3	6,535.4	6,656.0	6,516.4	6,471.5
Weighted Avg. Lending Rate %	10.6	11.0	11.0	10.9	11.1	10.6	10.9	11.5
Weighted Avg. Deposit Rate %	3.8	3.4	2.6	2.0	1.7	2.2	1.8	1.6
Treasury Bill Rate %	2.8	2.4	1.0	0.6	0.7	0.6	0.5	0.7
Gross Int'l Reserve (B$M)	815.9	860.4	884.8	810.2	741.6	928.0	797.1	1,016.8
Import Cover Ratio*	20.9	21.6	19.7	16.0	15.4	18.3	17.0	20.4
Current Balance (B$M)	-808.5	-796.8	1,192.7	1,504.6	1,490.1	-548.3	-476.4	-669.7
as % of GDP	-10.3	-10.1	-150	-18.3	-17.7	n.a.	n.a.	n.a.
Total Public Sector Debt (B$M)	4,266.1	4,799.7	4,948.0	5,770.2	6,350.7	5,138.4	6,069.5	6,534.9
of which: External	767.3	915.9	1,044.5	1,464.3	1,612.0	1,160.9	1,481.3	1,918.3
Internal	3,498.8	3,883.8	3,908.7	4,305.9	4,737.0	3,977.5	4,588.2	4,616.6
Total Arrivals ('000s)	4,645.1	5,254.8	5,587.6	5,940.2	6,150.8	3,180.6	3,224.6	3,315.0
Tourist Expenditure (B$M)	2,014.2	2,163.2	2,141.6	2,311.6	2284.7	1,328.9	1,237.3	1,255.5
Construction Number of Permits Issued	2,416.0	1,996.0	1,948.0	1,916.0	1,462.0	1,004.0	661.0	n.a.
Value of Starts (B$M)	360.9	154.2	147.5	116.6	140.2	62.9	49.4	n.a.
Value of Completion's (B$M)	297.0	337.6	500.6	317.1	216.6	102.1	110.8	n.a.
Oil Prices**	63.5	80.3	111.8	111.4	109.1	112.5	107.5	109.7

Source: Central Bank of The Bahamas, Department of Statistics, Bloomberg

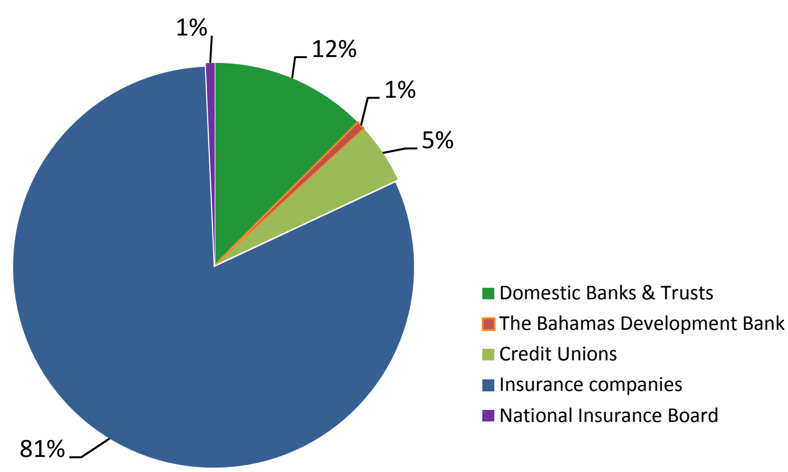
n.a. - not available; *Non-oil (cif) in weeks; ** Brent Crude Oil Index

CHAPTER 2: THE FINANCIAL SYSTEM

2.1. Overview

The Bahamian financial sector contributes approximately 15% of the country's GDP, has in excess of 400 banks and non-banks and employs over 6,500 individuals. The sector is comprised of domestic banks & trusts, money transmission businesses (MTBs), credit unions, insurance companies, financial and corporate service providers, capital market entities, The Bahamas Development Bank, the National Insurance Board and The Bahamas Mortgage Corporation[1] (see Chart 5). Within the dominant banking and trust sector, domestic banks numbered 18, offshore banks and trust companies, 246 (see Table 4).

Chart 5
Domestic Banks & Non-banks (June 2014)



Banking and trust business recorded an estimated US$283.4 billion[2] in assets at end-June 2014, the bulk of which was in offshore banks ($227.6 billion), followed by domestic banks ($55.7 billion), and the Bahamas Development Bank ($0.06 billion). Among the non-banks, assets of the insurance companies, credit unions and the National Insurance Board totalled $1.5 billion, $345.3 million and $1.8 billion, respectively (see Chart 6).

2.2. Domestic Banks & Trusts

Regulated by the Central Bank under the Banks and Trust Companies Regulations Act, 2000, banks and trust companies comprise commercial banks, other local financial institutions (OLFIs) and offshore banks. During the first half of 2014, the number of banks and trust companies decreased marginally, by 3 to 264 (see Table 4), attributed solely to a decline in the offshore banks' count, to 246 from 249, while the aggregate number of domestic banks held steady at 18 (see Table 4). When compared to the first

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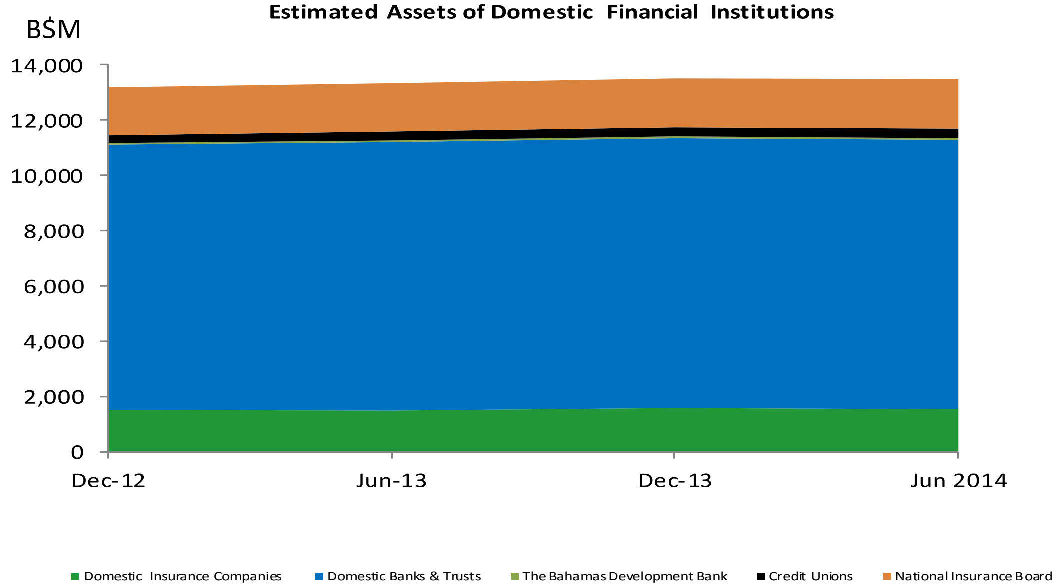
[1] Balance sheet information for the Bahamas Mortgage Corporation is currently not available.
[2] The Bahamian Dollar is equivalent to the U.S. Dollar.

six months of 2013, domestic banks and trust companies' assets firmed by $42.2 million (0.4%) to $9.8 billion, which contrasted with a contraction in the assets of offshore banks, by 13.4% ($35.1 million) to $227.6 billion.

Chart 6
Estimated Assets of Domestic Financial Institutions



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

TABLE 4
Structure of the Financial System

	2009	2010	2011	2012	2013	Jun-13	Jun-14
Banks &Trusts							
Offshore Banks	252	256	260	249	249	249	246
Domestic Banks	20	20	18	19	18	19	18
Total	**272**	**276**	**278**	**268**	**267**	**268**	**264**
The Bahamas Development Bank	1	1	1	1	1	1	1
Non-Bank Financial Institutions							
Mutual Funds	788	753	713	652	735	660	768
International Business Companies	160,383	160,793	163,499	166,342	169,575	167,873	171,104
Credit Unions	13	13	13	13	11	7	7
Insurance companies	174	178	127	139	147	141	144
Domestic Companies & Agents	*154*	*157*	*114*	124	128	123	124
External Insurers	*20*	*21*	*13*	15	19	18	20
National Insurance board	1	1	1	1	1	1	1

Source: Central Bank of The Bahamas

2.2.1. The Bahamas Development Bank

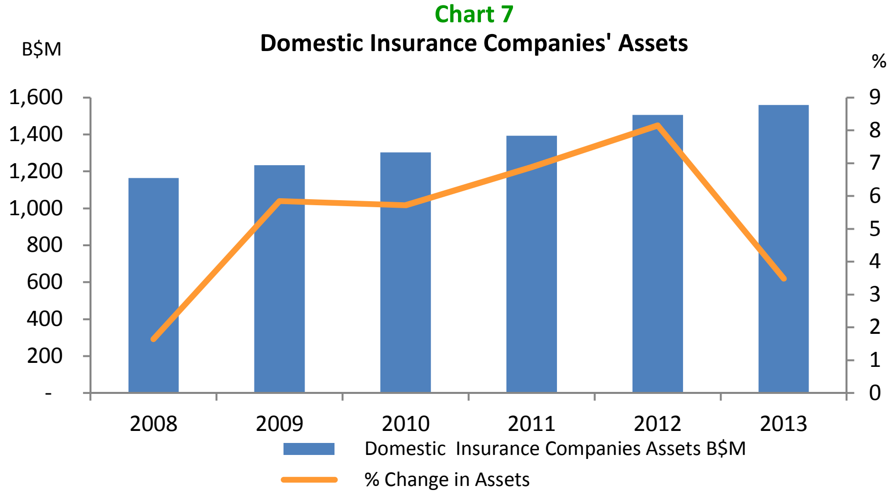
The Bahamas Development Bank (BDB), a state-owned lending institution[3], is regulated by the Bahamas Development Bank Act, 1974, and facilitates funding for investments in agriculture, fisheries, tourism, manufacturing and transportation services, which have the potential to positively impact the growth and development of the economy. During the first six months of the year, BDB's total assets contracted by $3.6 million (5.4%), year-on-year, to $61.7 million. Underlying this outturn, total loans fell by $2.5 million (6.2%) to $38.4 million, while balances held for other local institutions decreased relative to the corresponding 2013 period, by 20.5% to $2.8 million.

2.3. Non-Bank Financial Institutions

2.3.1. Insurance Companies

Insurance companies and insurance intermediaries are non-bank institutions which fall under the supervisory control of the Insurance Commission of The Bahamas and are governed by the Insurance Act of 2005 and the External Insurance Act, 2010. According to preliminary statistics, the number of insurance companies and intermediaries fell by 3 (2.0%) over December 2013 to 144 at end-June, after increasing by 2 (1.4%) to 141 in the corresponding period of 2013. In particular, the number of domestic and external insurers grew by one (1) each, to 27 and 20, respectively. Based on provisional statistics, the value of domestic insurance companies' assets decreased by 3.4% ($53.0 million) over December 2013 to $1.52 billion (see Chart 7)—extending the 1.8% ($27.8 million) year-earlier reduction in total assets to $1.48 billion. Gross premiums were up by $7.7 million to $368.5 million at end-June, 2014.

Chart 7
Domestic Insurance Companies' Assets



Source: Insurance Commision of The Bahamas

[3] The Central Government also holds a majority interest in the Bank of The Bahamas International (BOB).

2.3.2. The National Insurance Board (NIB)

The National Insurance Board's portfolio investments continued to expand during the first half of 2014. From end-2013, the value of total assets firmed by $18.3 million (1.0%) at $1.79 billion—although below the previous year's $34.0 million (1.9%) gain. Assets are predominantly held in the form of Bahamas Government Registered Stock (BGRS), which decreased, year-on-year, by $26.7 million (4.0%), while holdings of equity securities advanced by $22.8 million (19.1%) and net investments in direct finance leases, moved lower by $31.5 million (34.6%).

2.3.3. Credit Unions

Governed by the Cooperatives Societies Act, 2005, credit unions continue to establish themselves as an alternative to conventional commercial banks, providing savings and loan services to more than 38,000 members. At end-June 2014, the number of institutions registered stood at seven (7), a decline of four (4) when compared to end-December 2013, as some entities were consolidated and others were wound-down. Since end-December 2013, growth in total assets of the sector slackened to 5.4% ($17.7 million) from 13.7% ($38.3 million) in the same period a year earlier. Loans to members comprised the majority of the assets, at 64.6%, and increased by 1.8% ($4.0 million) to $222.9 million from a year earlier. Of this amount, consumer loans represented 73.9%, followed by mortgages at 19.9% and revolving lines of credit at 6.0%.

On the liabilities side, total deposits rose by 6.0% ($16.4 million) to $291.1 million over the six months to end-June 2014, a marked slowdown from the 14.5% ($34.1 million) gain registered in the prior period. The aggregated capital & surplus position improved by 2.6% ($1.0 million) to $39.4 million.

2.3.4. Other Non-Bank Institutions

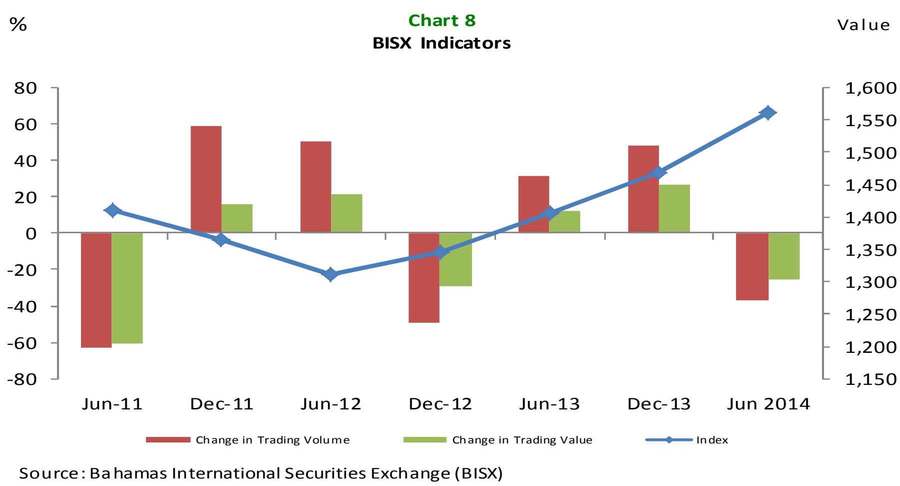
The Securities Commission of The Bahamas oversees the activities of mutual funds, the domestic capital market, and financial and corporate service providers, as governed by the Securities Industry Act, 2011, the Investment Funds Act, 2003, and the Financial and Corporate Service Providers Act, 2000, respectively. Supervision of International Business Companies (IBCs) falls under the purview of the Registrar General Department, which ensures that these entities are compliant with respect to the International Business Companies Act, 2000.

Mutual funds business—second only to offshore banking in terms of size—registered further gains in the first half of 2014 over end-December 2013. The number of active funds firmed by 33 (4.5%) to 768 at end-June, significantly outpacing the previous period's increase of 6 (1.2%) to 660. In addition, net asset values moved higher by 16.1% ($20.6 million) to $148.7 billion, in contrast to the prior year's 2.2% ($2.5 million) contraction. In the area of company formation, IBC registrants rose by 1,529 (0.9%), for an overall count of 171,104 at end-June 2014, which was in line with 2013's gain of 1,531 (0.9%).

2.3.4. Other Non-Bank Institutions

During the six-month period, activity on the Bahamas International Securities Exchange (BISX) was relatively subdued. Compared with the same period last year, both the volume and value of securities traded fell by 7.2% to 1.5 million, and by 5.4% to $7.0 million, respectively. Total market capitalization of all of the shares listed on the Exchange advanced by $194.9 million (6.2%) to $3.32 billion, and the number of listings—comprising common and preference shares and debt tranches—remained at 27.

As depicted in Chart 8, the BISX All Share Index—a market-capitalization weighted index, consisting of all primary market listings excluding debt securities—rebounded by 6.2% to 1,559.9 during the six-month period, from a 4.2% reduction a year earlier.



CHAPTER 3: BANKING SECTOR

As a major international financial jurisdiction, The Bahamas' banking sector comprised one hundred and eight (108) public licensees at end-June, of which one hundred (100) were offshore banks with assets totalling $227.6 billion. The remaining eight (8) were onshore (domestic) commercial banks, having assets totalling $9.7 billion. As a result of the country's Exchange Control regime, offshore banks are not permitted to hold balances in Bahamian dollars, except for local expenses, and are prohibited from investing in domestic securities. As a consequence, this report only provides an in-depth analysis of onshore banks.

3.1. Onshore Banking Sector

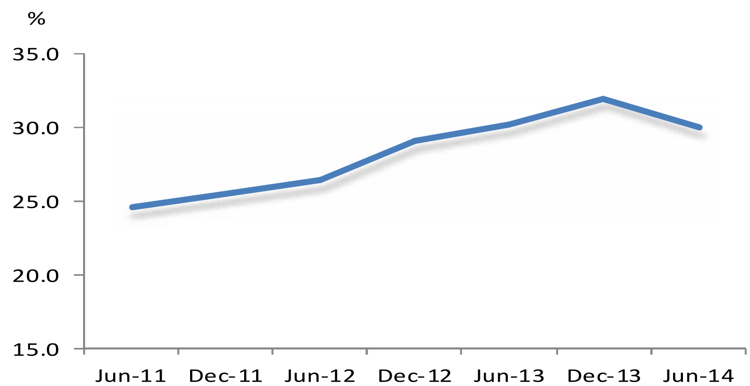
The domestic banking sector is comprised of eight (8) commercial banks, of which five (5) have parent institutions headquartered in Canada[4], while three (3) are domestically owned. Asset holdings of the three (3) largest banks account for the bulk (66.7%) of the total. Their funding derives mainly from sizable deposit holdings, and lending is concentrated in residential mortgages and consumer loans. During the first half of the year, banks maintained their high liquidity levels in the form of balances with the Central Bank and investments in Government paper.

[4] Four (4) are subsidies and one (1) is characterized as a branch.

3.1.1 Capital Adequacy

As illustrated in Chart 9, the banking sector continued to be adequately capitalized, with a Tier 1 capital ratio of 30.0% at end-June 2014. Although the ratio was 20 basis points lower than the same period last year, it remained well above the Bank's target and trigger ratios, of 17.0% and 14.0%, respectively, and significantly in excess of the 8.0% international benchmark.

Chart 9
Regulatory Capital to Risk-Weighted Assets

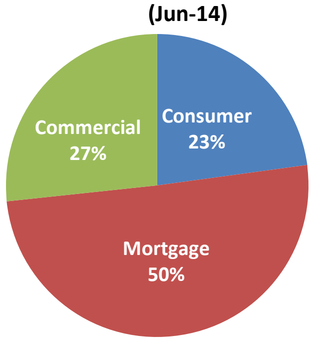


Source: Central Bank of The Bahamas

3.1.2 Asset Quality

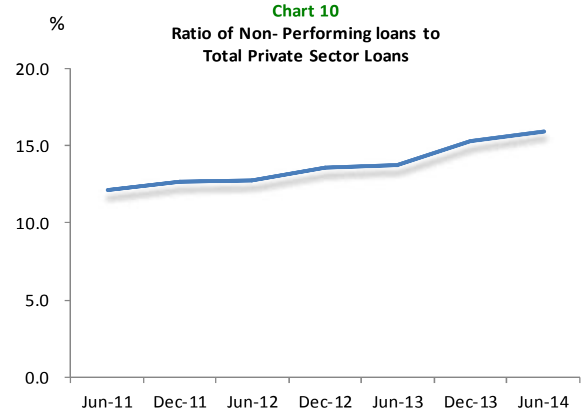
Amid persistent mildness in economic activity and the slack in the job market, total private sector loan arrears rose by $7.3 million (0.5%) to $1,359.5 million in the six months to June, albeit a slowdown from the $16.0 million (1.3%) growth in the corresponding 2013 period. Underlying this development, non-performing loans (NPLs)—which constitute arrears in excess of 90 days and on which banks have ceased accruing interest—expanded by $34.4 million (3.6%) to $1,000.4 million, extending 2013's increase of $6.0 million (0.7%) (see Chart 10). Providing some offset, arrears in the 31-90 day segment declined by $27.0 million (7.0%) to $359.1 million, reversing the year-earlier $10.0 million (2.6%) expansion.

Chart 11
Composition of Private Loan Arrears (Jun-14)



Source: Central Bank of The Bahamas

Chart 10
Ratio of Non- Performing loans to Total Private Sector Loans



Source: Central Bank of The Bahamas

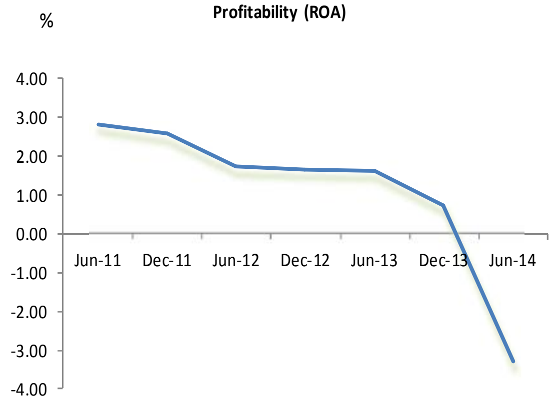
From a sectoral standpoint, the deterioration in credit quality during the six-month period was solely attributed to commercial loan arrears, which advanced by $19.2 million (5.6%) to $362.8 million, although moderating from the prior year's $77.5 million (28.6%) spike. In contrast, both the consumer and mortgage segments fell, by $7.3 million (2.3%) and $4.6 million (0.7%) to $310.3 million and $686.4 million, respectively, following reductions of $28.0 million (10.0%) and $33.4 million (4.8%) in 2013 (see Chart 11).

3.1.3 Profitability

Overall, banking sector profitability deteriorated during the first six months of 2014, mainly reflecting goodwill impairment within one domestic entity and a sharp increase in bad debt provisioning. Specifically, losses from "non-core" operations more than doubled to $127.7 million, exceeding the $30.3 million posted a year earlier. Underlying this outturn was a surge in the level of provisioning for bad debt and a rise in depreciation costs, which eclipsed the gain in fee-based income. Further, operating costs expanded by $133.8 million (81.7%) to $297.7 million, led by higher "miscellaneous" operating expenses ($133.4 million) and staff outlays ($2.1 million) (see Charts 12 & 13).

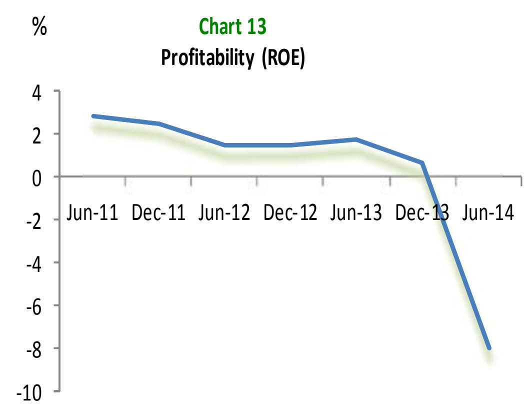
Over the six-months to June, banks registered a net loss of $160.2 million, vis-à-vis a net income of $78.1 million in the corresponding period of 2013, as the return on assets (ROA) and return on equity (ROE) contracted to -3.3% and -8.0%, relative to rates of 1.6% and 1.8% recorded during the same period of the previous year. The spread between loan and deposit rates narrowed by 6 basis points to 6.8%, following a 54 basis point widening to 6.3% a year earlier.

Chart 12
Profitability (ROA)



Source: Central Bank of The Bahamas

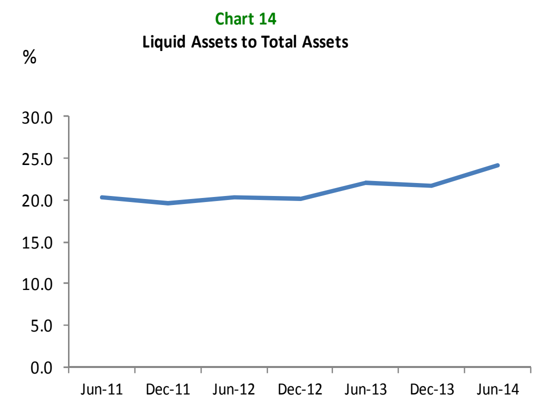
Chart 13
Profitability (ROE)

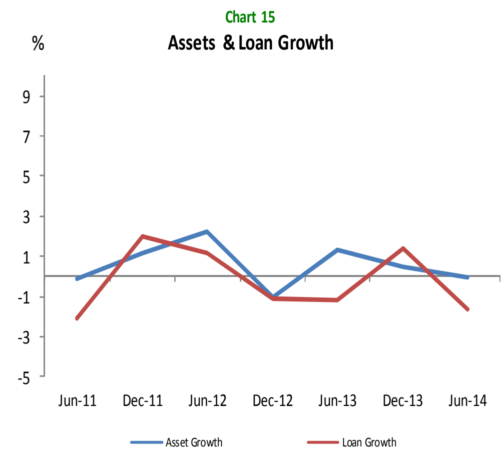


Source: Central Bank of The Bahamas

3.1.4 Liquidity

Supported by foreign currency inflows from Government's external bond receipts and real sector activity, banking sector liquidity levels remained elevated during the first half of 2014. Excess reserves rose by $150.3 million (36.9%) to $557.7 million at end-June 2014, while the ratio of liquid assets to total assets advanced to 24.2%, in comparison to 22.1% in the same period of 2013 (see Chart 14). In addition, the broader excess liquid assets—which include holdings of Government securities—stood higher by $222.4 million (19.5%) at $1.3 billion, when compared to 2013, with the excess over the statutory requirement broadening to 135.4% from 116.0%.





Source: Central Bank of The Bahamas

TABLE 5

Summary of Total Domestic Assets of the Banking System (B$M)

	2009	2010	2011	2012	2013	Jun-13	Jun-14
Total Domestic Assets	**8,970.8**	**9,382.6**	**9,489.0**	**9,602.1**	**9,773.3**	**9,723.5**	**9,765.7**
Loans and Advances	**6,951.1**	**7,075.5**	**7,103.7**	**7,106.0**	**7,118.8**	**7,021.3**	**7,003.0**
Government	76.5	180.3	145.7	152.4	253.6	164.0	230.9
Public Corp.	305.9	339.8	326.8	338.5	329.8	340.8	300.6
Other	6,568.7	6,555.3	6,631.1	6,615.2	6,535.4	6,516.4	6,471.5
Other Assets	**479.4**	**449.0**	**441.6**	**491.6**	**512.3**	**484.3**	**332.6**
Till Cash	**111.8**	**113.2**	**126.9**	**127.4**	**138.1**	**93.7**	**100.2**
Balance with Central Bank	**375.6**	**518.7**	**560.1**	**563.3**	**513.6**	**659.0**	**757.5**
Securities	**1,052.9**	**1,226.3**	**1,256.7**	**1,313.9**	**1,490.5**	**1,465.3**	**1,572.4**
Central Government	918.6	1,093.3	1,123.0	1,180.4	1,354.6	1,332.9	1,436.6
Rest of Public Sector	107.0	115.6	117.4	119.4	119.4	119.4	119.1
Private Sector	27.2	17.4	16.4	14.1	16.6	12.9	16.7

Source: Central Bank of The Bahamas

3.1.5. Growth in Assets

Domestic banks' total assets decreased slightly by 0.1% ($7.6 million) over the first half of 2014, reversing the 1.3% ($121.4 million) expansion for the corresponding period of 2013. Other "miscellaneous" assets contracted by 35.1% ($179.7 million), while loans and advances fell by 1.6% ($115.7 million), primarily due to reductions in loans to the private sector, of $63.9 million (1.0%); Government, of $29.2 million (8.8%) and public corporations, of $22.7 million (8.9%). In a significant offset, banks' balances with the Central Bank surged by $243.9 million (47.5%), amid sizeable Government debt-related foreign currency inflows and weak domestic demand. Banks' holdings of securities grew by $81.9 million (5.5%), mainly in the form of Treasury bills (see Table 5).

3.1.6. Loan Rates

Banks' weighted average loan rate rose by 40 basis points to 11.5% at end-June 2014 (see Table 6). By loan type, the average interest rate firmed by 10 basis points to 7.3% for residential mortgages, but steadied at 13.7% for the dominant consumer loan segment. In contrast, the average commercial mortgage rate receded by 10 basis points to 8.1%.

TABLE 6
Banking System Loan Rates (%)

	2009	2010	2011	2012	2013	Jun-13	Jun-14
Weighted Average Rate	10.6	11.0	11.0	10.9	11.1	10.9	11.5
Consumer Loans	12.7	13.2	13.4	13.4	13.7	13.5	13.7
Residential Mortgages	8.3	8.1	7.8	7.5	7.3	7.3	7.3
Commercial Mortgages	8.6	8.8	8.4	8.3	8.2	7.8	8.1

Source: Central Bank of The Bahamas

3.1.7. Deposit Rates

In terms of deposits, the weighted average interest rate fell by 10 basis points to 1.6% at end-June 2014 (See Table 7). By category, the range on fixed balances narrowed to 1.2% - 1.9%, from 1.4% - 2.4% a year earlier. In contrast, the average rate of interest earned on saving deposits stabilized at 1.0% at end-June 2014.

TABLE 7
Banking System Deposit Rates (%)

	2009	2010	2011	2012	2013	Jun-13	Jun-14
Weighted Average Rate	3.8	3.4	2.6	2.0	1.7	1.8	1.6
Savings Deposits	2.1	1.9	1.7	1.6	1.0	1.0	1.0
Fixed Deposits							
Up to 3 Months	3.6	3.2	2.3	1.6	1.4	1.4	1.2
Up to 6 Months	3.9	3.6	2.7	1.9	1.4	1.6	1.3
Up to 12 Months	4.3	4.0	3.2	2.5	2.2	2.3	1.9
Over 12 Months	4.4	4.0	3.2	2.7	2.2	2.4	1.9

Source: Central Bank of The Bahamas

TABLE 6							
Banking System Loan Rates (%)							
	2009	**2010**	**2011**	**2012**	**2013**	**Jun-13**	**Jun-14**
Weighted Average Rate	10.6	11.0	11.0	10.9	11.1	10.9	11.5
Consumer Loans	12.7	13.2	13.4	13.4	13.7	13.5	13.7
Residential Mortgages	8.3	8.1	7.8	7.5	7.3	7.3	7.3
Commercial Mortgages	8.6	8.8	8.4	8.3	8.2	7.8	8.1

Source: Central Bank of The Bahamas

3.1.8 Stress Testing Analysis

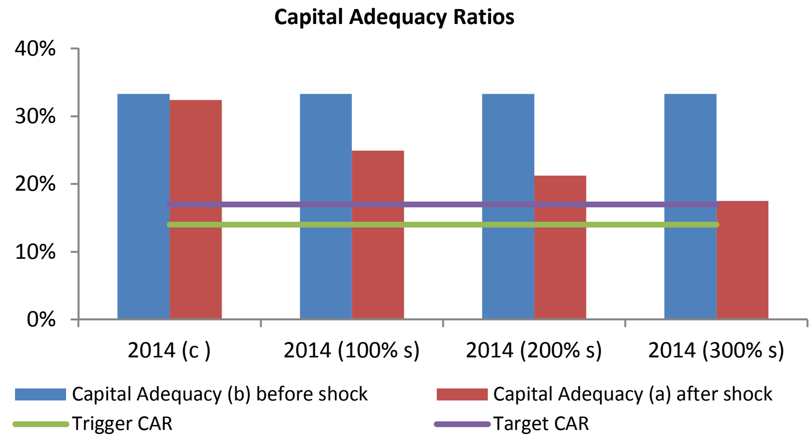
During the first half of 2014, the Central Bank updated its stress testing framework by adding liquidity and interest rate models to its analysis. Unlike the credit risk model, which is forward looking and projects three years into the future, the liquidity and interest rate stress tests provides results at a point in time. The findings of all three tests showed that the overall banking system continued to be resilient to shocks.

Credit Risk Stress Test Results: The credit risk stress test model analyses the level of non-performing loans, provisioning levels, earnings and the banks' overall compliance with the set 17% (Target) and 14% (Trigger) capital adequacy ratios. The model is used as a supervisory tool to form judgments relative to either an improvement or deterioration in banks' credit portfolios, and to determine the impact on earnings and the risk-weighted capital ratio.

In the initial credit risk stress tests undertaken in 2009, shocks of 25, 50 and 100 percent were applied to the forecasted non-performing loan (NPL) rate. However, as time evolved, and due to the continued resilience of the domestic banking system at those levels, the shocks were increased to 100, 200 and 300 percent, respectively. In conducting the stress scenarios for the forecasted years 2014 through 2016, and with the level of deterioration in the non-performing loan book continuing at a slow rate, the shocks to the NPL rates have changed to 100, 150 and 200 percent, respectively. The main reason for the change was to prevent the level of non-performing commercial loans from exceeding the level of outstanding commercial loans.

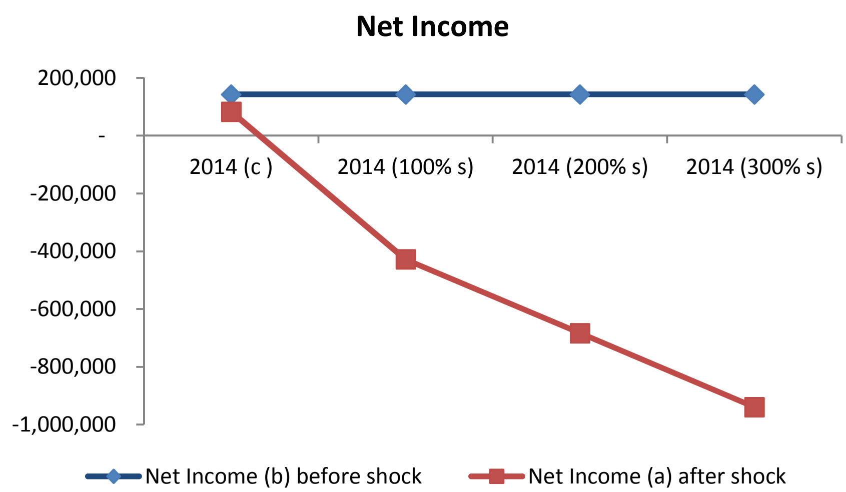
At forecasted levels over the 3-year period, NPLs remain at the $1.0 billion mark. At the shocked levels, NPLs increased within the $2.0 billion to $2.1 billion range (at 100 percent); $2.5 billion to $2.7 billion (at 150 percent) and $3.1 billion to $3.2 billion (at 200 percent). Chart 16 shows that, at the current (c) levels, the capital adequacy ratio (CAR) remains above 30%; however, with the decreasing levels of net income over the period at various shocks—due to the anticipated deterioration of loans, there is no need for capital to be injected into the system; the lowest ratio reaching a minimum of 17.50%, some 50 basis points above the 17.0% target capital ratio.

Chart 16



As depicted in Chart 17, projected net income, before any shock, is around $153.6 million, but net income steadily declines when shocks of 100%, 150% and 200%, respectively, are applied to given levels of NPLs, due to shortfalls in provisions and loss in interest income. Despite this, the impact on individual banks will vary. It is anticipated that the level of deterioration in NPLs will moderate for the remainder of 2014, unless there is slower than anticipated economic growth, which could exacerbate consumer's ability to meet debt commitments.

Chart 17



Interest Rate Risk Stress Test Results: The interest rate stress test model utilizes the duration method in computing the impact that interest rate changes, in both local and foreign currency, will have on commercial banks. However, with no recent movement in the Bahamian Prime Rate, the impact on banks' capital levels is nil. At end-June 2014, banks' estimated capital levels stood at $1.92 billion; and, after the impact of assumed changes in the yield curve of 100 basis points for Bahamian currency and 200 basis points for foreign currency, the capital falls to $1.87 billion. Given these results from the model, it was concluded that banks remain resilient, with adequate capital buffers for shock absorption.

Liquidity Risk Stress Test Results: The liquidity risk stress tests model focuses on projecting the solvency of a bank, should there be a run on deposits. It employs a cash flow baseline for liabilities due within a 30-day period or less and long-term assets which can be quickly converted into cash to meet the obligations of the depositors. Using quarterly data reported to the Central Bank, various assumptions were 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 the gap of the system's maturities within the short-term buckets is covered by the long-term, highly liquid assets.

CHAPTER 4: THE INSURANCE SECTOR

4.1 Overview

Preliminary data available from the Insurance Commission of The Bahamas (ICB) showed that the sector added one (1) new company during the six-month period, bringing the total number of firms to twenty-seven (27) at end-June 2014. The companies include twelve (12) life insurers, offering whole life, term life and universal life, and fifteen (15) non-life insurers, comprising, *inter alia*, companies providing cover for automobiles, fire, liability and property. The sector continued to be dominated by a few large firms—four (4) life insurers and six (6) non-life insurers—capturing more than 80% of total gross premiums written and the majority share of insurance coverage. Under the External Insurance Act, there are 103 companies, of which fifteen (15) are insurers, eighty (80) captive cells and eight (8) insurance managers.

Reflecting the mildly positive growth in economic activity, the domestic life insurance sector posted higher levels of assets, equity and net income during the first half of the year. Similarly, the non-life segment of the market registered gains in equity and profitability levels. Overall, these developments contributed to the general improvement in the financial soundness indicators, for both the life and non-life sectors, over the review period.

4.2 Life Insurance

The most recent data from the ICB, suggests continued growth in the dominant life insurance business over the six months to June, with these companies accounting for 76.1% of total assets and 55.1% of aggregate gross premiums. Based on preliminary information, aggregate assets increased by 1.1% to $1.2 billion, following on a 0.8% gain in the corresponding six months last year. Among the components, cash & deposits—the most liquid asset—advanced by 4.6% to $198.9 million, and receivables were higher by 17.9% at $59.0 million. Other "miscellaneous" assets and fixed assets also firmed, by 39.5% to $30.7 million and by 5.9% to $43.8 million, respectively. Conversely, investment portfolios were down by less than 1.0% to $818.9 million—although the mix of assets shifted towards more conservative investments, with holdings of corporate securities contracting by one-half to $15.2 million. Property investment holdings were also lower, by 5.7% to $81.7 million; policy loans, by 2.1% to $90.9 million; other investments, by 18.9% to $2.4 million; non-listed corporate equities, by 25.1% to $10.2 million and listed corporate equities, by 10.1% to $23.4 million. In addition, the relatively safe Government issued securities—the largest asset category—expanded by 5.9% to $380.5 million; mutual funds more than doubled to $12.4 million; preference shares advanced by 11.8% to $34.3 million, and the mortgage loan book increased by 2.1% to $167.8 million.

During the first half of the year, total liabilities grew by 1.2% to $833.2 million, exceeding last year's 0.4% expansion. This was bolstered by an 18.1% advance in other liabilities to $125.0 million—inclusive of payables and accrued expenses—which outpaced the 1.8% falloff in technical reserves to $708.1 million. Total equity rose by 1.0% to $326.8 million, as shareholders augmented their share capital by 3.6% to $96.1 million and retained earnings firmed by 5.0% to $171.1 million; however, other reserves declined by 14.8% to $59.6 million.

The sector's profitability improved vis-à-vis the first half of 2013, with net income higher by 12.3% at $19.8 million—which amounted to 9.7% of total revenues. Underlying this outcome, total receipts rose by 2.9% to $205.3 million, driven by an increase in premium collections, which offset the 2.0% claims-led growth in expenses to $185.5 million.

The aggregate financial soundness indicators for life insurance companies remained above international benchmarks, although profitability weakened. Specifically, the ratio of equities to total assets firmed by 0.2 of a percentage point to 5.9% at end-June, year-on-year, and the proportion of real estate to total assets narrowed by 0.3 of a percentage point to 7.0% (see Table 8). However, capital adequacy ratios increased, as the ratio of capital to both total assets and technical reserves firmed, by 1.5 and 1.6 percentage points, to 28.2% and 46.1%, respectively; whereas the net premiums-to-capital ratio declined, by 3.9 of a percentage point, to 54.6%. The expense ratio decreased by 4.0 percentage points to 30.4%, owing to higher premium-related income and reduced expenditure. However, the return-on-equity ratio firmed slightly by 0.1 of a percentage point to 6.1%, while declining investment returns caused both the investment yield ratio and investment income ratio to move lower, by 0.3 and 1.1 percentage points, to 3.3% and 15.1%, respectively.

Table 8:

Life Insurance: Financial Soundness Indicators (%)

	2009	2010	2011	2012[R]	2013[P]	Jun-13	Jun-14
Capital Adequacy							
Capital/Total Assets	24.0	25.0	26.2	26.2	28.2	26.7	28.2
Capital/Technical Reserves	36.0	37.4	40.1	41.2	44.9	44.5	46.1
Net Premium/Capital	148.6	126.4	128.5	119.0	108.7	58.5	54.6
Asset Quality							
Real Estate + unquoted equities + receivables)/Total Assets	23.2	19.3	16.4	16.3	14.7	14.5	13.0
Equities/Total Assets	24.0	5.5	5.1	5.0	6.0	5.7	5.9
Real Estates/Total Assets	8.0	7.8	7.6	7.3	7.5	7.3	7.0
Earnings & Profitability							
Expense Ratio (expense/net premium)	35.6	41.6	31.4	31.0	30.0	34.4	30.4
Investment Yield (investment income/investment assets)	7.0	7.2	4.9	6.7	6.1	3.6	3.3
Investment Income/net premium	21.2	24.1	15.2	14.9	14.2	16.2	15.1
Return on Equity (ROE)	24.0	14.5	10.9	12.5	12.4	6.0	6.1

Source: Insurance Commission of The Bahamas & Central Bank of The Bahamas

[R] = revised

[P] = provisional

4.3. Non-Life Insurance

Provisional data for the first half of 2014 showed the asset portfolio of the non-life insurance sector contracting by 15.4% to $363.7 million, extending the 8.8% decrease posted in 2013. This outturn reflected reductions in receivables, fixed assets and reinsurance recoveries of 31.1%, 44.5% and 59.6% to $119.4 million, $16.2 million and $13.1 million, respectively, and a 1.1% decline in cash & deposits to $112.3 million. In contrast, the aggregate investment portfolio expanded by 20.1% to $92.2 million, benefitting from a more than four-fold rise in property holdings, to $16.4 million, as well as a doubling in preference shares to $11.8 million. Holdings of corporate securities and mutual funds also firmed, by 74.6% and 52.4%, to $2.5 million and $4.6 million, respectively.

Total liabilities decreased by 29.0% to $183.3 million, relative to the year-earlier 12.7% contraction. This outcome was partly explained by a 43.0% fall-off in technical reserves to $117.1 million, which outpaced the growth in other liabilities of 25.0% to $66.2 million. The total capital stock was 5.1% higher at $180.3 million, underpinned by expansions in other reserves and retained earnings, of 25.3% and 6.4%, to $26.1 million and $90.5 million, respectively, which negated the 2.9% reduction in share capital to $63.7 million.

The sector's overall profitability improved during the first half of the year, when compared to the same period of 2013, as a rise in receipts and a reduction in expenses led to an almost two-thirds contraction in net earnings to $9.3 million—to represent 16.8% of total income. The marginal 0.5% growth in total revenue, to $55.3 million, was solely attributed to gains in net premiums—which represents earnings from the main line of business—of 11.4% to $47.5 million. The other revenue streams, namely investment and other "miscellaneous" income, registered respective declines of 4.9% and 43.5%. Total expenses contracted by 6.9% to $46.1 million, as the 26.8% falloff in net claims, offset the 6.8% expansion in expenses.

Table 9:

Non-Life Insurance: Financial Soundness Indicators (%)

	2009	2010	2011	2012[R]	2013[P]	Jun-13	Jun-14
Asset Quality							
(Real Estate + unquoted equities + receivables)/Total Assets	44.9	40.6	56.9	58.4	50.8	59.4	43.0
Reinsurance and Technical Reserves							
Risk Retention Ratio (net premiums /total gross premiums)	37.2	35.4	29.2	33.9	34.7	25.8	28.7
Technical Reserves/Net Claims	302.2	380.6	554.1	500.0	463.8	824.6	791.8
Technical Reserves/Net Premiums	135.1	153.3	207.3	188.9	167.4	390.7	246.5
Earnings & Profitability							
Expense Ratio (expense/net premium)	45.7	50.5	63.8	63.7	58.2	68.6	65.7
Loss Ratio (net claims/net premium)	44.7	40.3	37.4	37.8	36.1	47.4	31.1
Investment Yield (investment income/investment assets)	9.4	9.2	11.1	7.6	9.7	2.3	2.1
Investment income/net premium	5.0	5.5	8.4	5.3	6.1	4.8	4.1
Return on Equity (ROE)	39.6	10.9	4.5	6.4	11.3	3.6	5.2
Return on Assets (ROA)	5.5	4.9	1.7	2.4	4.5	1.5	2.6

Source: Insurance Commission of The Bahamas & Central Bank of The Bahamas

[R] = revised

[P] = provisional

The sector's capital adequacy indicators continued to improve over the review period. The ratio of capital to total assets was higher by 9.0 percentage points at 49.6%, reflecting an expansion in capital, coupled with a reduction in total assets. In addition, the ratio of net premiums to capital fell by 1.4 percentage points to 26.3%, indicating a lowering in risk arising from underwriting operations. In terms of the reinsurance ratios, the risk retention ratio rose by 2.9 percentage points to 28.7% (see Table 9), signifying that less risk was transferred to reinsurers, while a reduction in receivables contributed to a decline in the combined ratio of real estate plus unquoted equities and receivables to total assets, of 16.4 percentage points to 43.0%.

Based on earnings ratios, the return on equity and return-on-assets firmed, by 1.5 and 1.1 percentage points, to 5.2% and 2.6%, respectively. In contrast, the loss ratio, which measures net claims to net premiums, and the expense ratio—representing expenses to net premiums—contracted by 16.2 and 2.8 percentage points to 31.1% and 65.7%, respectively. Owing to a decrease in investment income, both the investment yield and investment income ratios recorded respective declines, of 0.2 and 0.7 of a percentage point, to 2.1% and 4.1%.

CHAPTER 5: CREDIT UNIONS

The primary business of the seven (7) credit unions is the provision of personal banking services, such as savings accounts and term deposits, as well as the extension of consumer, mortgages and other credit facilities to its members. Credit unions are currently under the supervision of the Department of Cooperative Development within the Ministry of Agriculture and Marine Resources but, in the near-term, are to be transferred to the regulatory and supervisory purview of the Central Bank of The Bahamas.

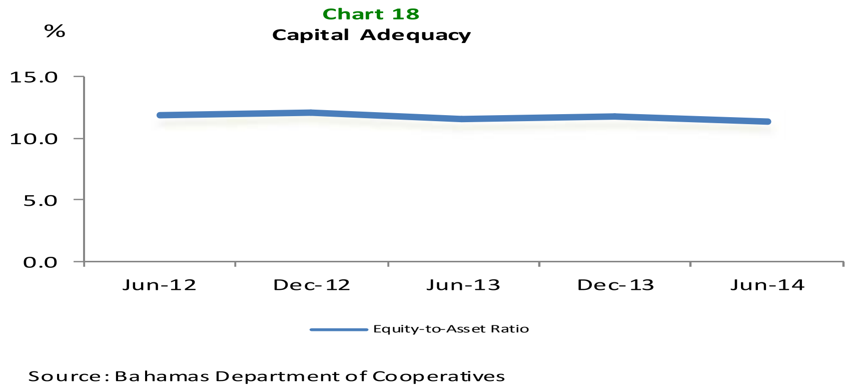
In the six months ended-June, 2014, the sector registered growth in total assets, deposit liabilities, liquidity and capital. However, rates of growth have been dampened by the general softness in economic conditions, which also contributed to the sector recording modest declines in asset quality, profitability and capital adequacy.

5.1. Capital Adequacy

The aggregate capital & surplus position of the sector, held to cover unforeseen losses, improved by 2.6% ($1.0 million) to $39.4 million at end-June, although below the prior period's 7.9% ($2.7 million) accumulation. The ratio of total equity[5]-to-total assets (the gearing ratio) was slightly lower at 11.4%, compared to 11.5% a year earlier, reflecting the faster growth in the asset base vis-à-vis the capital stock. Despite this marginal decrease, the sector remained well capitalized, as the gearing ratio

[5] Total equity includes members' capital, institutional capital and the reserve fund. Total equity is used in calculations in the absence of Tier 1 and Tier 2 data.

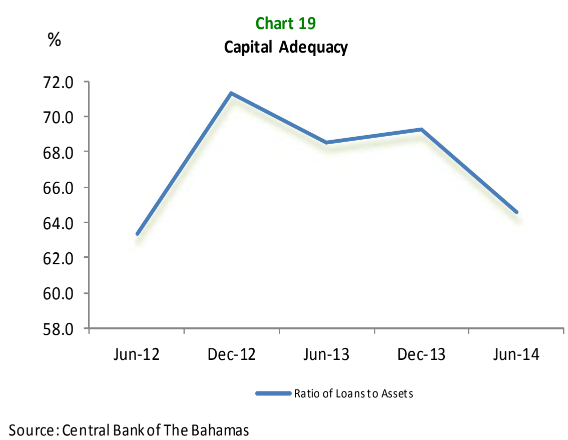
exceeded the minimum prudential norm, of 10%, as per the PEARLS[6] standard set by the World Council of Credit Unions (WCOCU).

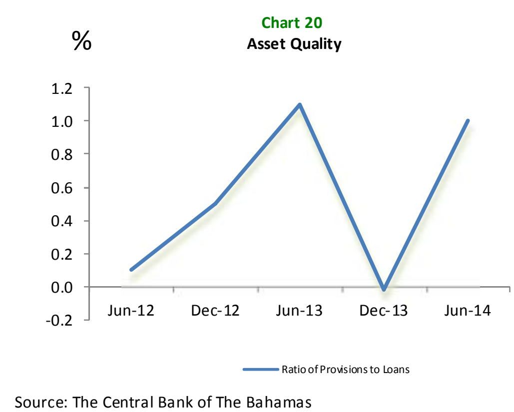


5.2. Asset Quality

As a proxy for assessing credit quality, the ratio of loan loss allowances-to-gross loans rose by a full percentage point to 5.5% at end-June, signalling higher levels of loan delinquencies.

Non-earning assets—inclusive of land, buildings, vehicles, furniture and cash—grew at a faster rate, of 61.6% ($10.6 million) to $27.8 million, compared to the 50.9% ($5.9 million) in 2013. Further, non-earning assets increased to some 8.1% of total assets at end-June, up from 5.5% in the prior year, and significantly above the 5.0% prudential norm maximum (see Chart 20).

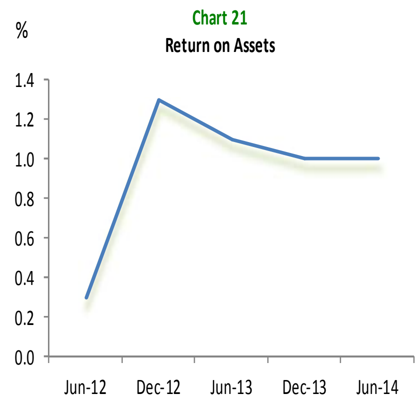




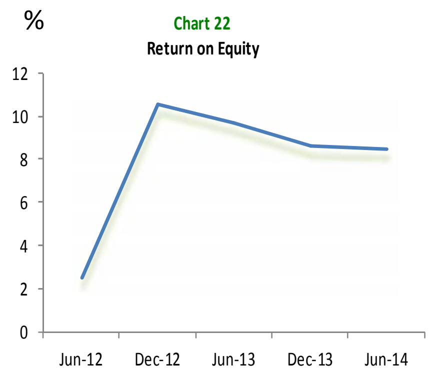
[6]PEARLS is a financial performance monitoring system based on the International Credit Union Safety and Soundness Principles. It consists, *inter alia*, of a series of financial ratios which provide an assessment of an institution's performance in the areas of, Protection, Effective financial structure, Asset quality, Rate of return and Costs, Liquidity and Size of growth.

5.3. Profitability

Paced by a fall-off in investment property earnings, the sector's overall net income contracted by 5.9% ($0.2 million) to $3.4 million in the first half of 2014, when compared to the same period of 2013. As a consequence, both the return on assets ratio (ROA) and the return on equity ratio (ROE) declined, year-on-year, by 0.1 and 1.2 percentage points, to 1.0% and 8.6%, respectively.



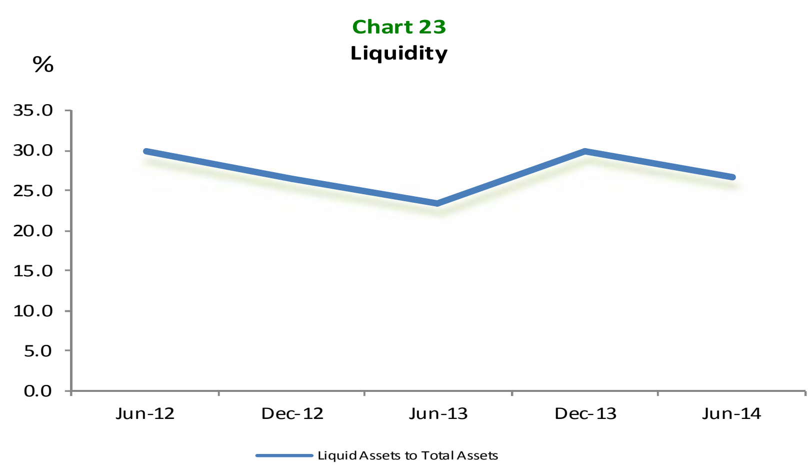
Source: The Central Bank of The Bahamas



Source: Central Bank of The Bahamas

5.4. Liquidity

During the six-month period, the sector's liquidity position improved, with the ratio of liquid assets to total assets firming to 26.8% at end-June from 23.5% in the prior period, benefitting from a more than two-fold increase in cash balances. Another liquidity indicator, the ratio of liquid assets *(net of short term payables) to total deposits,* strengthened by 3.9 percentage points to 31.4%, year-on-year. Both ratios surpassed their minimum prudential requirements of 15%—confirming the adequacy of credit unions' liquidity levels to meet their short-term obligations (see Chart 23).



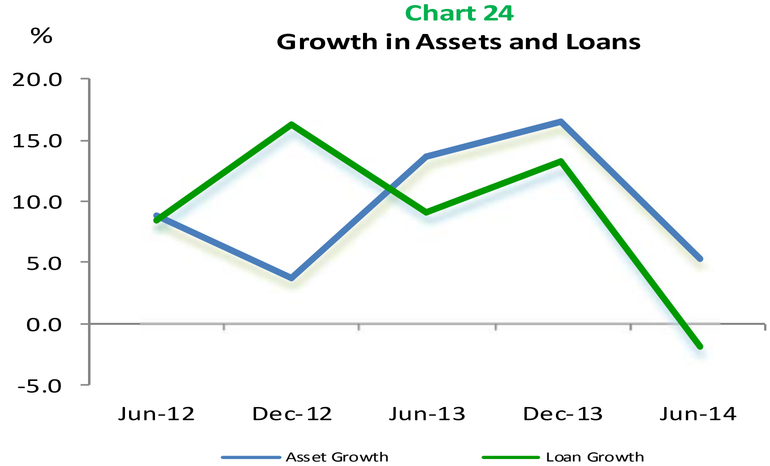
Source: Central Bank of The Bahamas

5.5. Growth in Assets

Total assets of credit unions continued to grow, although the pace slowed to 5.4% ($17.7 million) vis-à-vis last year's increase of 13.7% ($38.3 million), for an ending balance of $345.3 million. The stock of liquid assets (26.8% of the total) firmed by 28.5% ($20.5 million) to $92.5 million, slightly higher than the 30.7% ($17.6 million) advance recorded in 2013. In contrast, the dominant loan segment (64.6% of the aggregate), which grew by 9.1% ($18.3 million) a year ago, contracted by 1.8% ($4.1 million) to $222.9 million, reflecting significant reductions in the other loans & advances category.

Disaggregated by component, the loan portfolio was concentrated in consumer credit (73.9%), while mortgages/land purchases and revolving lines of credit accounted for smaller proportions, of 19.9% and 6.0%, respectively. The remaining 0.2% of the total loans was for education, SME development and other "miscellaneous" purposes (see Chart 24).

Chart 24
Growth in Assets and Loans



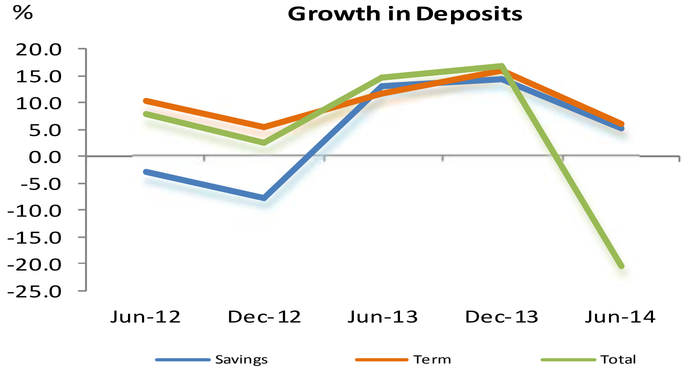
Source: The Central Bank of The Bahamas

5.6. Growth in Deposit Liabilities

Credit unions' deposit base rose by 6.0% ($16.4 million) to $291.1 million, although moderating from a gain of 14.5% ($34.1 million) in the corresponding period of 2013. Savings balances, which accounted for the largest share (48.6%) of the total, grew by 5.1% ($6.8 million) to $141.6 million, a slowdown from the prior year's advance of 13.0% ($15.3 million). Similarly, term deposits (at 43.8% of the total), increased by 6.0% ($7.2 million) to $127.6 million, albeit below the year-earlier 11.6% ($12.1 million) gain in 2013 (see Chart 25 and Table 10).

Chart 25

Growth in Deposits



Source: Central Bank of The Bahamas

TABLE 10

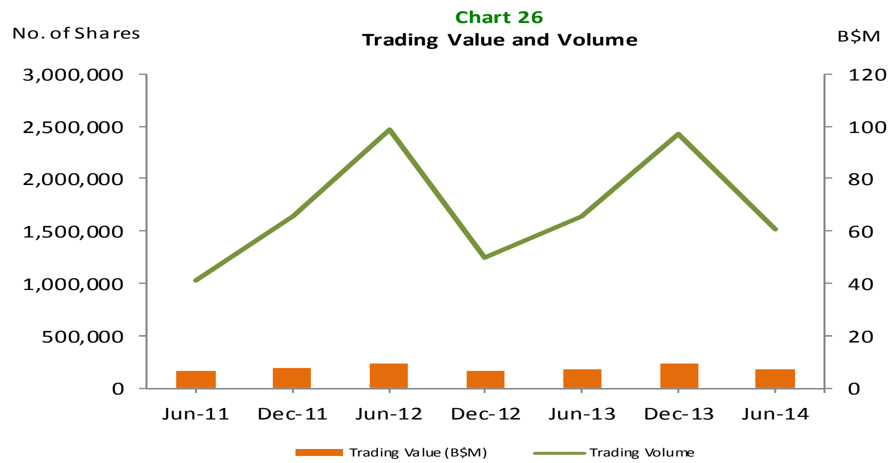
Selected Financials for Credit Unions (B$M)

	2009P	2010P	2011P	2012P	2013P	Jun-13	Jun-14
Assets	231.9	246.5	270.6	280.9	327.6	319.2	345.3
Loans	160.1	163.5	172.4	200.6	227.0	218.9	222.9
Deposits	195.9	208.2	229.7	235.3	274.7	269.4	291.1
Liquid Assets	58.6	69.8	86.2	74.7	98.6	75.0	92.4
Savings	121.1	123.4	127.6	117.8	134.8	133.1	141.6
Term Deposits	64.8	79.1	98.2	103.8	120.4	115.9	127.6
Non-Earning Assets	10.8	15.8	12.7	11.6	17.2	23.6	27.8
Allowance	6.3	6.7	7.5	8.5	11.2	9.8	12.2
Short-Term (ST) Payables	n/a	6.5	6.4	0.7	1.2	0.8	1.0
Capital & Surplus	26.0	28.1	31.3	34.1	38.4	36.8	39.4
Provisions	-0.6	-1.3	-1.7	0.5	-0.01	1.1	1.0
Net Income	2.1	2.5	1.0	4.5	6.9	3.6	3.4
# of Credit Unions	13.0	13.0	13.0	13.0	7.0	7.0	7.0
Financial Ratios (%)							
Equity-to-Asset Ratio	11.2	11.4	11.6	12.1	11.7	11.5	11.4
Return on Assets	0.9	1.0	0.4	1.6	2.1	1.1	1.0
Return on Equity	8.2	8.8	3.2	13.2	17.9	9.7	8.5
Provisions to Loans	0.4	0.8	1.0	0.3	0.7	0.5	0.5
Loans to Total Assets	69.0	66.3	63.7	71.4	69.3	68.6	64.6
Liquid Assets to Total Assets	25.3	28.3	31.9	26.6	30.1	23.5	26.8
Non-Earning Assets/Total Assets	4.7	6.4	4.7	4.1	5.3	7.4	8.1
Allow. for Loan Losses-to-Gross Loans	4.0	4.1	4.4	4.2	4.9	4.5	5.5
(Liquid Asses-ST Payables)/Total Dep.	29.9	30.4	34.7	31.4	35.5	27.5	31.4

Source: Department of Cooperative Development

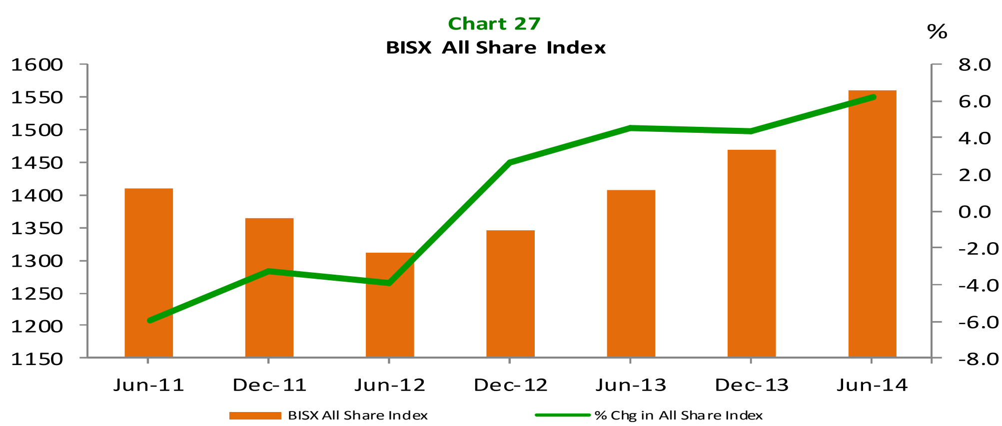
CHAPTER 6: CAPITAL MARKETS

During the first half 2014, activity in the local equity market was relatively subdued, as investors maintained their cautious stance given the softness in economic growth. Although the total volume of securities traded on the Bahamas International Securities Exchange (BISX) fell by 7.2% to 1.5 million, this was below the previous year's 33.6% decrease (see Chart 26). In a similar outturn, the fall-off in the value of shares traded, to an estimated $7.0 million, was lower at 5.4% from 20.8% in the same period of 2013. On an average basis, the daily trading volume retreated by 6.4% to 13,340 shares, vis-à-vis the previous year's decline of 44.5% to 14,245 shares.



Source: Central Bank of The Bahamas & BISX

In other market indicators, the BISX All Share Index rose by an estimated 10.9% to 1,559.9 points in 2013, to surpass the 7.3% growth posted a year earlier, supported by a general increase in share prices (see Chart 27).

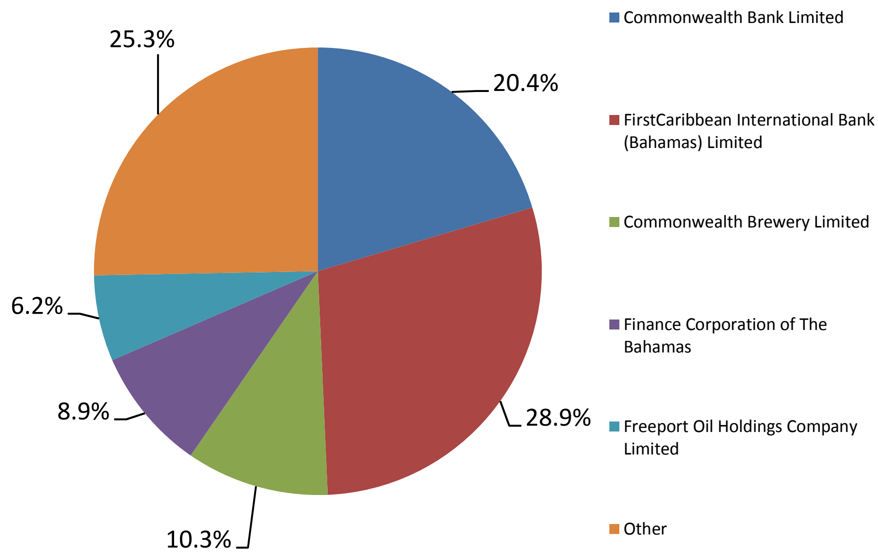


Source: Central Bank of The Bahamas & BISX

At end-June 2014, BISX's market capitalisation was 10.9% higher at $3,324.9 million, to exceed the prior year's gain of 7.2%, with the number of securities listed on the Exchange up by one (1) to 27, when compared to the prior year (see Chart 29). In terms of a breakdown, the five (5) largest companies accounted for a dominant 74.8% of the total, up from 63.7% at end-June 2013 (see Chart 28).

Chart 28

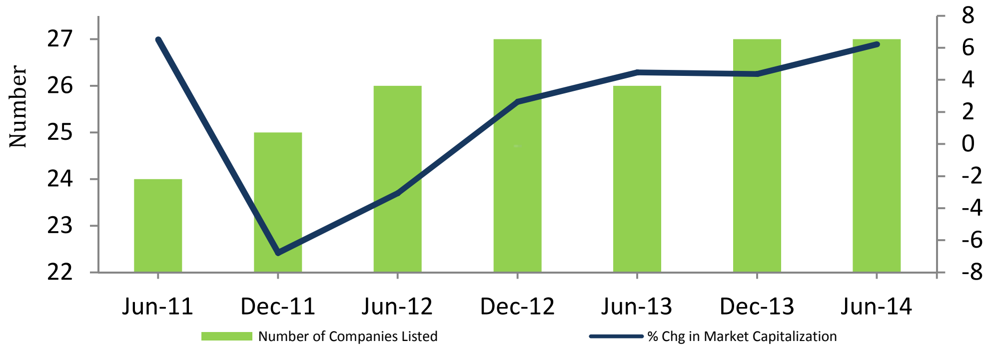
Share of Total Market Capitalization at end-June 2014



Source: Central Bank of The Bahamas & BISX

Chart 29

BISX Performance Indicators



Source: Central Bank of The Bahamas & BISX

CHAPTER 7: PAYMENT SYSTEMS

The national payment system is a critical part of the financial services infrastructure, supporting the safe and efficient transfer and settlement of interbank payments and therefore contributing to overall financial stability. The Central Bank, in its oversight role of the payments system, continued to closely monitor the operations of systemically important payment systems (SIPS).

7.1. Real Time Gross Settlement (RTGS)

The RTGS system is one of the two domestic SIPS, and is owned and operated by the Central Bank. It processes large value transactions (greater than B$150,000) and, during the first quarter of 2014, the value of transactions processed through the system steadied at $2.9 billion, while the volume decreased by 2.2% to 13,660 items. This compares with year-earlier decline of 1.4% to 13,966 transactions, although the corresponding value firmed modestly by 0.5% to $2.9 billion.

7.2. Payment Instruments

7.2.1. Cash

Despite the growing popularity of new and innovative non-cash platforms, including electronic transactions, cash remains the dominant method of making payments. Data for the first half of the year indicated that growth in currency in active circulation slowed to 2.7% to $209.7 million, relative to a 4.0% increase registered in the same period a year earlier. However, its share relative to the more encompassing broad money (M2), was relatively stable at 3.4%.

7.2.2. Automated Teller Machines (ATMs)

As commercial banks continued their efforts to provide customers with access to banking services beyond the traditional branch network, the number of ATM/ABM terminals has expanded significantly. During the first half of 2014, the number of machines installed throughout The Bahamas in commercial banks and other retail outlets, firmed by 4.5% to 325 installations. Of this number, approximately 90% were configured to dispense only Bahamian currency, while the remaining machines provide both local currency and US Dollars. Similarly, the volume of transactions processed through ATM/ABMs expanded by 2.8% during the review period to 3.1 million transactions, while the corresponding value grew by 4.2% to $1.78 billion.

7.2.3. Cheques and NACHA Payments

Cheques are the most dominant form of non-cash payment for goods and services; however, their importance for facilitating transactions has continued to diminish over the last decade. During the first six months of 2014, data reported by the Bahamas Automated Clearing House (BACH), showed that the volume and value of cheques presented for clearing, net of National Automated Clearing House Association (NACHA) Payments, declined further, by 3.4% to 1,404,055 items, following a year-earlier 3.8% contraction.

The value of cheques cleared through the ACH increased by 9.2% to $3.4 billion, after a marginal 0.9% decline a year earlier. NACHA direct debit transactions—such as payroll payments—processed by BACH, advanced by 12.9% in volume to 0.89 million items, and by 18.3% in value to $643.6 million.

7.2.4. Debit Cards

The majority of banks have converted their ATM/ABM cash cards to internationally branded debit cards, due to the popularity of these types of instruments as a means of payment for both in-store and online transactions. Currently, only 2 of 5 commercial banks have yet to re-brand their cash/ATM cards with true debit functionality, although this is expected to decline to just one bank in the near-term. Since June 2013, the volume of debit card transactions rose by 5.3% to 1.3 million, and the corresponding value surged by 43.9% to $1.58 billion.

7.2.5. Credit Cards

Credit card usage during the first half of the year reflected the ongoing weakness in the general economy, as cardholders reduced their use of this high cost line of credit, and banks issued fewer numbers of cards with lower limits. As a result, over the six-month period, the volume and value of transactions declined substantially, by 26.3% and 15.5% to 1.33 million and $15.8 million, respectively. In addition, banks saw a net repayment of $33.1 million (14.0%) in credit card related consumer installment credit, compared to a $34.4 million (12.7%) reduction in repayments during the same period last year.

In contrast, new consumer installment credit, for credit cards of selective clients with favorable credit records, advanced by $38.7 million (17.1%) to $265.3 million, a reversal from a $31.7 million (12.3%) decrease to $226.6 million in the comparative 2013 period. Further, total credit card debt outstanding, for the period, firmed by a modest $3.1 million (1.3%), following a $5.4 million (2.3%) accretion in the January-June, 2013 period.

CHAPTER 8: ASSESSMENT OF RISKS

A fundamental part of the Central Bank's mandate involves promoting the stability of the domestic financial sector—an objective which is substantially attained through monitoring of commercial banks' key risks, especially credit-related exposures, that can potentially impact the soundness of the banking sector and the entire financial system.

As outlined in the previous sections of the report, the risks to the financial sector are being closely monitored by the Central Bank, in conjunction with the other regulators' focus on institutions under their purview. In addition, individual firms—particularly those within the banking sector—have taken measures to ensure that they continue to comply with international and domestic prudential norms and requirements.

Among initiatives underway to bolster the resilience of the regulatory and supervisory regimes is the Central Bank's implementation of the Basel II and III frameworks. Recent efforts have centred on Pillar 2—Supervisory Review requirements, with the Bank issuing its framework on the Internal Capital Adequacy Assessment Process (ICAAP). To assess licensees' readiness for Pillar 1, the Central Bank introduced reporting for Pillar 1, on a '*best efforts basis*', for two quarters. The Bank's ongoing strategic initiative, the Online Reporting Information Management System (ORIMS), aims to secure greater efficiency in the expanding regulatory reporting regime.

Work also progressed towards putting in place the legislative infrastructure for a national Credit Bureau, as a means to help mitigate risk in lending activities. The Credit Reporting Bill, 2014, and the draft Credit Reporting Regulations, 2014, documents were close to completion, with the public consultation period and issuance of the Request for Solution scheduled for the latter half of 2014.